UK hotels forecast 2017 and 2018:
Weak pound helps hotels defy global uncertainty

Summary

What a difference the last two months of 2016 made to London's hoteliers. After a largely dismal year, December marked London's highest year-over-year RevPAR growth since the 2012 Olympic Games, according to STR Global data. We didn't anticipate such a sensational finish in London although in the Provinces our growth outlook was largely correct. This latest forecast provides our updated views on what will drive hotel performance across both the Provinces and London in 2017 and our first thoughts on the outlook for 2018.

While we retain a largely unchanged view on our latest outlook for the Provinces, anticipating a sixth consecutive year of ADR growth in 2017, we are now more optimistic about London hotel performance. There are two key reasons for this. First, the economy hasn't turned out as bad as previously predicted post the Brexit vote, after better than expected GDP growth in 2016. Stronger World and European economies has meant a growth upgrade since our last forecast and the assumptions underpinning this forecast are now more positive and should drive or maintain business and leisure travel volumes. Second, the weak pound appears to be finally driving stronger travel demand and this is reflected in robust RevPAR growth since November 2016 and importantly, into January 2017.

Hoteliers we have spoken to are much more optimistic, at least about the first half of 2017. Staycations should help drive demand also.

Nevertheless, despite all this, there remain considerable headwinds and notwithstanding recent reported rises in business confidence, there are reasons to remain gloomy on the outlook for household expenditure, inflation, costs and business investment. Global turbulence is making for a highly unpredictable future. PwC expect politics will drive global uncertainty and economics in 2017.

In particular, there are two crucial issues that could upset London hotel's return to growth. First, safety and security concerns are a key problem for travellers and international events can cast a pall over UK cities. London only recently shrugged off the terrorism 'effect' from Paris in November 2015. In addition, we expect above average supply growth in 2017 and possibly 2018. This will make it a challenge to fill all the new rooms. However, as two-thirds of new rooms comprise branded budget, which have a largely domestic customer base, we believe non-budget operators should still be able to benefit from stronger demand driven by the weak pound.

Our latest forecast for **London** in 2017 anticipates RevPAR growth of 3.3% taking RevPAR to £120, driven by a 2.4% ADR increase. After two consecutive years of declines, we anticipate a 0.9% increase over 2016, keeping occupancy high at 82%. In 2018 we anticipate a further 2.5% RevPAR advance to £123, supported by a 2% ADR gain, taking ADR to £149 in nominal terms.

See Table 1 and Chart 2.

Despite a slower start to 2017 outside London, our latest forecast for the **Provinces** in 2017 expects further RevPAR growth of 3% taking RevPAR to £54, again driven almost exclusively by ADR growth of 2.9%, taking ADR to £71, the highest ever in nominal terms. Occupancy is expected to remain very high at 76% but occupancy growth is expected to remain muted in both 2017 and 2018.

In 2018 we anticipate RevPAR growth slowing to 1.7%, supported by a further 1.5% ADR improvement, taking rates to £72 – which would further break records.

Taking into account both current deals in the market and improved UK economic forecasts (following better than expected GDP growth in 2016), we forecast **deal volume** in the UK to be c. £5 billion in 2017, up from £3.7 billion in 2016.

Table 1: UK hotels forecast 2017 and 2018

	London			Provinces		
	2016A	2017F	2018F	2016A	2017F	2018F
Occupancy %	81%	82%	82%	76%	76%	76%
ADR (£)	143	146	149	69	71	72
RevPAR (£)	116	120	123	53	54	55
% growth on previous year						
Occupancy	-0.9%	0.9%	0.5%	0.0%	0.1%	0.2%
ADR	0.0%	2.4%	2.0%	3.1%	2.9%	1.5%
RevPAR	-0.9%	3.3%	2.5%	3.2%	3.0%	1.7%

Econometric Forecasts: PwC February 2017.
Benchmarking Data: STR Global January 2017.
A: Actual F: Forecast

Growth makes a comeback in London in 2017

2016 recap

2016 was characterised by weak demand and strong supply growth and London saw negative RevPAR trading in 8 out of 12 months in 2016, although a dynamic November and December (RevPAR leapt 14.3% year-over-year growth in December 2016) helped lift the year. Recent tourism data show strong inbound growth in holiday travel in November and December. While the end of year flourish is partly a reflection of the impact of weak comparables following the November Paris bombings in 2015, it also reflects the positive impact of the weak pound. In the end 2016 saw occupancy average 81%, a 0.9% decline over 2015; ADR stayed at record levels at £143 despite zero growth, and as a result, 2016 RevPAR saw a 0.9% decline to £116.

