

UK hotels: early check-out for good times



Half way through 2008 PricewaterhouseCoopers' update to its biannual hotel sector forecast finds that the deteriorating economic backdrop has left hoteliers in a less optimistic mood

July 2008

Introduction

This interim forecast provides a snapshot of recent trends in the UK hotel sector, incorporating the latest macro-economic indicators and our consultations with key operators and experts. It supersedes our previous forecast published in March 2008. This update looks at UK, Provinces and London only and we will analyse trends in Birmingham, Manchester and Edinburgh later in the year.

Six months in: hotels performing well as room rates continue to grow...

Benchmark data show that despite the economic and consumer slowdown, UK hotels continued to report positive trading results in the first half of this year. The UK saw RevPAR growth of 3.1 per cent in the five months to May compared to the same period in 2007. This was largely London-led as hotels pushed room rates up higher still with a 6.1 per cent gain between January and May. The average achieved room rate for all London hotels in May itself was £119 (ranging from £60 in economy scale; £84 midscale and £289 luxury scale). A 1.1 per cent occupancy gain underpinned RevPAR growth for London of 7.3 per cent over the first five months. Provincial comparables were less buoyant seeing 1.9 per cent room rate growth but, with an occupancy decline of 1.3 per cent, this took RevPAR growth to just 0.6 per cent.¹ From our discussions with operators, June also looks to have been a reasonable month, especially in London.

...but the deteriorating economic backdrop heralds a slowdown in the second half continuing into 2009

Looking ahead to the year end and to 2009, the prospects for overall UK hotel sector growth have nevertheless shifted downwards since our March forecast and, although they continue to be underpinned by London, we anticipate a more severe slowdown in the capital in 2009. We now expect around 2.8 per cent RevPAR growth this year for the UK as a whole (compared to 4.1 per cent forecast in March) and a further 1.4 per cent growth in 2009 (compared to 3.0 per cent in March). For London we expect a robust 5.2 per cent RevPAR gain this year, slowing to 1.5 per cent next year. For the Provinces we now forecast only 0.5 per cent RevPAR growth this year as occupancies fall by 1.6 per cent. 2009 may see marginal RevPAR improvement as rates show a little growth and occupancies rally slightly.

High but flat occupancies and rising room rates are characteristic of a cycle peak. The current mix of financial and economic events is likely to hasten this cycle along and demand will continue to slow as customers travel and spend less or trade down. Operators will be forced to target alternative markets, typically at lower rates and margins and fierce price competition will impact revenues and profits. Our latest forecast shows that occupancies are likely to fall throughout the UK by the year end and into 2009. London hoteliers recently told us that although busy, demand was “fragile and volatile” and bookings beyond the summer “uncertain”. As tougher conditions begin to bite, London is expected to suffer most.

Revised forecast highlights 2008-2009 (growth %)						
	UK	2008 London	Provinces	UK	2009 London	Provinces
Occupancy	-0.8%	-0.1%	-1.6%	-0.8%	-1.2%	-0.4%
ARR	3.7%	5.3%	2.1%	2.2%	2.8%	1.5%
RevPAR	2.8%	5.2%	0.5%	1.4%	1.5%	1.1%

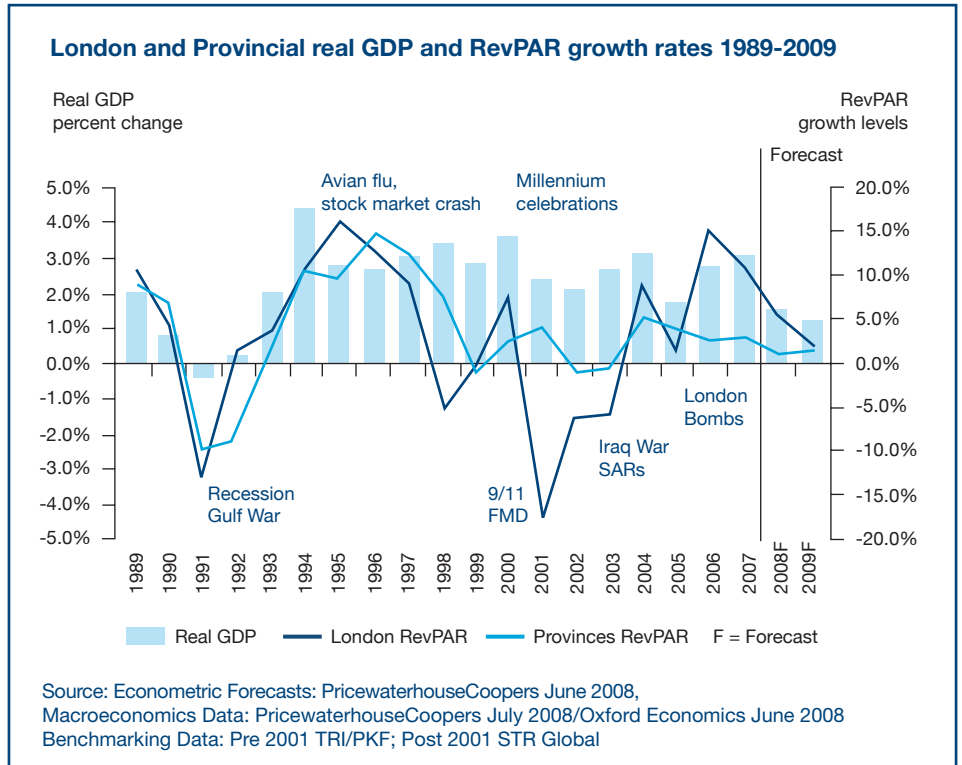
Based on 1.8% and 1.25% GDP growth in 2008 and 2009 respectively

