

Room for improvement:

Contrasting prospects for the US and UK
hotel sectors in 2010



January 2010

The recession has hit global travel demand and, as a consequence, both the US and UK hotel sectors have struggled to fill empty rooms without cutting their prices. To date it's been a similar story in both countries but the plot could be set to change in 2010.

This article compares each country's experience and offers some insights into which will display the strongest recovery trajectory in 2010 and what factors might derail recovery.

In many ways it has been a remarkably similar and depressing story on both sides of the Atlantic despite any differences between each country's hotel sectors. The US has the most mature hotel sector in the world with almost 70% of its rooms branded or chain affiliated – the UK might approach such a level in the larger cities only. In terms of hotel provision per head of the population the countries are not that far apart – the US has over 65 people for every one of its 4.7m hotel rooms and the UK over 85 people for each of its 700,000 bedrooms¹. In terms of the bare metrics, US hotels appear to have had a worse recession so far, perhaps the recession London might have had were it not for the weak pound that has buoyed up performance by attracting euro-zone leisure visits.

Contrast two iconic cities – New York and London – as room prices fell, both cities became more affordable. However, New York saw double digit RevPAR declines of 28% in July, as too many new rooms (especially luxury), too few visitors and too few corporates, forced hoteliers to offer steep rate discounts. In the year to September RevPAR decreased by 31.5 percent, compared to the same period last year. Yes, London suffered too, and sacrificed rates some, but RevPAR declines were around only a quarter of New York's.

But this situation may be set to change; PwC expects a return to US economic growth will stabilise US travel and hotel demand during 2010. In contrast, more sluggish UK economic growth could mean a slower paced and weaker hotel recovery with continued RevPAR declines, albeit like the US, it will get worse at a slower rate. Prospects of public sector travel and meetings cuts in the UK, and intense budget pressure at state and local governments in the US, could further slow any rebound.

2009 numbers tell a similarly depressing story

The effects of the recession have been particularly concentrated in 2009, and the RevPAR declines currently expected in the US (16.4%) and the UK (12.1%), have been severe. See Table 1. By the first quarter, the US was experiencing a swift contraction in business and consumer spending, causing RevPAR to fall 17.8% below the prior year, and travel remained suppressed in the second quarter. US leisure travel activity held up better than anticipated in the third quarter, but effects of the recession continued to weigh on performance, and RevPAR for the second half of the year has remained below year-ago levels. In the UK hoteliers we interviewed in early 2009 expected trading to fall into a black hole, but when re-interviewed this summer, we found that the mood had improved and three quarters were more optimistic.

¹ Hotel bedrooms per head: UK 61m population and 700,000 bedrooms. US 308m population and 4.7m hotel bedrooms

Hotels in New York and London have lost pricing power

In both territories hoteliers have lost pricing power as corporate travel remains restrained and those still travelling show a marked reluctance to pay the high room prices of recent years. Discounts have been necessary to attract most value driven travellers. Customer mix effects have also impacted rates with fewer commercial travellers on peak days. Average room rates are expected to fall by over 8% in each country this year. But these are averages and not all operators or cities are suffering to the same extent; for some it is much worse.

In contrast to the US, UK travel and hotel demand has been propped up by a weak currency, which attracted overseas leisure visitors to the UK – especially euro-zone travellers and especially London where some hoteliers have seen occupancies hit the 90's recently. The US experienced the effect of a stronger dollar early in the year as well as the global economic recession on inbound travel, and has not been able to rely on overseas visitors as a positive. Nevertheless the level of overseas arrivals to the US is reported to have held up relatively well and the dollar has been weakening recently. Overseas arrivals declined 9.8% year-to-date through July, however this decline has been less severe than the 24.7% decline experienced in the same period of 2002, and arrivals remain at levels that are more similar to the situation before the events of September 11, 2001.

On the flip side (domestic travel), the US is a large and diverse country and Americans have a much higher propensity to domestic travel than the UK. This year though the UK mirrored the US and more value-seeking UK 'staycationers' are reported holidaying at home. In the US the term has also been attributed to those Americans that have chosen to holiday in their home state this year.

US occupancies are expected to slip by 8.4% in 2009, compared to a fall of 4.3% in the UK. See Table 1. Hoteliers stress they have had to work much harder for every piece of business won but many acknowledge it could all have been a lot worse.

