

UK hotels forecast 2010 and 2011:

On the comeback trail



Overview

Hotels are on the comeback trail. More accurately hotels appear to be on two separate trails to recovery – a super-highway for London and a much rougher Provincial trail. London stormed home in Q4 2009 and, unless it was just end of year exuberance, should manage to keep the pace up through 2010, strengthening further in 2011. We accept visibility is limited and the risks high, including a public sector squeeze. But reports of higher levels of transient travellers, more group conference bookings and an incipient – if slow – return of business travellers are all positive; especially for the capital, where we forecast 5.8% RevPAR growth in 2010 and a further 7.8% growth in 2011.

It is likely to be a more difficult journey for the Provinces, where the challenging economic environment and a reliance on dwindling domestic business, supports prospects of a much more gentle comeback in hotel fortunes. We forecast 1.6% RevPAR growth in the Provinces in 2010 and a further 3.1% in 2011.



Trail ahead looks clearer for London

After an extremely challenging 18 months, we appear to have turned a corner, at least in London. PricewaterhouseCoopers (PwC's) latest hotel forecast anticipates moderate growth in demand for UK hotels, driven largely by London. London proved resilient in 2009 and trading turned positive in terms of occupancy and room rate (just in the last quarter of the year. In fact Q4 2009 was the highest Q4 occupancy on record¹.

We expect London to carry on this winning streak through the first quarter of 2010 at a pace most cities will envy. We expect that London could see an occupancy gain of 2.3% and rate growth of 3.5% in 2010. IHG's recently published results for Holiday Inn and Holiday Inn Express in London reflect this emerging pattern, with occupancy growth from Q2 2009 onwards, slowing ARR declines and a small ARR gain in Q4 2009.

Some overall observations include:

- A return to UK and global economic growth is good news for UK hotels and business travel volumes;
- Inbound travel declines appear to have stabilised towards the end of 2009 and the weak pound should continue to buoy-up continuing overseas leisure demand;
- Business travel saw an unprecedented decline in 2009 but signs of a slow improvement in business travel confidence is encouraging and key to recovery;
- Pricing power remains weak and ARR growth will largely reflect a reversal of changes in business (customer) mix, as more corporate, conference and transient guests return, rather than hoteliers simply raising prices;
- Counterbalancing this, many corporate buyers negotiated hard for 2010 and these corporate agreements will exert a downward pressure on ARR in H1 2010;
- London reached a turning point in Q4 2009 as occupancy started to stabilise from Q2 2009 and rate in Q4 2009;
- In the Provinces, domestic business travel frequency has dwindled severely² and conferences and meetings will face another difficult year, but there are pockets of good news and occupancy declines overall slowed towards Q4 2009. ARR remains under pressure though and oversupply could polarise city performance;
- Growth rates are perhaps not all they seem to be – any growth is off a low base and comparables are poor. Inflation is expected to be relatively high in 2010, however an overlay in PwC's forecast model incorporates some decoupling of pricing and inflation for 2010. This is based on current industry experience as higher inflation rates cannot be pushed through to pricing.
- It is probably self evident, but economic recovery is vulnerable and may falter; public sector cut-backs are almost certainly coming and they will impact hotels just as the private sector business travel market starts to recover, potentially shaving off close to 1% from UK RevPAR growth in 2010 and 2011.

UK's economic recovery still vulnerable

The business travel recovery is highly dependent on a global and UK economic recovery. The UK economy is finely poised and although the economy turned a corner, emerging from recession in Q4 2009 there are still significant short and medium term risks to a robust recovery. Overall the recession in the UK lasted six quarters and saw the economy contract by 6.0% overall and by 4.8% in 2009 alone. Our model is underpinned by relatively sluggish growth of around 1.1% in 2010 and around 2.5% in 2011. Inflation will be relatively high in 2010 at 2.6% but is expected to fall to 1.9% in 2011. See Appendix 3 for model GDP and inflation assumptions.

1: STR Global historical data 2000 - 2009
2: BDRC 2010

Key findings

PwC's latest hotel forecast: business travellers crucial to a comeback

For PwC's latest forecast we present one main forecast this time for UK, London and the Provinces, with no alternative scenarios. If we had decided to present a downside scenario, as we have done in recent editions, the economic environment would now necessitate an upside forecast as well, just in case things get better faster.

Table 1 shows the latest RevPAR forecast for the UK, London and the Provinces for 2010 and 2011. For more detail please see Appendix 1 as well as the commentary, charts and tables in subsequent sections of this report.

Table 1: PwC UK hotel forecast 2010 and 2011 (premised on 1.1% GDP growth in 2010 and 2.5% GDP growth in 2011) % growth on previous year

	2010 F			2011F		
	UK	London	Provinces	UK	London	Provinces
Occupancy	1.3	2.3	0.9	1.7	3.8	0.8
ARR	1.8	3.5	0.6	2.9	3.7	2.2
RevPAR	3.1	5.8	1.6	4.7	7.8	3.1

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

UK growth reflects London's comeback

Overall, our latest forecast for UK hotels for 2010 reflects London's strength and the Provinces' weak fight-back. The UK saw RevPAR decline by almost 10% in 2009 but we predict overall UK growth of 3.1% this year, driven by a 1.8% ARR gain and 1.3% occupancy growth. Further growth of 4.7% is predicted in 2011 as ARR nudges up to 2.9% growth and occupancies show a 1.7% increase. Dire comparables in Q1 to Q3 in 2009 make the figures shine brighter than they otherwise would. See Appendix 2.

London expected to trade strongly as customer-mix effects take hold

London is the engine driving UK hotels along the route to recovery and our forecast for London is noticeably more optimistic than in September. We think the worst is over and the capital looks set to build on its final quarter flourish in 2009 and pull away further from the Provinces. Much will depend on economic growth and confidence but over 55% of those we interviewed think London will continue to trade above 2009 levels in 2010, with this rising to 78% for 2011 (over 2010) as the Olympic flame approaches.

In demand terms, London has seen five consecutive months of occupancy growth (September 2009 to January 2010) and three consecutive months of ARR growth (November 2009 to January 2010). January 2010 saw a RevPAR gain of almost 9% as occupancies climbed by 6.6% and room rates by 2.1%. If the growth spurt continues, this should allow hoteliers sufficient volume to push up room rates by around 3.5% this year, to give an average rate of £119.60. We interpret that much of this ARR gain will be due to the changing customer-mix as business travellers return rather than hoteliers actually raising prices. Considerable new pre-Olympic supply kicks in during 2011, but 3.7% ARR growth remains on the cards, still sufficient to push rates to £124.03.

Provinces see domestic travel dwindle

The Provinces have seen as bad a revenue decline as they endured in 1992 and are heavily dependent on dwindling domestic corporate and leisure demand. Except for a few regional centres they remain under pressure to attract new markets and now face an uphill climb to regain lost ground, especially rates. Research from BDRC shows that the domestic business market has shrunk to its lowest level since 2005 as the frequency of travel has reduced. Overall, the 2010 BDRC British Hotel Guest Survey reports a decline in total domestic adult room nights (British business and leisure travellers) from 107m to 104m nights over the past 12 months. Of course London was able to replace the 'missing' guests more easily.

Occupancies will hopefully start to stabilise in Q1 this year following eleven quarters of decline. Room rates are forecast to start recovering from Q2 this year, although growth will be marginal. In January the regional market saw a 2.6% occupancy gain, even though rates fell by a further 5.3%. UK GDP growth should stimulate some corporate markets to stir, even if it is ever so slowly, from their hibernation. Overall, the Provinces could see 1.6% RevPAR growth in 2010 with a more solid recovery of 3.1% in 2011.

What did our research show?

Does industry opinion offer any support to these forecasts? Yes, broadly speaking, as hoteliers in our research expect flat UK occupancies or a little occupancy growth this year, with only a small proportion expecting growth of over 2.5%. In 2011 over half expect a 2.5% occupancy gain, a similar direction but slightly higher than our UK forecast. On rates, 2010 is expected to remain flattish although a third expects rates to increase by around 2% – close to our expectation. In 2011 the majority expect a rate lift of over 2% with half over 3% – again, close to our forecast.

Key findings

Quarterly outlook – onward and upward for London

Looking at the forecast outlook by quarter (see Table 2 and Chart 1 for RevPAR and Appendix 2 for occupancy and ARR data) we can see London's occupancy stabilising further and indeed strong occupancy growth in 2010 Q1, compared to the same quarter in 2009, together with reasonable growth in Q3. Q2 and Q4 see marginal declines largely due to seasonal factors and a strong comparable in the final quarter of 2009, when occupancy saw a 6.1% gain. ARR strengthens through all four quarters of 2010 and drives RevPAR growth upwards – double digit growth in 2010 Q1 and single digit thereafter.