Source: PricewaterhouseCoopers June 2008. Rounding errors may mean RevPAR does not equal sum of ARR and occupancy

Key elements of our revised forecast follow:

London on track to grow revenues by a further 5.2 per cent this year but sharper demand slowdown expected in 2009

There is little change to our previous forecast for London for 2008. RevPAR is expected to slow during the second half to around 5.2 per cent for the year as a whole, on the back of a marginal occupancy fall of 0.1 per cent and room rate growth of 5.3 per cent. This compares to our March forecast for 5.5 per cent ARR and 6 per cent overall RevPAR gains. However, although we still expect continued growth in 2009, the economic backdrop continues to worsen. In London visitor levels are expected to decrease by 1 per cent in 2008 and although increased volumes of domestic visitors have been reported recently, these visitors are reluctant to stay overnight.² This, together with considerably weaker GDP forecasts and fears of a more severe consumer-led downturn, have driven us towards a less optimistic view than we held earlier this year. With hotels less able to raise rates, as demand slips, ARR growth of 2.8 per cent now looks more realistic - a third of that achieved in 2007 - and compares to 5.0 per cent expected earlier this year. We now forecast RevPAR growth for 2009 of just 1.5 per cent, compared to 4.4 per cent expected in March. This takes RevPAR to £98.32, as room rates top £122, and occupancies slip a little to a still high 80.4 per cent. See graph above and summary table at end.



Spectre of harsher times in Provinces as slowdown arrives earlier than expected

The Provinces have felt the squeeze a lot faster than many observers expected earlier this year and do not appear to have benefitted from such a robust first half year as London. Occupancies fell for four of the first five months of this year, the reduction averaging 1.3 per cent over that period. Overall the Provinces only achieved 0.6 per cent RevPAR growth in the first five months. Operators suggest rising fuel prices, an increased squeeze on consumer budgets and a reduction in 24 hour conference trade have all contributed to a deceleration in fortunes.

“Many rural Provincial areas outside London and the south-east are going to face tough times over the next 18 months to two years as a poisonous mix hits them and their customers. Our members tell us that with rising food and energy costs and flat or declining revenue, profit margins will be squeezed, making future investment in the business difficult”

Bob Cotton, Chief Executive, British Hospitality Association, June 2008

“The anticipated slowdown in the hospitality sector appears to have begun much earlier than had been expected”

Robert Kajkowski, Head of Group Planning, QMH Hotels, comment to PricewaterhouseCoopers July 2008

“Corporates will be scrutinising their spend in all travel areas and looking to reduce costs without compromising their travellers. Obvious areas will be to consolidate and leverage spend with fewer suppliers.”

Samantha van Leeuwen, Head of Hotels Procurement, PricewaterhouseCoopers, July 2008

With little prospect of a buoyant second half, we have now revised downwards our forecast for room rates growth to 2.1 per cent in 2008 and 1.5 per cent in 2009. Occupancies are expected to fall by 1.6 per cent this year and a further 0.4 per cent next year taking RevPAR growth to just 0.5 per cent this year and 1.1 per cent in 2009. This is considerably lower than our March baseline forecast of 3.2 per cent for both 2008 and 2009.

Key changes driving the current forecast include:

Economic growth now expected to slow to 1.25 per cent in 2009

UK economic growth is reported to have slowed more than expected in Q1 2008 and although PricewaterhouseCoopers still views a recession as an unlikely outcome, uncertainties centre around fears that the underlying health of the economy will prove fragile and households and companies may soon realise they cannot spend and employ as before.³ As a result many economic forecasters now expect 2009 to reflect a much sharper consumer-led downturn than forecast earlier this year. Accordingly we have now revised our GDP growth projections to 1.8 per cent in 2008 (marginally lower than the 1.9 per cent GDP growth we expected in March).⁴ We now expect economic growth to dip to 1.25 per cent in 2009 (compared to 2 per cent expected in March).⁵ There are considerable risks to these forecasts in the current climate and PricewaterhouseCoopers' most recent UK Economic Outlook report reminds us that “The risks remain firmly anchored on the downside”.⁶

Resilient corporate travel expected to slow too...

Corporate travel spend has held up so far but there is typically a delay before companies can both implement new policies and before the impact of such policies are felt. The majority of hotel operators we interviewed expect reduced corporate spend as companies seek to control costs. Hogg Robinson recently reported that financial services clients have started to reduce travel spending.⁷ We would expect to see further shortening of trips to reduce expenditure and/or trading down. A number of operators we questioned also expected day conferences to increase at the expense of 24 hour conferences as companies try to save money. Some also reported a trend to holding more meetings in-house. We were told by some airport hotel operators that fuel surcharges will further depress business travel volumes.