Table 1. US and UK hotel forecasts to 2010

	2004	2005	2006	2007	2008	2009F	2010F
US							
Occupancy	61.4	63.1	63.3	63.1	60.3	55.2	55.8
% change	3.6%	2.9%	0.3%	-0.4%	-4.3%	-8.4%	1.0%
ARR (\$)	\$86.41	\$91.17	\$98.01	\$104.09	\$106.86	\$97.51	\$95.79
% change	4.2%	5.5%	7.5%	6.2%	2.7%	-8.8%	-1.8%
Nominal RevPAR (\$)	\$53.03	\$57.56	\$62.04	\$65.63	\$64.46	\$53.86	\$53.47
% change	7.9%	8.5%	7.8%	5.8%	-1.8%	-16.4%	-0.7%
UK							
Occupancy	72.20	71.83	74.21	74.33	72.15	69.06	68.89
% change	3.0%	-0.5%	3.3%	0.2%	-2.9%	-4.3%	-0.2%
ARR (£)	£72.82	£75.38	£78.14	£82.64	£84.53	£77.69	£76.00
% change	3.2%	3.5%	3.7%	5.8%	2.3%	-8.1%	-2.2%
Nominal RevPAR (£)	£52.61	£54.19	£58.05	£61.47	£61.07	£53.67	£52.38
% change	6.4%	3.0%	7.1%	5.9%	-0.7%	-12.1%	-2.4%

F: Forecast
Sources: STR Global, Macroeconomicadvisers LLP, PricewaterhouseCoopers LLP,
US data November 2009, UK data September 2009

It's hard to tick all the boxes on a recovery, even in 2010

Looking to 2010, the global economy has pulled back from the brink and commentators now look to better times ahead. But, recovery is likely to be slow on both sides of the Atlantic, with no swift return of the essential corporate traveller or conference guest in 2010. PwC expect RevPAR declines to moderate through 2010, but not to halt. Rates are likely to remain under pressure and PwC anticipates a 2.4% UK RevPAR decline in 2010. The US should see a better performance with a marginal fall of 0.7% projected.

A number of crucial elements are necessary for a sustained hotel recovery, particularly growth in key drivers such as business travel. While not many boxes earned a tick for growth in 2009, the exception being UK and US leisure travel, by 2010 it should get easier to tick more boxes. See Chart 1.

Chart 1. How hard is it to tick all the boxes on a recovery?

	2009		2010	
	UK	US	UK	US
1 GDP	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
2 Consumer spend	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
3 Consumer sentiment	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
4 Business travel	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5 Leisure travel	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
6 Occupancies	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
7 Room rates	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>

Box 1 GDP growth

Economists expect to see GDP contract by around 2.4% in the US in 2009 and by 4.4% in the UK. Signs of a broadening economic recovery bring hope of economic stabilisation and a transition to positive economic growth. For 2010 this growth is likely to be stronger (around a 3.5% GDP gain) in the US than the weak GDP growth projected for the UK (more like 0.6%). However, in this environment any growth is encouraging news for hotels and as economic growth resumes hotel demand should begin to recover.

Box 2 Consumer spend

This is expected to contract by 3% to 3.5% this year in the UK and to remain under pressure, with a possible further contraction in 2010, as unemployment impacts spending. This segment may see a return to growth in 2011 but this is not expected to be to pre-recession trend. In stark contrast, real US consumer spending is expected to recover and show a 2.8% gain in 2010 over 2009.

Box 3 Consumer sentiment

PwC independent consumer research indicates that consumer sentiment is starting to recover in the UK, with fewer consumers feeling that they will be worse off over the next 12 months. Significant issues remain though, including the state of household balance sheets; variations in the shape and timing of any recovery by consumer profile; a housing market recovery and in the UK the impact of an election year on public sentiment. Research also suggests that the UK recovery in consumer confidence reflects optimism surrounding the UK economy rather than an improvement in their personal financial situation, with confidence in employment remaining low. Consumer sentiment in the US is expected to gradually improve, though the substantial setbacks experienced by many households and the slow pace of the recovery will, like the UK, limit the shift in sentiment. Job growth is expected to resume by the second quarter, helping to bring the unemployment rate down to 9.1%. The recent stabilisation of housing prices, and recovery in equity values, helps moderate concerns of further wealth declines.

Box 4 Business travel

The key segment for a demand revival in both the US and the UK. A question mark hangs over the pace of recovery and just how long changes in travel policy and shifts in perception which see group travel as a visible indicator of corporate spending, will stick. In the US, firms are expected to begin restocking inventories, and investment spending on equipment and software is expected to strengthen as the year progresses. But as businesses continue to focus on containing costs

we expect to see further consolidation of travel policies, near term shifts in the perception of meetings and events and no real recovery in the meetings sector. However, group booking windows have shortened, and solid economic growth, if it comes about, could help contribute to a nascent recovery in the second half of 2010.

Box 5 Leisure travel

This segment has taken up the demand mantle in many markets and is a driver that is expected to remain resilient, but subject to uncertainty, as consumer balance sheets remain under pressure, employment continues to contract and job losses mount. Consumer spending may typically be less cyclical than business spending, but has nevertheless been badly impacted this time. Leisure travellers in the US are expected to continue to respond favourably to reduced prices, and as job security improves, leisure travellers are expected to continue to help support hotel occupancies.