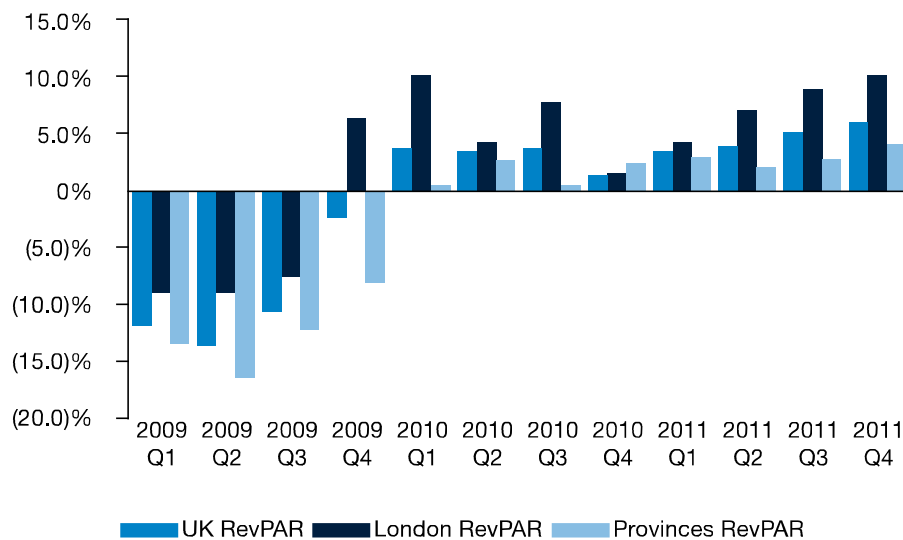
For the Provinces there is occupancy growth in three of the quarters and from 2010 Q2 some ARR gains, the strongest in Q4 2010. This drives RevPAR growth, especially in Q2 and Q4. But this growth looks more fragile and is against some very poor comparables in 2009.

Table 2: 2010 RevPAR forecast growth rates by quarter for UK, London and Provinces (% growth on same quarter of previous year)

	2010 Q1	2010 Q2	2010 Q3	2010 Q4
UK	3.7%	3.6%	3.7%	1.5%
London	10.3%	4.3%	7.8%	1.7%
Provinces	0.6%	2.7%	0.6%	2.5%

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

Chart 1: RevPAR growth trends by Quarter 2009 to 2011



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

How did we do in our last forecast?

Hospitality and Leisure
Hospitality Directions Europe

UK hotels forecast:

Not out of the woods yet



Bull's-eye for the Provinces but we underplayed Q4 2009 for London

We were absolutely bang-on for the Provinces in 2009. If you wanted to split hairs we forecast a RevPAR decline of -12.3% and the outcome was -12.6%. In fact ARR fell a tad sharper than we envisaged and occupancy was ever so slightly more resilient

However, we cannot afford to be smug about London where we were not so accurate and did not anticipate such a strong finish to the year. London saw stronger growth in occupancy than we forecast in the last two quarters, particularly in the final quarter. W

-12% decline in Q4 2009 nominal ARR, but amazingly the capital turned in a 0.4% gain, driven by increased leisure demand. All this added up to a forecast RevPAR decline for 2009 of -10.9%, whereas in reality London managed a fall less than half that.

In terms of 2010, we were in a more pessimistic mindset than currently and forecast continuing, but much reduced, RevPAR declines. We did see stabilisation in London occupancies but no ARR growth. For the Provinces we expected a small RevPar decline but now look to modest growth. In Appendix 4 we outline in more detail the PwC forecasting model.

Key findings

What are operators seeing?

Frits van Paasschen, Starwood Hotels and Resorts' CEO said in February:

“ Lodging demand continued to improve in the fourth quarter, with group and business transient posting positive bookings. After being buffeted by headwinds throughout 2009, our portfolio is set to begin a rebound in 2010 from a deep drop-off.³ ”

Marriott also recently stated that they have seen signs of a return of business travellers in international markets and have expectations that London and Paris could see occupancy up by double digits in Q1 2010. Accor have also reported signs of occupancy stabilisation outside the US.

IHG recently reported seeing the business traveller returning in recent months,⁴ and its CEO Andrew Cosslett said on publication of the Group's 2009 results in mid-February:

“ 2009 was a very challenging year for the industry. The fourth quarter did show some improvement in trends and occupancy has now stabilised. Rate however remains under pressure and we expect trading to stay tough until business travellers return in greater numbers. ”

It is not just international chains that are feeling a bit more optimistic. Whitbread CEO Alan Parker has recently commented that he thought the gloom factor can be overdone and in a trading statement, the MWB Group (owner of Hotel du Vin and Malmaison) said it had managed to maintain occupancies in 2009 thanks to the robust leisure market and that they had seen improvements in ARR every month in H2 2009.

No return to business as usual

It is encouraging that we can see a recovery in prospect and PwC research shows the mood in the sector continues to improve, with almost 70% of survey respondents more optimistic than they were six months ago. Group and transient business is picking-up and there is hope of pent up demand for face-to-face meetings.

But many believe it could be 2012 or beyond before hotels see a return to long term average trading levels. Our latest forecast suggests that while this prognosis is likely to be true for the Provinces, London could get back or close to top-form much faster.⁵ That said, PwC research shows that public sector cutbacks could shave off some of the new-found growth.

Nor would we suggest that this embryonic recovery means a return to business-as-usual for the hotel world, as this is far from the truth for owner operators and hotel property investors.

3: Starwood reports fourth quarter 2009 results, White Plains, NY, February 4, 2010

4: IHG predict 2010 will be year of recovery rather than growth, Hotel Report February 2010

5: PwC research among 67 hotel operators, investors and owners, January and February 2010

As trading fundamentals have suffered and property values fallen, the majority of mid-tier UK hotel groups probably now find themselves in, or close to, negative equity and will need to restructure their debt. For many this restructuring will involve negotiating debt for equity swaps with their lenders, who as effective economic owners of the business, will expect to benefit from the upside as values improve. Following the 1990s recession, values took between five to seven years to return to pre-recession levels. However, it appears likely that lenders will be keen to unravel their interests over a shorter timeframe, possibly via the consolidation of hotel assets in the short-term, prior to crystallising their interests at a future date.⁶

Challenging route back for rates

Pressure from tighter corporate travel policies, the need for promotional deals and difficulties passing on increased costs and services means that pressure continues on room rates with little pricing power. A steady return of the corporate traveller though will support a changing customer mix and as a result modest ARR growth for the UK in 2010 of around 1.8% (contrasting with a 6.2% decline last year). This average hides a dissimilar story for London and the Provinces. In London ARR could show a 3.5% gain this year but more lacklustre growth is probable in the Provinces where ARR is expected to show only a 0.6% gain. If we strip out inflation, rates have a long-haul back to past peaks.

Even though the growth word is being used again, growth in 2010 is off a low base and comparables from 2009 are poor, sometimes very poor. For example, London's room rates fell by 5.7% in 2009 and those in the Provinces by an average of 7.6%. The trail ahead remains challenging, and for some it could be a Class 3, but hopefully no longer a Class 4 climb.⁷

Samantha van Leeuwen, Head of Hotels Procurement at PwC, adds:

“ Corporates have now largely got their houses in order in terms of tighter travel policies and have secured significant savings by negotiating better rates. Corporate travel and meeting volumes are expected to climb back slowly. There is a feeling that businesses have got to get back to 'normal', meeting clients, training their staff and restoring essential meetings. ”

Supply issues

According to data from STR Global (STR), despite the credit crunch, UK new hotel room supply saw above average growth in 2009. Although the pipeline is reported to be slowing fast as availability of finance dampens developers' appetites, this was still the highest growth rate for eight years. Overbuilding issues in a number of cities in the UK should start to ease as fewer projects go ahead but will polarise performance between and within cities. New supply could impact London performance in 2011 in the build up to the Olympics.

6: See Hospitality Directions Europe, Market Briefing, March 2010, 'No chance of a fire sale: Debt restructuring prospects for UK hotels'

7: In climbing Classes 2 and 3 climbs are steeper scrambling with increased exposure and a greater chance of severe injury, but falls are not always fatal. Class 4 can involve short steep sections where the use of a rope is recommended, and un-rope falls could be fatal.



Quantifying the public sector spending threat to hotels

Budget cuts could slice 0.9% off our 2010 and 2011 UK forecasts

How dependent are hotels on the public sector?