Our latest revised forecast for London 2017 and 2018

We now forecast a much better year for London in 2017. The economy hasn't turned out as bad as previously predicted and the World and European economy are stronger which should drive demand for travel. Better than expected UK GDP growth in 2016 also means the assumptions underpinning this forecast are now more positive. In addition, the weak pound appears to be finally driving stronger travel demand and this is reflected in robust RevPAR growth since November 2016 and importantly, into January 2017.

Hoteliers we have spoken to are much more optimistic about the first half of 2017, although it's impossible to forecast how long the pound will remain weak.

Comparators for much of 2016 should also help flatter 2017 data, although quarter four will be a challenge.
Our latest forecast for 2017 anticipates RevPAR growth of 3.3% taking RevPAR to £120, driven by a 2.4% ADR. After two consecutive years of decline in occupancy rates, we anticipate a 0.9% increase over 2016, keeping occupancy high at 82%. In 2018 we anticipate a further 2.5% RevPAR advance to £123, supported by a 2% ADR gain, taking ADR to £149 in nominal terms. Above average supply growth continues and potentially could inflict pressure on existing supply in some new development hot spots.
See Table 1 and Charts 1 and 2.

The Provinces keep on growing

2016 recap:

2016 saw the Provinces enjoy a fifth consecutive year of ADR growth and a fourth year of RevPAR gains, albeit growth slowed considerably compared to 2015. December saw some dynamic results with Belfast enjoying almost 23% RevPAR growth and the city was not alone: Liverpool (22%), Edinburgh (17%) York (16%) all grew strongly too. There were also some supply increases in cities as developers capitalised on the strong trading. Supply growth picked up a little overall in 2016 with 1.4% annual net growth over 2015.

Our latest revised forecast for Provinces 2017 and 2018

The economic growth upgrade for 2017 should help underpin demand.
Some destinations with overseas visitor demand will benefit from the weak pound effect as well as economic growth in key inbound markets.
Staycations will also drive demand.
Our latest forecast for the Provinces in 2017 expects further RevPAR growth of 3% taking RevPAR to £54, again driven almost exclusively by ADR growth.

Occupancy is expected to remain high at 76% for both years but growth is expected to remain muted in both 2017 and 2018. In 2018 we anticipate RevPAR growth slowing to 1.7%, supported by a further 1.5% ADR improvement.
See Table 1 and Charts 1 and 2.

Above average new supply growth continues in London and some UK cities

London

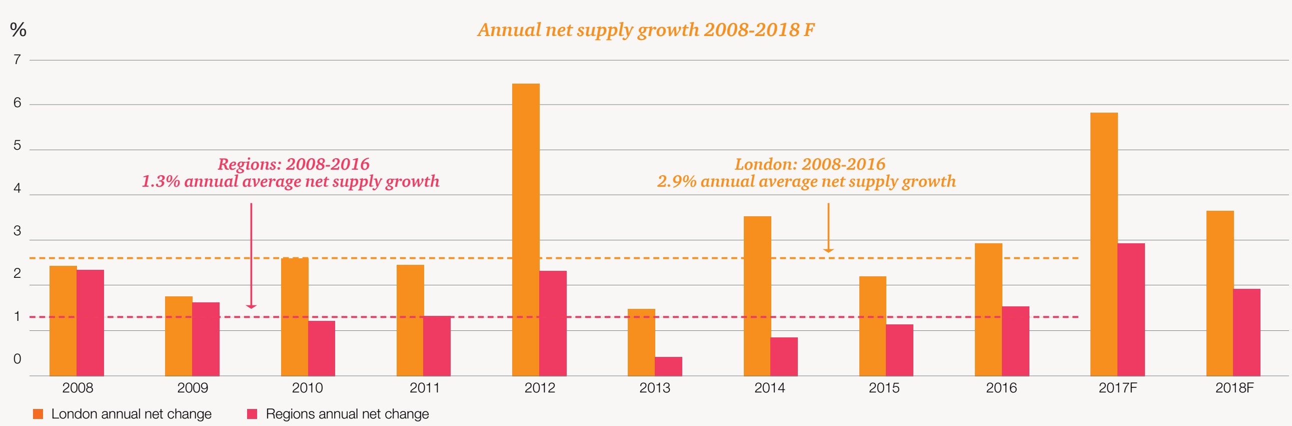
For 2017 around 8,000 rooms could open in the capital. If all open (and often this is not the case as opening dates slip) this will mean a 5.8% increase over 2016. This is practically double the figure added in 2016, according to AM:PM. This will make it a challenge to fill all the new rooms but with a high proportion of the new rooms being branded budget, with a largely domestic customer base, existing non-budget operators should still be able to benefit from stronger demand driven by the weak pound. For 2018 there are already around 5,000 rooms set to open, meaning potential net growth of 3.7%.