Box 6 Occupancy growth

In the UK, 41% of operators polled in a PwC research survey in summer 2009 expected occupancy rates to grow next year. We concur for London where we think the capital could see a 1% gain in 2010, taking occupancy to almost 80%. Outside London, where the options to attract new demand remain more limited, we expect demand to remain flat. In the US we expect overall occupancy growth of 1% in 2010 but at 55.8 percent US occupancy in 2010 would be seven percentage points below its long-run average of 62.8 percent, the lowest level in over 20 years. In the UK, occupancy is forecast to reach 68.9 per cent, the lowest since the mid 1990's.

Box 7 Stabilised rates

We expect rates to remain under pressure and to see further declines in both countries through 2010. We have no expectation of a corporate demand resurgence in 2010; changing value perceptions, discounting and promotions, customer mix effects and trading down will compress the market and keep rates low.

New supply

A slower pace of hotel openings and construction starts will help reduce supply growth and ensure recovery has a fighting chance of survival both sides of the Atlantic. But competition will remain tough and destinations continue to see a range of new openings which will make life difficult for some hoteliers. London hosts the Olympics and Paralympics in less than three years and is expected to see over 12,000 new rooms open by 2012 with some 6,000 rooms in the 5 star segment. This year performance in London was aided by a number of large luxury hotels closures. New York continues to see more new development with Manhattan's supply of hotel rooms continuing to increase through September 2009 as a number of hotels that had secured financing and started construction prior to the credit crisis continued to open. Through September 2009, Manhattan's supply of hotel rooms increased 4.6 percent, compared to a 2.1 percent increase through September 2008. Overall PwC expect supply growth in the US will slow to 1.3% in 2010, which is much lower than the 20-year average pace of 2.1%.



Revenue managers will have to navigate a new landscape

Just how long it could take to get room prices back up again is a topic exercising the finest hoteliers' minds at present. Consumers and businesses are more price conscious than ever and PwC research this summer showed that pricing strategy and revenue management is now a key focus with many hoteliers suggesting it could be several years before prices recover to past peaks. Reflecting this, PwC forecast that average rates will remain under pressure and will decline by 2.2% in 2010 in the UK and by 1.8% in the US. A hotel room in London next year could cost almost £20 less next year than in 2008. As well as business travel demand shifts, the downturn has accelerated structural shifts in the market, with holiday-buying consumers also shopping around online even more for all elements of their holiday, including accommodation.

US likely to lead the recovery as Q3 2010 returns to positive RevPAR growth

It has been suggested that given the synchronised plunge into the trading morass in late 2008 perhaps global hotel sectors are aligning. This time we saw that US and European RevPAR turned down together (Q3 2008) although the US had seen a longer lead up and it all happened faster in Europe.

Given a more aligned downturn, what about the prospects of a more synchronised recovery this time? 2010 quarterly forecast comparisons between the US and UK show that US RevPAR is expected to recover sooner than in the UK. Presuming hotel pricing begins to stabilise, positive RevPAR growth returns to the US in Q3 2010 as demand strengthens and occupancy shows a 1.8% gain. In the UK we do not forecast a RevPAR recovery in any quarter of 2010, although the rate of decline slows extensively. In London only a marginal decline is predicted in Q4 2010. Room rates remain under pressure both sides of the Atlantic, but more so in the UK.

Could the spectre of a public sector recession derail a recovery?

While consumer and corporate travel volumes have already been impacted by this recession, it is now likely, especially in the UK where the economic recovery is likely to be sluggish, that public sector budget cuts will curtail travel volumes in this sector and deliver a further blow to hotels. US state and local governments are expected to come under increasing budget pressure in the year ahead, which may result in further travel reductions. Anecdotal evidence in the UK suggests that while some of these cutbacks are also in the 'pipes', they have yet to come emerge in hotel's forward bookings.

In the US, direct government sector expenditure has historically accounted for around 14% of all accommodation purchased. Including industries like healthcare or education would take the total closer to 20%. In the UK this remains a more difficult figure to define. The British Hospitality Association has estimated that UK government spending on travel and hotels could be worth around £1bn annually. Contracted room bookings from government departments are theoretically relatively easy for hotels to identify – one large international chain suggested around 5% of all their room bookings this year came from this source – but local business is much harder to split out by public sector origin and suggests a higher figure more reflective of the US experience.

2010 will see the sector continue to count the cost of disappearing business travellers

Both countries' hotel sectors face a challenging 2010 with many hoteliers knuckling down for a rocky ride for the next few months and hoping things pick up during 2010. There have been some positive signs, the rate of revenue declines are forecast to slow in both the US and UK next year suggesting we are currently 'bumping along the bottom'; some businesses report occupancies starting to stabilise too, but 2010 is likely to remain weak and there are many reasons to remain fearful. The prolonged absence of corporate travellers has caused a severe deterioration in revenue for most hotels and it remains unclear when a recovery will take firm root. We are by no means out of the woods yet, but a way out is starting to look clearer, with much riding on the global economic recovery.



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This article draws on data from 'UK Hotels Forecast: Not out of the woods yet' September 2009 and Hospitality Directions US Q3 2009, November 2009.

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