Data from our research survey suggests that hoteliers believe on average around 8% of their business is sourced directly from the public sector. This figure is likely to underestimate the impact, as many hotels will have more indirect public sector business than they think and additionally, there will also be private sector business which is dependent on public sector contracts. W

Id be indirectly dependent on the public sector. (In the US, direct government sector expenditure has historically accounted for around 14% of all accommodation purchased. Including industries like healthcare and education takes the total closer to 20%). Our scenarios of the potential impact of public sector spending cuts have as alternative assumptions either 20% dependence or 30% dependence on public sector related bookings.

How large could the cutbacks be?

We have already seen efforts by public sector bodies to economise on spending. To understand the effects of this on the hotels market in the medium term, we used an example from PwC's Public Sector Research Centre publication 'Dealing with (even more) debt'. In our high-level analysis, we take a 3.1% cut in government departmental spending in both 2010 and 2011.

What will be hit first?

Logic suggests that occupancy is likely to be the first casualty of the cuts as travel budgets are simply 'switched off' and public sector employees travel less. However, for the purposes of this forecast we have made no assumptions on ARR or occupancy and have calculated the impact on hotels' RevPAR.

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What is the potential impact on PwC's RevPAR growth forecasts for 2010 and 2011?

The impact of the cuts, assuming a 20% dependency, is likely to be to slice 0.6% off our latest UK RevPAR forecast of 3.1% in 2010. This would take forecast growth down to 2.5%. In 2011 the impact could be a further 0.6% taking RevPAR growth from 4.7% to 4.1%.

Assuming a higher hotel dependency of 30% on the public sector could take up to 0.9% off RevPAR in 2010 and in 2011. This would lower our forecast to 2.2% this year and 3.8% in 2011.

See Table 3 below.

Table 3: Additional RevPAR impact of public sector cutbacks

	2010	2011
Assumed departmental spending cut	3.1%	3.1%
Impact of spending on RevPAR growth		
20% of dependency on public sector	0.6%	0.6%
30% of dependency on public sector	0.9%	0.9%
Impact on RevPAR growth rates		
Baseline UK RevPAR forecast	3.1%	4.7%
Growth assuming 20% dependency	2.5%	4.1%
Growth assuming 30% dependency	2.2%	3.8%

Source: PricewaterhouseCoopers research 2010

What might impact the recovery?

Banana skins on the comeback trail

As the UK and its key markets start to experience economic growth again, a sustained hotel recovery should be driven by the return of corporate business demand. It won't be a moment too soon given likely public sector budget cuts and an expected further squeeze on consumer balance sheets in the future as possible wage freezes and higher interest rates impact. The following lists some potential banana skins that may litter the comeback trail ahead:

Table 4: What might impact recovery for hotels?

Factor	Comments
Consumer spending	Consumer spending is projected to grow again in 2010 after 2009's decline, strengthening in 2011. However, pressures on household finances may also intensify and could include higher taxes; a wage freeze; higher energy costs; the debt overhang from the past excesses as well as Christmas spending; possible higher interest rates impacting mortgages and a potential VAT rise post election.
Consumer sentiment	Consumer sentiment is reported improving. PwC research in January 2010 showed more consumers feel they will be better off after paying essential bills over the next 12 months ⁸ . However, consumers are increasingly hard to read and sentiment may change. Leisure travellers are expected to require more deals or promotions or they may not travel.
Labour market	Further job losses including more in the public sector would likely have a negative impact on consumer sentiment.
Travel outlook	<p>The economic recovery is expected to stimulate the steady return of the business traveller and later, the meetings market. A slower than expected economic recovery here or globally could stall this recovery.</p> <p>In terms of the, so far, resilient leisure traveller, the continued weak pound is expected to support inbound leisure visits and meetings. An appreciation of the pound would impact growth. We would expect leisure travellers to keep travelling this year but we note that Britain's official tourism organisations forecast unspectacular growth for inbound markets to the UK and London. 'Staycations' are expected to catch on again this year but outbound travel agents also expect a reasonable year citing the fact that many 'staycationers' last year may decide not to risk the vagaries of the British summer weather again.</p>
Public sector cuts	Post election, public sector cutbacks are expected to impact central and local government and other tax-payer funded demand for hotels and travel and, as a consequence, hotel trading.
Increased costs	Businesses could potentially experience negative cost impacts such as the business rates increases in 2010 and beyond; legislation including the Carbon Reduction Commitment (CRC) Energy Efficiency Scheme and the Landfill Tax ⁹ will also have an impact.
Supply growth	The difficulties impacting projects securing finance has postponed or stopped many projects and this will help prop up occupancies. However supply is still growing and considerable new rooms have been added, are under construction or are still planned and this will impact performance around the country. In London, for example, the Waterloo area will see a lot of additional rooms this year. New supply and the opening or re-opening of luxury hotels like the Four Seasons and the Savoy may also impact performance at the upper end of London's hotel market.

This forecast assumes no significant terrorist acts in the UK or other events that could negatively impact consumer travel. Nor does it incorporate an expectation of any major natural disasters.

8: When consumers were asked about their disposable income (and whether they felt that they would be better or worse off after paying essential bills) over the next 12 months, the balance of opinion (i.e. worse-off) stood at -21% compared to -23% in October 2009 and compared to a low of -51% in October 2008, PwC research

9: Environmental Value at Risk in the Hospitality and Leisure Sector: The CRC Energy Efficiency Scheme and Landfill Tax, PricewaterhouseCoopers, November 2009

59% of respondents are optimistic about trading prospects in the second half of 2010



Compared to **39%** in the first half of 2010

PwC's latest research survey suggests provincial hotels face a steady convalescence rather than London's more nimble recovery

For this survey we interviewed 67 key participants in the sector and in the following pages we highlight the main findings. We would like to thank all those who took part and shared their insights with us. Thanks also to those members of the British Association of Hospitality Accountants (BAHA) for their participation.

More New Year cheer

The New Year finds around 70% of respondents more optimistic than six months ago (slightly less than in September 2009 when we were comparing the mood to March 2009). Only a few admitted to being 'much more' optimistic (but this was a definite improvement on September last year). In counterbalance though, 13% are now 'more' pessimistic (about half the proportion in September). Interestingly a small percentage are now 'much more' pessimistic whereas in September no-one admitted that!

Which half of 2010 will be best?

In terms of the timing of the recovery, opinion was pretty evenly divided between those who are optimistic and those who are pessimistic about the outlook for the first half of 2010. More are optimistic about trading prospects for the second half of 2010. In contrast, in the retail sector consumer businesses expect the second half to be tougher, as expected higher taxes, possible higher interest rates and public sector cuts take their toll of household budgets. But much depends on who you ask.

Faster bounce-back expected in London

Given the speed at which the economy and indeed the hotel sector plunged into decline in late 2008, some had hoped that the process might go into reverse and bounce back equally fast. The internet, in its infancy at the time of the last recession, provides a level of pricing transparency that works both ways. It allows customers to surf for lowest prices and it allows operators to see competitors' pricing. The internet also provides (a very fast and cost effective) ability to change pricing at will. Yield management systems will detect increased demand patterns and increase prices. Our forecast for London suggests that a bounce back could well be the case in the capital, but unfortunately not in the provinces. Overall, the expectation is for 'steady as she goes' for the UK as a whole, rather than spectacular improvement this year.

Survey results

“Whilst we are seeing some growth in business travel in our city centre property, the provincial hotels are still relying on leisure business to maintain occupancy levels”

Marshall Dallas, Group Managing Director, Bravara Management



Has confidence in business travel returned?

There have been some signs of a recovery in business travel, as IHG, Marriott and Starwood have reported recently. In addition, several surveys show more confidence in a revival in 2010, with an American Express survey expecting travel budgets to increase. Research from organisers of the Business Travel & Meetings Show also found that over a quarter of companies intend to spend more on organising corporate travel this year. On the other hand BDRC's research points to a slow improvement in confidence, with many travellers expecting to further reduce spend in the coming months and only 13% anticipating an increase. Morgan Stanley's global travel survey expects volumes to rise but rates to remain under pressure.

W . The results were finely balanced although those who thought business travel unlikely to recover this year edged ahead of the optimists. Even the optimists admitted any recovery is off a very low base and it is certainly not expected to be a miracle recovery that might cause the patient to leap out of bed – rather a gradual convalescence allowing the sector to limp along – perhaps to 2011 before seeing a significant improvement.