Provinces

As at January 2017, overall hotel capacity is forecast to expand by 12,000 new rooms, which would mean 2.4% net growth, one of the highest supply growth increases since 2008 (2.5%) and compared to 1.4% growth in 2016. For 2018 there are currently over 5,000 rooms expected to open. This would suggest growth of 1.4%, but projects can slip or new ones come into the mix. Looking around the country at where developers are busy: Edinburgh could see an additional 730 rooms open in 2017 and a further 1,120 in 2018; Glasgow's pipeline comprises almost 500 rooms with a Motel One and a Point A Hotel set to open in 2017, Belfast should see 260 new rooms this year and almost 900 in 2018; Manchester opens over 1,500 rooms in 2017.

What next for the sharing economy?
Read about our 10 key predictions for the sharing economy in 2017 in our latest European cities hotel forecast, 'Standing out from the crowd'.

Chart 2: New hotel room openings. *2017 is forecast to see above average growth.*



AM:PM January 2017

International politics to drive continued uncertainty and economics in 2017

UK outlook

While the UK saw economic growth in the final months of 2016 and led the G7 rankings with 2016 GDP growth of around 2%, it is expected to fall back to a middling position in 2017 as growth slows. This reflects the gradual drag on business investment from Brexit-related uncertainty, as well as the squeeze on real household spending power from the weaker pound. Nevertheless, parts of the UK economy should remain relatively strong, particularly in the consumer services, technology and importantly for the forecast, tourism sectors. Recent business trends surveys including the ICAEW report confidence on an upward trend.