... and leisure travellers are also likely to tighten their belts

In terms of leisure travel, consumers are likely to become more price and deal conscious in the future, even though they are still currently on the move. Holidays still remain a ‘must have’ but in a severe consumer downturn it will prove harder for family budgets to sustain this lifestyle. A decline in leisure discretionary spend was cited by a number of operators as a key threat to continued revenue growth in the sector. Real disposable income fell 1 per cent in Q1 2008 and consumers may yet be forced to tighten their belts and take fewer or shorter holidays.

³ ‘Shoppers actions’ prove much louder than words’, Financial Times, 1 July 2008

⁴ Oxford Economics June 2008

⁵ PricewaterhouseCoopers July 2008

⁶ UK Economic Outlook, July 2008, PricewaterhouseCoopers

⁷ ‘Hogg Robinson hit by cuts in travel budgets’, Financial Times 4 June 2008



Although we expect the downturn to impact all segments of the hotel sector, the budget operators we have spoken to expect value to become an important consideration for travellers.

Many hotel operators, especially those with rural properties, expect a decline in weekend leisure breaks next year, exacerbated by rising petrol prices.

In the current climate, new supply will start to impact occupancy rates

Although our research found few operators concerned that oversupply is a big issue in the UK, strong trading has encouraged ambitious schemes from a variety of global and domestic brands and some cities have seen considerable room additions in recent years.

Despite supply additions, tight room supply in London has allowed six years room rate growth. London is expected to see almost 6,500 rooms opening in total in 2008 and 2009 which, despite longer term supply shortages in London, may impact some existing operators in the short term. According to Lodging Econometrics a total of 321 projects and 46,531 rooms are in the construction pipeline for the UK overall.⁸ Although the generally benign supply situation is likely to help reduce the impact of an even more severe slowdown, increases in supply will (as we are starting to see) impact occupancies and then rates. A few cities that have experienced considerable new supply in recent years (e.g. Leeds, Liverpool and Manchester) were cited by hotel operators in our research as likely to find the going tougher in the short term.

“If you’re having to cut back, you’re not going to pay £100 for a night in a four-star hotel!”

Alan Parker, Chief Executive Whitbread, on a 10 per cent rise in sales for Premier Inn, The Times, 18 June 2008

“Like retail there will no doubt be a consumer downshift from mid market to the budget offer. I would not say that any hotel sector is immune to an economic downturn but budget is no doubt the most resilient.”

Guy Parsons, Managing Director, Travelodge UK, comment to PricewaterhouseCoopers July 2008

Hotel Statistics for UK, London, Provinces 2003-2009							
Hotel Statistics for the UK	2003R	2004R	2005R	2006R	2007R	2008F	2009F
Average Room Rate (£)	69.22	71.75	74.23	77.02	80.99	83.97	85.82
% Change	-2.2%	3.6%	3.5%	3.8%	5.2%	3.7%	2.2%
Occupancy (%)	69.9	72.0	71.7	73.6	73.6	73.0	72.4
% Change	-0.9%	3.0%	-0.5%	2.7%	-0.1%	-0.8%	-0.8%
RevPAR (£)	48.42	51.66	53.21	56.70	59.58	61.26	62.10
% Change	-3.1%	6.7%	3.0%	6.6%	5.1%	2.8%	1.4%
Hotel Statistics for London	2003R	2004R	2005R	2006R	2007R	2008F	2009F
Average Room Rate (£)	91.64	94.70	97.43	103.33	112.92	118.92	122.26
% Change	-3.6%	3.3%	2.9%	6.1%	9.3%	5.3%	2.8%
Occupancy (%)	72.4	75.9	74.9	80.9	81.5	81.4	80.4
% Change	-2.5%	4.9%	-1.3%	8.0%	0.7%	-0.1%	-1.2%
RevPAR (£)	66.32	71.88	72.99	83.62	92.02	96.82	98.32
% Change	-6.0%	8.4%	1.5%	14.6%	10.0%	5.2%	1.5%
Hotel Statistics for the Provinces	2003R	2004R	2005R	2006R	2007R	2008F	2009F
Average Room Rate (£)	58.26	60.0	62.34	63.39	65.20	66.55	67.54
% Change	-0.6%	3.0%	3.9%	1.7%	2.9%	2.1%	1.5%
Occupancy (%)	68.8	70.2	70.1	70.3	70.2	69.1	68.8
% Change	-0.2%	2.0%	-0.1%	0.3%	-0.2%	-1.6%	-0.4%
RevPAR (£)	40.09	42.10	43.72	44.58	45.76	45.97	46.47
% Change	-0.8%	5.0%	3.8%	2.0%	2.6%	0.5%	1.1%

Sources: Forecast: PricewaterhouseCoopers Forecasting Model, June 2008. Note: Historic data are from STR Global

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