Conferences and meetings should see a slight improvement

But another tough year ahead was the clear message – almost 55% of respondents stressed the meetings and conference market is unlikely to recover dramatically this year. Those hopeful it might recover anticipate only a slight improvement, probably towards the end of H2 2010, again noting that any recovery is off a low base. The recovery was thought likely to start in London and gradually spread to the regions. BDRC's Director of Hotels & Hospitality, Matt Costin told us that:

“London is still seeing quite significant monthly declines in quoted (conference) rates, although there is also evidence of polarisation in pricing policy, with some properties offering vast price cuts in an effort to drive short-term revenue outcomes, and others maintaining or even building their rates.”

Lead times remain short but some had seen attendance numbers growing per event. One hotel group noticed a change of attitude with a “we need to get back to work/having meetings mentality in the market now”. And that “2010 will still see evaluation as to the benefit of moving large numbers of employees around”. Others thought there will be ‘pockets of positive performance’.

Responding to consumers' changing behaviour – buying less and buying clever

A key trend in this downturn has been that the value sector across retail, consumer and leisure has benefited from the recession. Consumers are responding to the recession by reining back on their spending and value operators have seized the opportunity this presents, positioning their offer as a way to maintain the same standard of living at a lower cost. Given the current climate this is perhaps no great surprise; the more critical question is whether these changes are likely to be permanent and how will they impact hotels.

Hoteliers we questioned reported that they had seen the following types of consumer behaviour, but particularly 1 and 2 – buying clever and buying less:

1. Buying clever e.g. using promotions and doing more research before buying
2. Buying less
3. Trading down the product hierarchy
4. Trying new brands or hotels e.g. value segments

One operator commented that “60% of our leisure segment is driven by promotions”. Another added, “Internet activity within the leisure market has seen a huge rise with more questions about price and product based on desktop research evident”. Another commented, “I would say consumers are buying clever more in Leisure, when spending their own money”.

Will it stick?

Almost 80% of our respondents felt that the new consumer behaviour would stick after the recession ends. Only 17% disagreed, believing that the changes will fade as the recovery strengthens. As Andy Cosslett, CEO of IHG, commented in an interview with PwC in 2009:

“ it all depends on what consumers found when they traded down or tried new brands – was it what they hoped for? ”



Improving trends but challenging year ahead

The UK has seen some of the best and worst of times over the past 30 years as Chart 3 on pages 14 and 15 reminds us. This latest crisis has been as bad as it gets, especially outside London, but given the scale of the GDP contraction in 2009 it could have been worse and the bounce back, at least in London, could surprise us all. BDRC's British Hotel Guest Survey 2010 reports around three million fewer domestic room nights at British hotels in the past 12 months. Recently some businesses such as Starwood, IHG, Marriott, Rezidor and Accor have reported improving trends in occupancy which is starting to stabilise. Group bookings and transient travellers have been sighted again. Accor's UK mid and upscale hotels (5,568 rooms in the UK) posted a 2.1% revenue gain in Q4 2009, a better performance than their economy brands (almost 9,000 rooms in the UK).

Which segments have been most resilient?

It has been a mixed bag across the country in terms of segments and in the UK in 2009 luxury and upper upscale actually did a tad better than other segments in terms of RevPAR declines. In the Provinces all segments were hit although it varies widely by city. Recent research into value and investment, which of course reflects trading, reveals that opinions on the relative performance of different hotel categories span a wide range too.¹⁰ For some, "the top end of the market—i.e. four- and five-star hotels—are suffering a lot." "The best return [forecasts] for hotels are for the medium-level categories, while luxury and low-budget ones are generating profits." "Best values will be among three- to four-star portfolios." "Volume business will fare best. However, there will be interest in opportunities all through the spectrum." Others expect a polarisation. "The two-star segment will grow, four-star will do well, three-star will become extinct." "Middle market is getting killed." "Budget hotels are performing well, so they will also in 2010." Weaker chains will face a tough time, "due to a lack of access to booking systems."

Travel outlook improves as declines slow

Last September we were writing about the spectre of swine flu, which thankfully didn't materialise on the scale feared, as well as the slump in business travel and the resilience of the leisure market. Looking back, demand remained weak, overall global tourism contracted by about 4% in 2009 and global airline passenger demand fell by 3.5%.

Closer to home, overall visitation was down 7% in 2009 to 29.6m. Q4 figures suggest that the market may have begun to stabilise and the declines slow. While business tourism was down, the number of overseas holidaymakers grew by 3% to 11.3 m in 2009. There has been an easing in the rate of decline of overseas arrivals from North America and in fact Q3 and Q4 2009 saw some growth (not seasonally adjusted), although for the year arrivals were down by 7% compared to 2008. Looking to this year's prospects, a recovery in the economies of the UK's main markets may drive a further upswing in tourism although this could also work in reverse. Increased volumes of North American visitors traditionally benefit hotels in London and other tourism popular centres such as Edinburgh. VisitBritain forecasts overseas visits will see only a modest increase in volume this year.

A stay at home year

The fall in global airline passenger demand in 2009

3.5%

Events such as the biennial Farnborough Air Show, which takes place July 19-25th this year, will provide a boost for hotels in the area and in London. Other events include the Ryder Cup in October in South Wales.

Business travel to the UK was estimated down 20% in 2009 to 8.1m – an unprecedented decline. Compared to visits in the corresponding quarters in 2008, visits declined by 7% in Q4 as against 19% in Q3, 24% in Q2 and 27% in Q1 – so an improvement and the outlook for business travel remains brighter than this time last year. Although demand is likely to remain weaker than in the past, some signs of incipient recovery in this market have been reported.

10: Emerging Trends in Real Estate Europe 2010, PricewaterhouseCoopers and the Urban Land Institute (ULI)

On the domestic front, will we see more domestic travellers mingling with overseas visitors and will more stay in UK hotels? In 2009 there was a 6.6% growth in UK domestic trips (for the 10 months to October). Overall, while VisitBritain consider this market could continue to grow, they think it unlikely that 2010 will demonstrate as robust domestic growth as 2009.

PwC's latest UK hotels forecast

Overall the UK saw a RevPAR decline of 9.7% in 2009 as most key cities reported declining average room rates and tumbling occupancies. Our latest forecast for UK hotels for 2010 essentially reflects London's strength as well as a modest Provincial recovery. Nevertheless it will be some years before revenues top 2007 levels. Overall we expect RevPAR to reverse the declines of 2008 and 2009 with a 3.1% gain in 2010, reinforced by a 4.7% gain in 2011. This will take UK RevPAR to £55.56 this year and £58.18 next year. This is underpinned by modest occupancy growth which should support room rate improvement. Occupancies should pick up through 2010 and 2011 registering 1.3% and 1.7% growth respectively, taking occupancy to almost 70% this year and just over 71% in 2011. Improving business travel volumes should also support some rate improvement and we forecast 1.8% and 2.9% ARR growth in 2010 and 2011. Dire comparables in Q1 to Q3 in 2009 make the figures shine somewhat unnaturally. See Table 5, Charts 2 and 3 and Appendix 1 for more details.

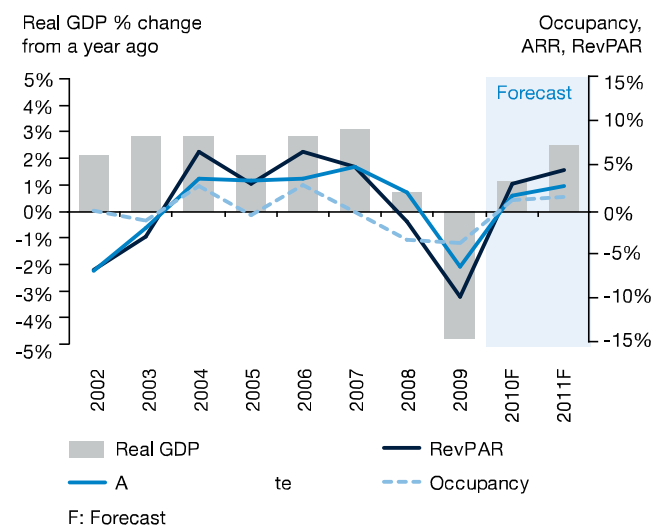
Table 5: PricewaterhouseCoopers latest forecast for UK February 2010

	2009	2010F	2011F
Occupancy (%)	68.99	69.88	71.09
% Change	-3.6%	1.3%	1.7%
ARR (£)	78.07	79.45	81.75
% Change	-6.20%	1.80%	2.90%
RevPAR (£)	53.87	55.56	58.18
% Change	-9.70%	3.10%	4.70%

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

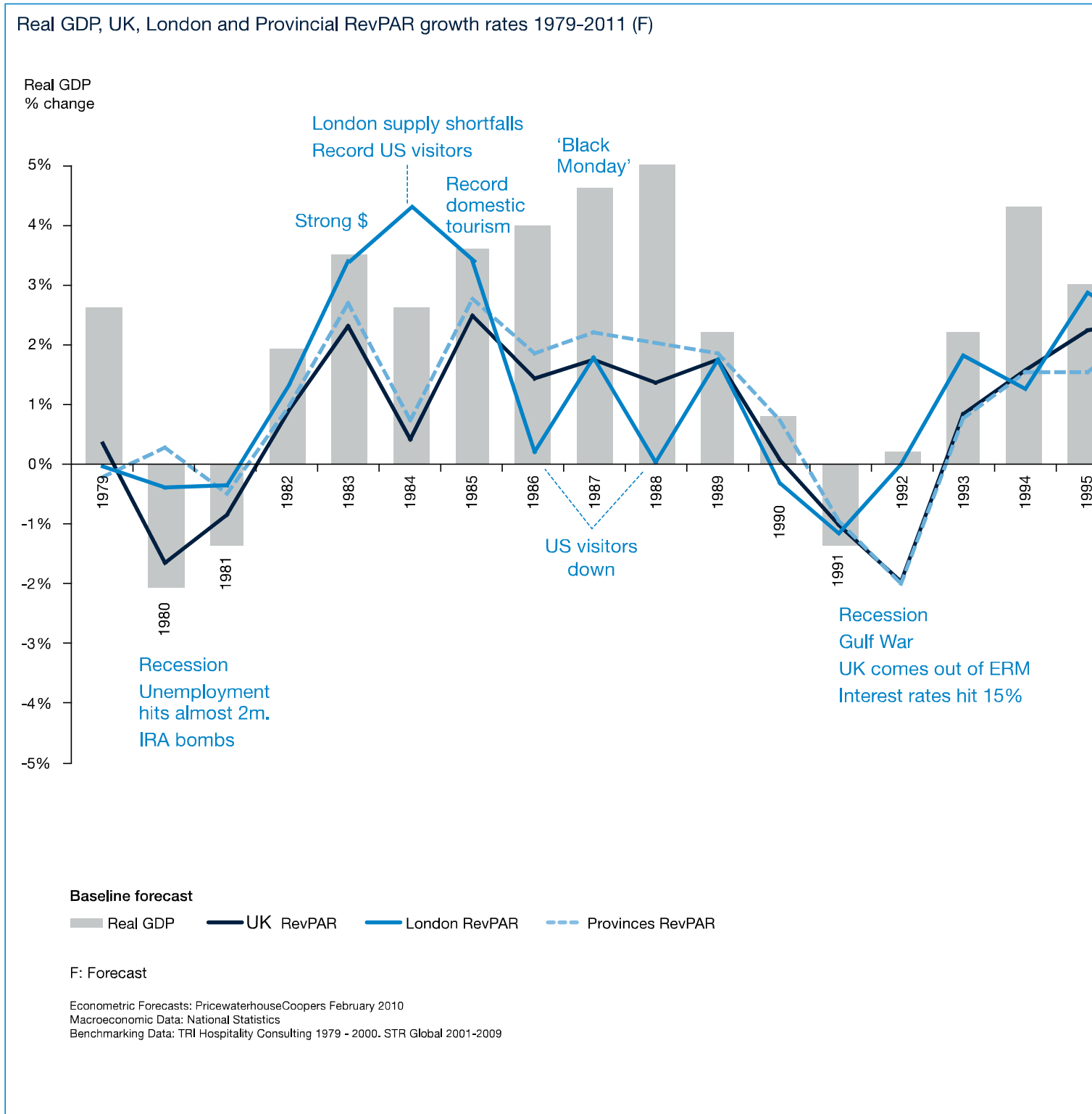
Chart 2 UK hotel performance 2002 to 2011

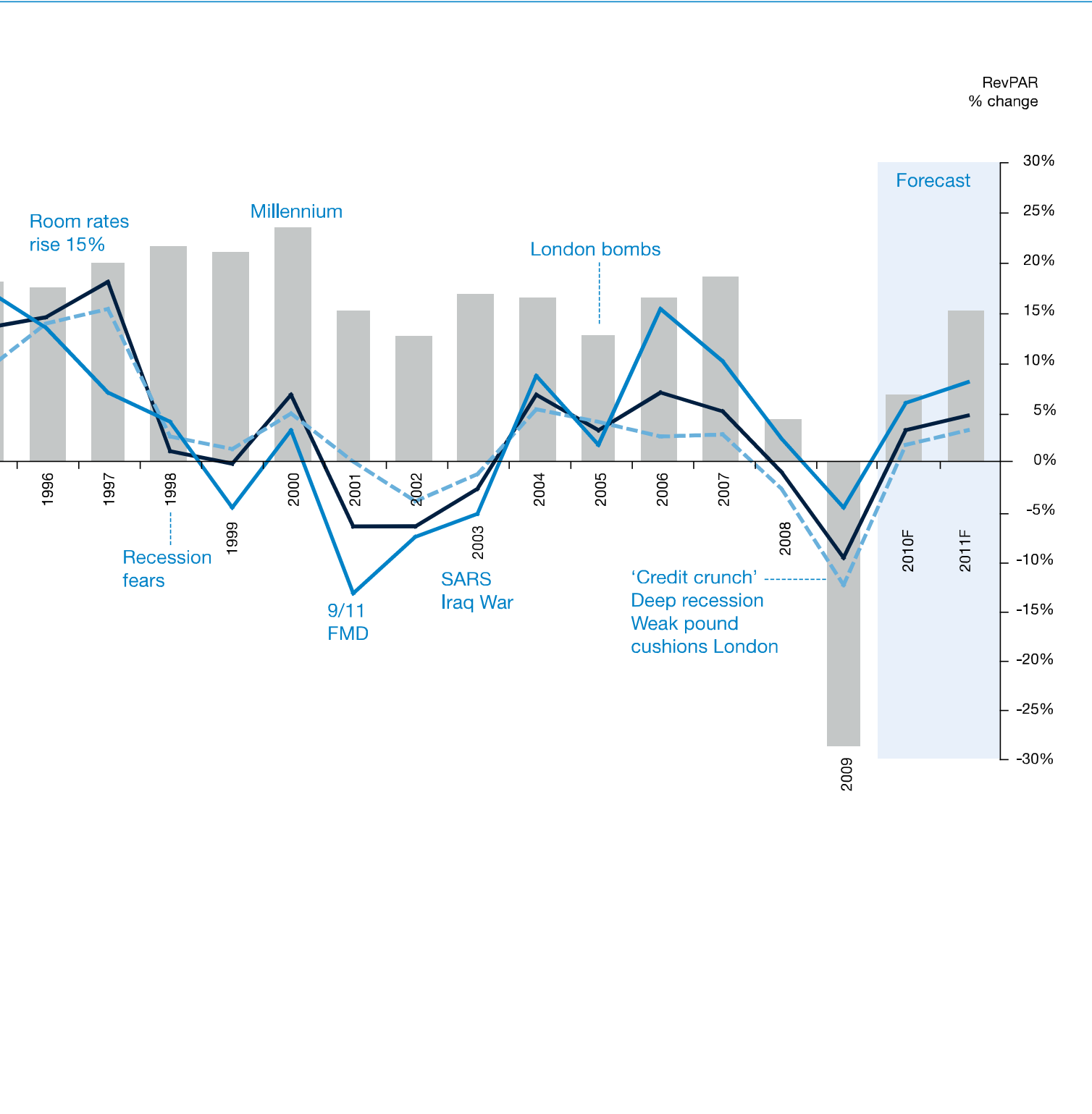
Real GDP, revenue-per-available-room, average room rate, and occupancy growth rates



Source: Econometric Forecasts: PricewaterhouseCoopers February 2010
 Macroeconomic Data: National Statistics
 Benchmarking Data: TRI Hospitality Consulting 1979-2000, STR Global 2001-2009

Chart 3: UK hotels: the way we were







London's comeback route, not paved with gold, but looks solid enough

Hogg Robinson's annual hotel survey found that London, as a gateway city, was one of the few cities to avoid the double-digit falls in room rates suffered by most destinations around the world last year, thanks largely to the weak pound. Indeed, although business travellers were here in reduced numbers, London managed to keep relatively busy as a tourist destination in 2009, albeit overall volumes were down on 2008. Visitors stayed a shorter time but spent more.

Overall, overseas visitor numbers to London in 2009 are expected to be down by around 4%, although the final score depends on Q4 being slightly better than 2008 (Visit London didn't have the final quarter's data as we prepared this forecast). Business tourism contracted by 24% in Q3 2009. Expenditure for the full year is expected to finish around 2.5% up on 2008.

In terms of outlook, the exchange rate should continue to encourage travellers to the UK, even though the pound has seen an appreciation of 7% against the Euro and around 10% against the dollar since the start of 2009. Forecasts for overseas arrivals for 2010 are for a modest 1.5% increase over 2009, with expenditure improvements of 5.3%. Although 2009 has been reported as a good year for domestic tourism across the UK, Visit London suggests London didn't share in this and domestic visits to London were down year-on-year (with resort regions benefitting most).

New and improved hotels galore as the Olympics approach

So, demand is recovering and on the other side of the equation supply is still booming as the Olympic build-up adds an urgency to be up and ready. Plans to develop, extend and upgrade mean a profusion of new schemes, even though some projects are reported to be on hold as funding stalls. Around 6,000 rooms are currently under construction and will open between now and 2013, a further 5,000 are classed as 'will probably' open and around 1,000 rooms as could 'possibly' open.¹¹ The four and five star sector is set to increase considerably over the next few years as is the budget sector.

¹¹ *Probable – with planning permission and likely to be constructed, ** Possible – with planning permission so may be constructed or likely to get planning permission

This year should see the following interesting openings, although there have been rumours of delays to a few:

- Re-opening of the Savoy (174 rooms)
- Re-opening of the Four Seasons Park Lane (187 rooms)
- W Hotel, Leicester Square (194 rooms)
- Corinthia Hotel London, Whitehall Place (296 rooms)
- Park Plaza Waterloo (1,037 rooms)
- Pestana Chelsea Bridge (218 rooms)
- H10 London Waterloo (177 rooms)
- Von Essen Hotel Verta at Battersea Heliport (70 rooms)
- Hilton Syon Park (155 rooms)

Further ahead, 2011 should see the re-opening of the splendid former Midland Grand Hotel at St Pancras now to be the Renaissance St Pancras Chambers. The Midland Grand was a salutary lesson in the dangers of failing to keep up with consumer aspirations, and with no en-suite bathrooms the hotel found itself by-passed by travellers seeking all mod-cons. Bang up-to-date new developments for London include an apart-hotel next to Olympia Exhibition Centre, a 500 bed pod hotel at the Trocadero, a new InterContinental in Westminster, the redevelopment of the former Playboy Club and Casino for the Dorchester Collection, the Hilton Wembley Stadium, the Yacht Hotel at Excel and the 600 room City Inn Tower of London (among others).

PwC's latest hotel forecast for London

In London, there are reports of a modest mid-week pick-up in transient business travel and reports that training volume is picking up too. Occupancies should continue their nascent stabilisation as corporates start to travel again. London occupancy showed almost a 1% gain overall in 2009 and managed some rate growth in the final quarter after four quarters of decline. In our latest forecast for London we expect to see ARR gains continue through each quarter of 2010 and 2011. This will take ARR growth to 3.5% in 2010 and 3.7% in 2011 and nominal ARR to £119.60 in 2010 and £124.03 in 2011. Real ARR still trails considerably below past peaks in 2000 and 2001.

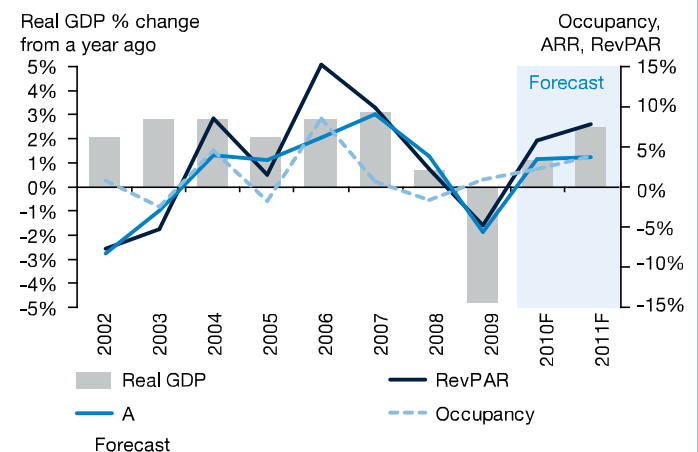
Table 6: PricewaterhouseCoopers latest forecast for London February 2010

	2009	2010F	2011F
Occupancy (%)	80.42	82.25	85.41
% Change	0.9%	2.3%	3.8%
ARR (£)	115.58	119.60	124.03
% Change	-5.70%	3.50%	3.70%
RevPAR (£)	93.1	98.47	106.15
% Change	-4.80%	5.80%	7.80%

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

Chart 4 London hotel performance 2002 to 2011

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



Source: Econometric Forecasts: PricewaterhouseCoopers February 2010
Macroeconomic Data: National Statistics
Benchmarking Data: TRI Hospitality Consulting 1979 -2000, STR Global 2001-2009

We anticipate that the considerable new rooms to be added to London supply in 2011 (above the 2000-2009 trends) will impact occupancies but not slow them unduly. Occupancies managed 0.9% overall growth in 2009 and should see a 2.3% gain in 2010 and a further 3.8% lift in 2011, taking them to almost 82% and 85.4% respectively, effectively full up. Interestingly, our occupancy forecasts are for record highs in 2010 Q1 and Q3 and all quarters in 2011. These are higher than prior peaks in 2000 (Q2 and Q3), 2007 (Q1) and 2007 (Q4) – a remarkable feat. RevPAR is forecast to grow by 5.8% and 7.8% in 2010 and 2011 respectively, taking RevPAR to over £98 and £106. See Table 6, Charts 3 and 4 and Appendix 1.

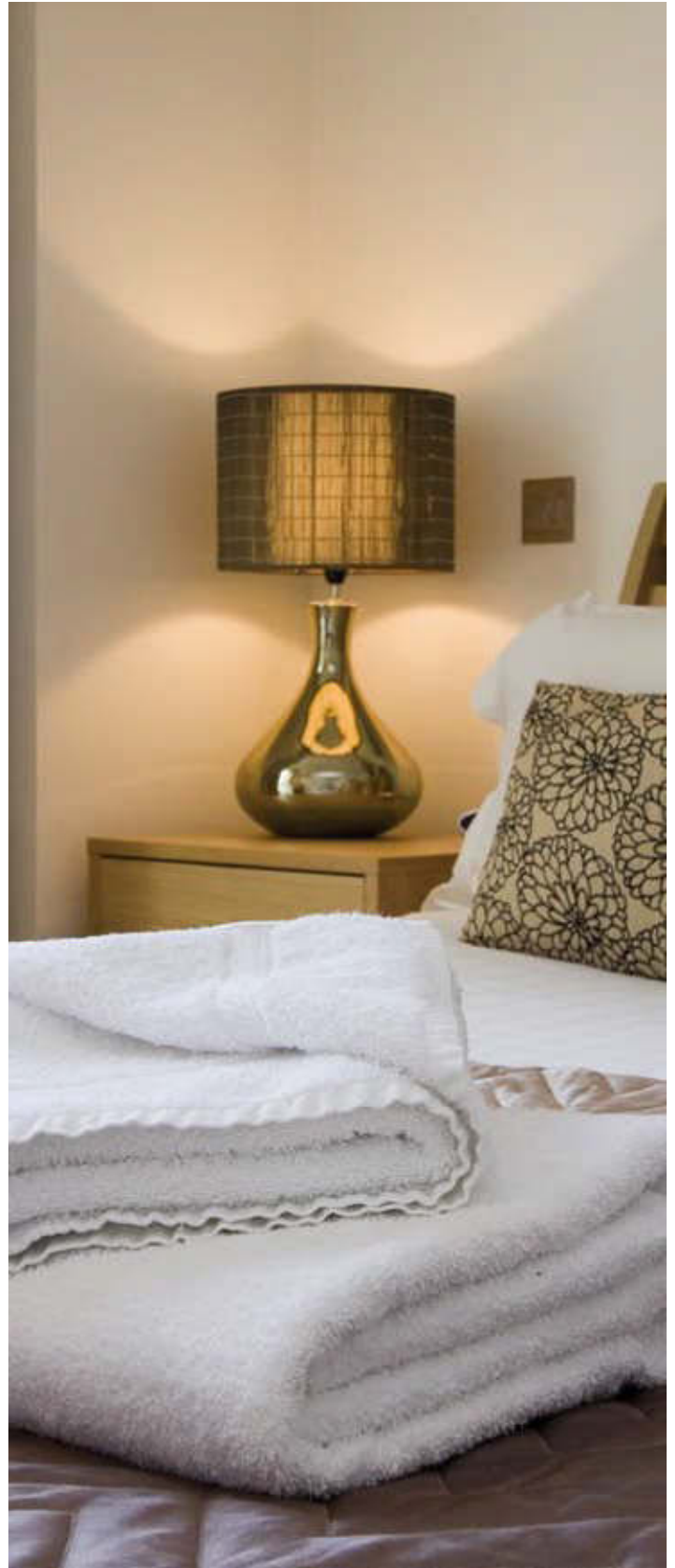
Provinces forecast

Gentler comeback for Provincial hoteliers' fortunes

While the economic recovery should start to take root in 2010, signs are of a long haul back for provincial hoteliers despite our overall view that there could be a slight RevPAR gain this year. The Provinces are more dependent on UK domestic business and leisure demand, underpinned by GDP growth and trends in UK unemployment and investment growth. As a result, many hotels have not been able to benefit to the same extent as London has from the weak pound and its ability to attract international guests. Of course there are Provincial tourist centres that also attract large numbers of international travellers but, while London sacrificed average rates to maintain occupancies, most cities outside the capital just did not have that option.

This does not tell the whole story though, as some centres have performed much better relatively than the Provinces overall, which saw a 12.6% RevPAR decline in 2009. In terms of bucking the trend, tourism to Scotland benefitted from the marketing initiative 'Homecoming 2009', outperforming the rest of the UK by increasing its share of overseas visitors between July and September 2009. It reported a 25% increase in visitors from North America in that period. Edinburgh and Glasgow saw 4.4% and 3% RevPAR declines respectively in 2009, a better result than many experienced. Cardiff and Newcastle also outperformed. Some resorts are reported as having been propped up by the 'staycation' trend. Others could have done with a prop, for example, Northern Ireland (-19.8% RevPAR), Liverpool (-18.3%), Manchester (-13.1%) and Leeds (-15%). Increased room stock in many cities resulted in decreases in room rates.

Overall our forecast for the Provinces proved only too accurate last year and our research among key participants found that most expect trading in the regions to remain pretty flat in 2010 but to start to improve in 2011. Some fear mid-market provincial hotels may never get back to peak trading but their demise has been reported for some time. Our forecast sees real ARR remaining in the £50's through the forecast period – a long way below the record quarters of 2000/2001 where real ARR reached £68 in Q1 2001.



The bad weather at the start of the year limited travellers and many regional businesses in December and January report an adverse impact. Despite this, January results show occupancy gains of around 2.6% and some airport hotels benefitted from cancelled flights. Resorts like Aviemore in Scotland reported four times as many skiers in early January compared to usual.

Oversupply has exacerbated the problems facing some areas but a lack of funding will moderate new supply for a while and constrained supply should help provincial hotels as domestic demand picks up slowly. There are still some notable new openings around the country, including the 128 room motor racing-themed Brooklands Hotel, due to open this year in Weybridge at the site of the original race track; The Dorchester Collection is launching the 70 room Coworth Park in Ascot; Glasgow's Blythswood Square; in Belfast the Lorne Hotel boutique opens and Citizen M is bringing its budget brand from Amsterdam to Glasgow.

PwC's latest forecast for the Provinces

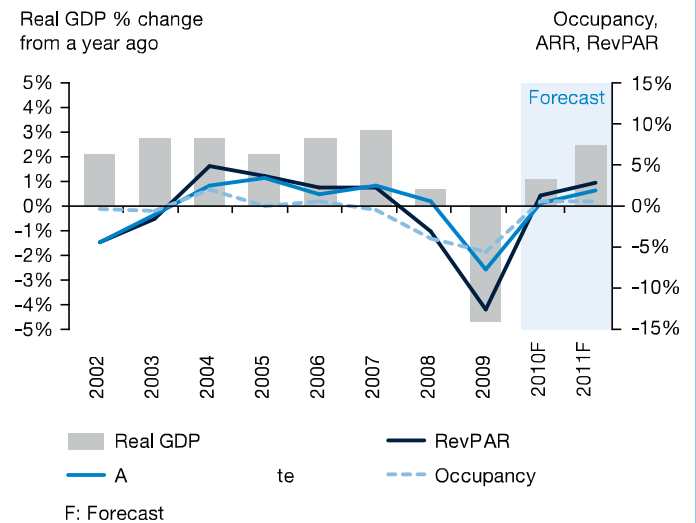
Our latest forecast for the Provinces expects the improved economic conditions to drive a small recuperation in 2010, with an occupancy gain of 0.9% and together with ARR growth of 0.6%, take RevPAR to 1.6%, not quite London's story but better than both 2008 and 2009. In 2011 occupancy growth remains virtually the same at 0.8% and keeps occupancy rates in the mid-60s. Better occupancy growth is on the horizon in 2010 Q1 and Q2, slowing in Q3 and Q4. ARR growth falters in Q1 2010 making this the sixth quarter of decline with ARR in the Provinces last in positive territory back in Q3 2008. ARR strengthens to 2.2% in 2011 taking RevPAR growth to 3.1%. See Table 7, Charts 3 and 5 and Appendix 1.

Table 7: PricewaterhouseCoopers latest forecast for Provinces February 2010

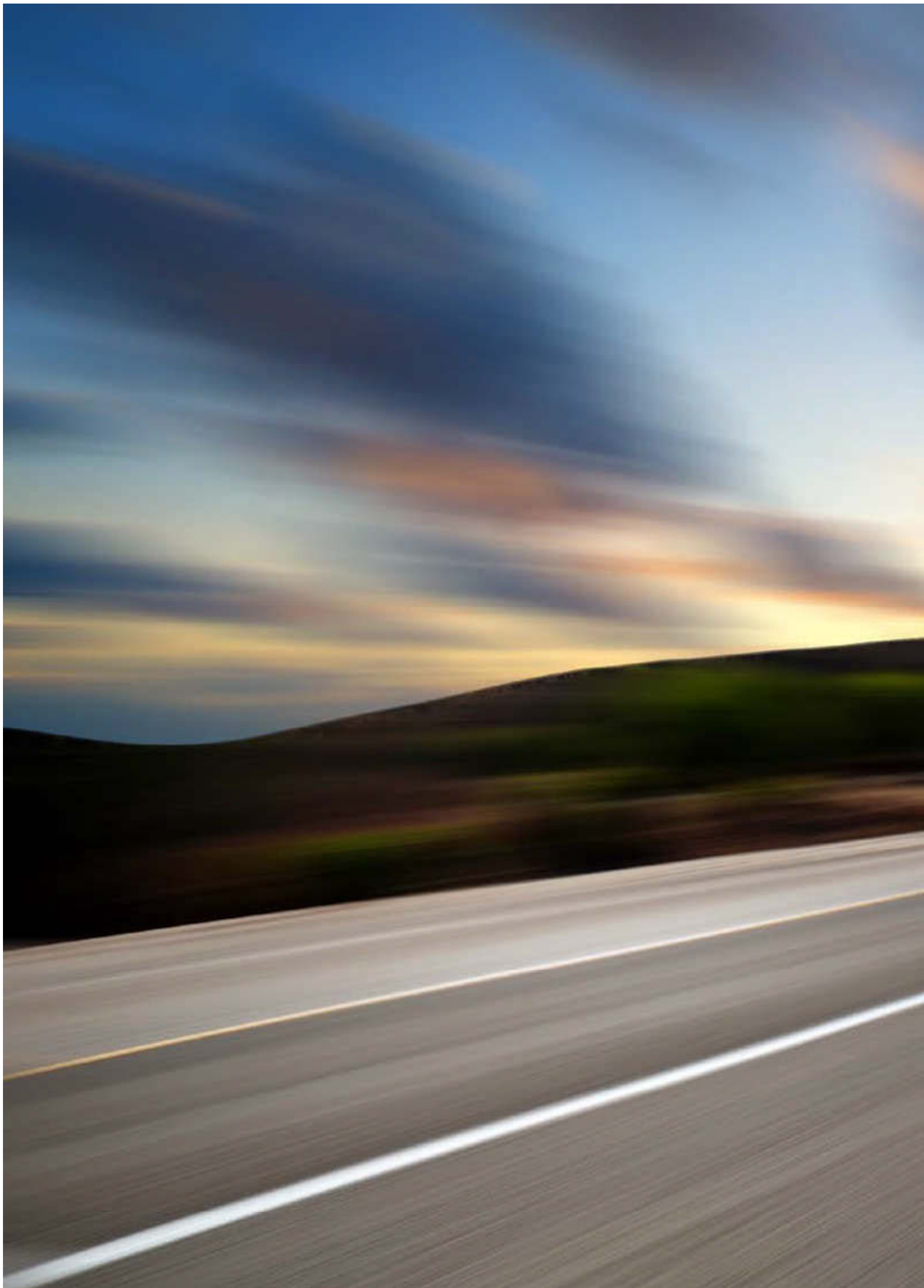
	2009	2010F	2011F
Occupancy (%)	64.98	65.6	66.13
% Change	-5.4%	0.9%	0.8%
ARR (£)	61.74	62.09	63.46
% Change	-7.60%	0.60%	2.20%
RevPAR (£)	40.13	40.75	42.0
% Change	-12.60%	1.60%	3.10%

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

Chart 5 Provinces hotel performance 2002 to 2011
Real GDP, revenue-per-available-room, average room rate, and occupancy growth rates



Source: Econometric Forecasts: PricewaterhouseCoopers February 2010
Macroeconomic Data: National Statistics
Benchmarking Data: TRI Hospitality Consulting 1979 -2000. STR Global 2001-2009



Appendices



Appendix 1: Annual hotel statistics for UK, London and Provinces 2004-2011(F)

	2004R	2005R	2006R	2007R	2008R	2009R	2010F	2011F
UK								
Occupancy %	72.10	71.84	73.97	73.97	71.58	68.99	69.88	71.09
% change	2.9%	-0.4%	3.0%	0.0%	-3.2%	-3.6%	1.3%	1.7%
ARR (£)	72.29	74.82	77.61	81.54	83.22	78.07	79.45	81.75
% change	3.7%	3.5%	3.7%	5.1%	2.1%	-6.2%	1.8%	2.9%
RevPAR (£)	52.15	53.79	57.46	60.35	59.64	53.87	55.56	58.18
% change	6.7%	3.1%	6.8%	5.0%	-1.2%	-9.7%	3.1%	4.7%
London								
Occupancy %	75.38	74.04	80.37	80.93	79.68	80.42	82.25	85.41
% change	4.5%	-1.8%	8.6%	0.7%	-1.6%	0.9%	2.3%	3.8%
ARR (£)	98.70	101.96	108.16	118.04	122.55	115.58	119.60	124.03
% change	4.0%	3.3%	6.1%	9.1%	3.8%	-5.7%	3.5%	3.7%
RevPAR (£)	74.45	75.56	87.06	95.64	97.78	93.10	98.47	106.15
% change	8.6%	1.5%	15.2%	9.9%	2.2%	-4.8%	5.8%	7.8%
Provinces								
Occupancy %	70.79	70.95	71.52	71.39	68.68	64.98	65.60	66.13
% change	2.3%	0.2%	0.8%	-0.2%	-3.8%	-5.4%	0.9%	0.8%
ARR (£)	61.02	63.31	64.42	66.23	66.79	61.74	62.09	63.46
% change	2.8%	3.8%	1.7%	2.8%	0.8%	-7.6%	0.6%	2.2%
RevPAR (£)	43.22	44.97	46.10	47.31	45.92	40.13	40.75	42.00
% change	5.2%	4.0%	2.5%	2.6%	-2.9%	-12.6%	1.6%	3.1%

R:Revised F:Forecast
 Econometric Forecast: PricewaterhouseCoopers February 2010
 Benchmarking Data: STR Global February 2010



Appendix 2: Quarterly hotel statistics for UK, London and Provinces 2009-2011

	2009Q1	2009Q2	2009Q3	2009Q4	2010Q1	2010Q2	2010Q3	2010Q4	2011Q1	2011Q2	2011Q3	2011Q4
UK	% change compared to same quarter of prior year											
Occupancy %	-6.9%	-5.7%	-2.5%	0.6%	3.6%	1.1%	0.6%	0.2%	1.4%	1.5%	1.2%	2.9%
ARR (£)	-5.2%	-8.4%	-8.2%	-2.8%	0.1%	2.5%	3.1%	1.3%	2.1%	2.4%	4.0%	3.1%
RevPAR (£)	-11.8%	-13.6%	-10.5%	-2.2%	3.7%	3.6%	3.7%	1.5%	3.5%	3.9%	5.2%	6.1%
London												
Occupancy %	-4.0%	0.1%	1.4%	6.1%	7.2%	-0.3%	3.0%	-0.2%	1.8%	3.8%	2.9%	6.8%
ARR (£)	-5.1%	-8.9%	-8.8%	0.4%	2.8%	4.6%	4.7%	1.9%	2.5%	3.2%	5.8%	3.3%
RevPAR (£)	-8.9%	-8.9%	-7.5%	6.5%	10.3%	4.3%	7.8%	1.7%	4.3%	7.1%	8.9%	10.3%
Provinces												
Occupancy %	-8.1%	-7.9%	-4.0%	-1.6%	2.2%	1.7%	-0.3%	0.4%	1.2%	0.5%	0.5%	1.1%
ARR (£)	-5.8%	-9.3%	-8.4%	-6.6%	-1.6%	0.9%	0.9%	2.1%	1.8%	1.7%	2.5%	3.0%
RevPAR (£)	-13.4%	-16.4%	-12.1%	-8.0%	0.6%	2.7%	0.6%	2.5%	3.0%	2.2%	2.9%	4.1%

R:Revised F:Forecast
 Econometric Forecast: PricewaterhouseCoopers February 2010
 Benchmarking Data: STR Global February 2010

Appendix 3: PwC hotel model GDP and inflation assumptions

PwC hotel forecasting model GDP and inflation assumptions (% growth in previous year)

	2007	2008	2009	2010F	2011F
UK GDP growth	2.6	0.5	-4.8	1.1	2.5
UK inflation	2.3	3.6	2.2	2.6	1.9

Source: PricewaterhouseCoopers February 2010
 For more detail of the PwC Forecasting Model see Appendix 4



Appendix 4: Methodology for PwC hotel forecasts



This section outlines in more detail the PwC model used to forecast hotel occupancy, ARR and RevPAR

Econometric model

The econometric model used is an updated version of the model used in September's Hospitality Directions forecast and is based on a Vector Autoregression (VAR) framework. This type of model was chosen because it allows for interaction between occupancy and average room rates, as we observe in the market. The VAR uses occupancy rate growth and real ARR growth as dependent variables, while the explanatory variables include lags of both the dependant variables and a set of macroeconomic explanatory variables.

Data

The model is based on data from STR Global from the period 2000 – 2009, containing monthly information on occupancy, ARR and RevPAR. We averaged this data to create a quarterly series.

Macroeconomic data was tested for the UK, US and Europe, as these regions comprise the main demand flows into the UK.

The model also incorporates some dummy variables. We included quarterly dummies to control for the strong seasonality of the data. Terrorism dummies were included to account for the affects of 09/11 and 07/07 on the UK hotel industry, while the Provinces model includes a pre-Q2 2003 dummy to account for data irregularities in the early part of the sample.

Final specifications

The final specifications for the London and Provinces models were chosen according to which variables exerted a statistically significant influence on the dependant variables. This means different macroeconomic variables were included in the two models, with London's having more international drivers. The optimal lag length (amount of lags of ARR and occupancy included in the model) was one quarter in the case of London and three quarters in the case of the Provinces. Table 8 gives the dependant and explanatory variables for the final specifications of the London and Provinces models.

Table 8 – Final specifications of the London and Provinces models

London model		Provinces model	
Dependant variables	Occupancy rate growth	Dependant variables	Occupancy rate growth
	Real ARR growth		Real ARR growth
Explanatory variables	1 quarter lagged occupancy rate growth	Explanatory variables	1, 2 and 3 quarter lags of occupancy rate growth
	1 quarter lagged ARR growth		1, 2 and 3 quarter lags ARR growth
	Quarterly dummies		Quarterly dummies
	Terrorism dummy for 9/11		Terrorism dummy for 07/07
	Terrorism dummy for 07/07		Pre Q2 2003 dummy
	GDP growth weighted by guests in London hotels		UK GDP growth
	1 quarter lagged dollar/pound exchange rate growth		UK unemployment rate change
US unemployment rate change	UK investment growth		

Forecasts

We used the model to generate forecasts through to Q4 2011. The forecasts were run separately for London and the Provinces, with forecasts for the UK constructed from a weighted average of these two regional forecasts.

PwC's in-house forecasts of the macroeconomic variables were used to drive the hotel forecasts.

An overlay was incorporated to the base forecast in order to account for three expected future changes that could not be picked up by the econometric analysis, as they represent a break in historic trends. The overlay includes:

- Higher than average supply of new rooms in the London market in 2011;
- Decoupling between pricing and inflation for 2010, based on current industry experience as higher inflation rates cannot be pushed through to pricing; and
- Limiting the model at a maximum operating occupancy, since hotels are typically unable to operate very close to 100% occupancy.

The impact of these three overlay factors was calibrated from industry sources and included as an adjustment to the pure econometric model, taking into account the supply and demand relationships in the model to balance prices and occupancy.

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