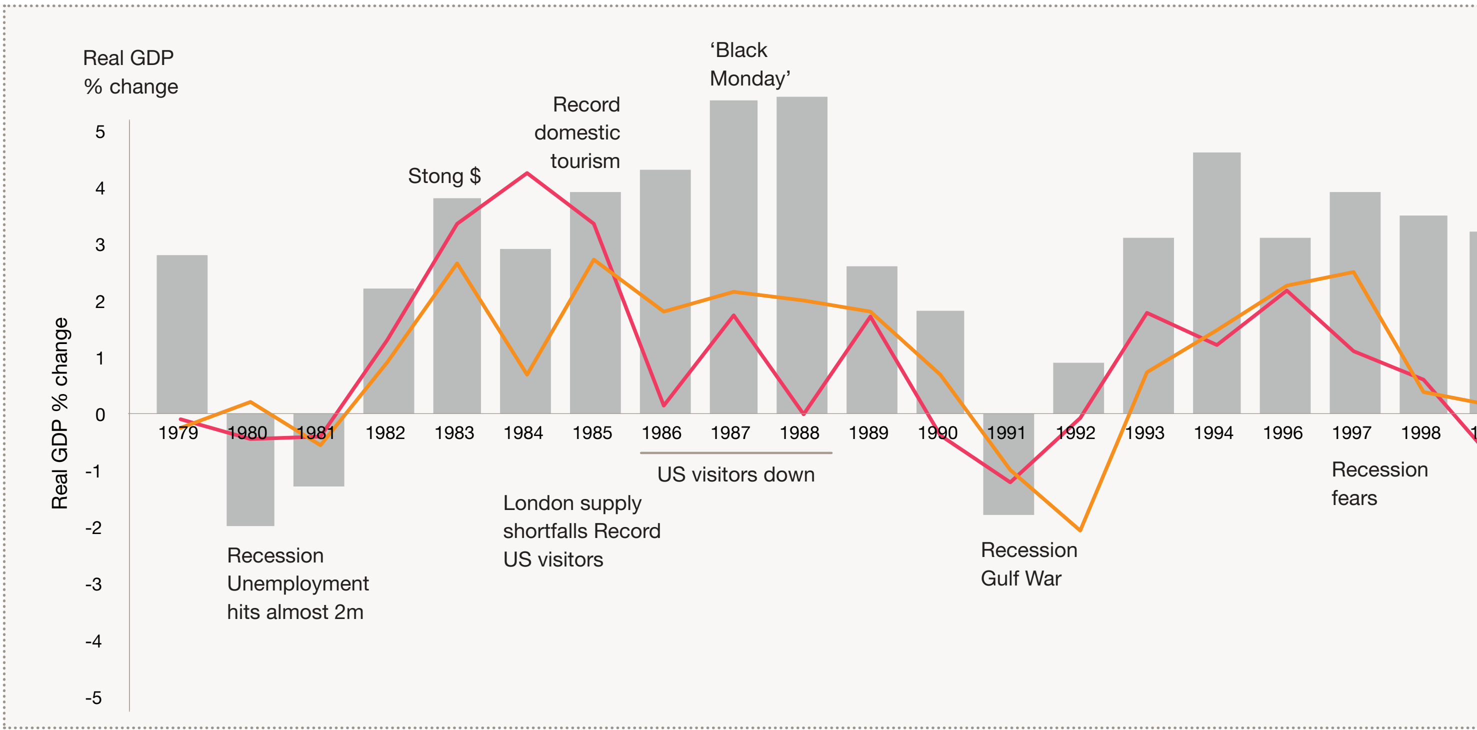
We anticipate a key feature of 2017 to be a re-emergence of inflation, which could squeeze real earnings growth and potentially rein in some leisure spend. We expect the Bank of England to keep interest rates on hold for at least the first half of 2017, waiting to see how the economic impact of Brexit unfolds. After boosting public investment in his Autumn Statement, the Chancellor is also likely to be in 'wait and see' mode in what could be a relatively boring Budget in March.

Global economic challenges

PwC expect globalisation to take a back seat this year as global trade comes under pressure from economic nationalism. International politics will drive continued uncertainty and economics in 2017. For example, the Eurozone may hold half a dozen elections. Germany, France, the Netherlands and potentially Italy and Greece are expected to run general elections and could experience disruption to their normal political cycle. On the international stage changing US – Russian relations could have spillover effects in Eastern Europe, the Middle East and potentially East Asia.

In terms of what may drive increased business and leisure travel to UK hotels, the global outlook remains mixed with continued growth in the US and the Eurozone. Asia is expected to become the fastest growing region in the world and the spotlight is anticipated to shift to India and Indonesia; nevertheless, Chinese growth is expected to remain around 6%, Brazil and Russia are expected to start growing again on an annual basis aided by a small increase in commodity prices; but a stronger dollar poses an increased risk to many emerging markets.

In our main scenario we expect the US economy to grow by around 2% – the fastest in the G7 on the back of strong job creation and household consumption and this could boost outbound travel to UK. The Eurozone economy is forecast to grow moderately by 1.5% this year and 1.7% next year, with inflation creeping up from 0.2% in 2016 to 1.3% in 2017 and 1.2% in 2018. The peripheral economies are expected to grow faster again than the core economies in 2017, the third year in a row. Job creation in the core economies is expected to hit an all-time high.



Source: Econometric forecasts: PwC February 2017. Macroeconomic data: National Statistics. Benchmarking data: Hot Stats STR Global. (Supply data: AM:PM.)

Weak pound should lift the travel outlook in first half of 2017

Continued economic growth remains a positive factor underpinning business and holiday demand.

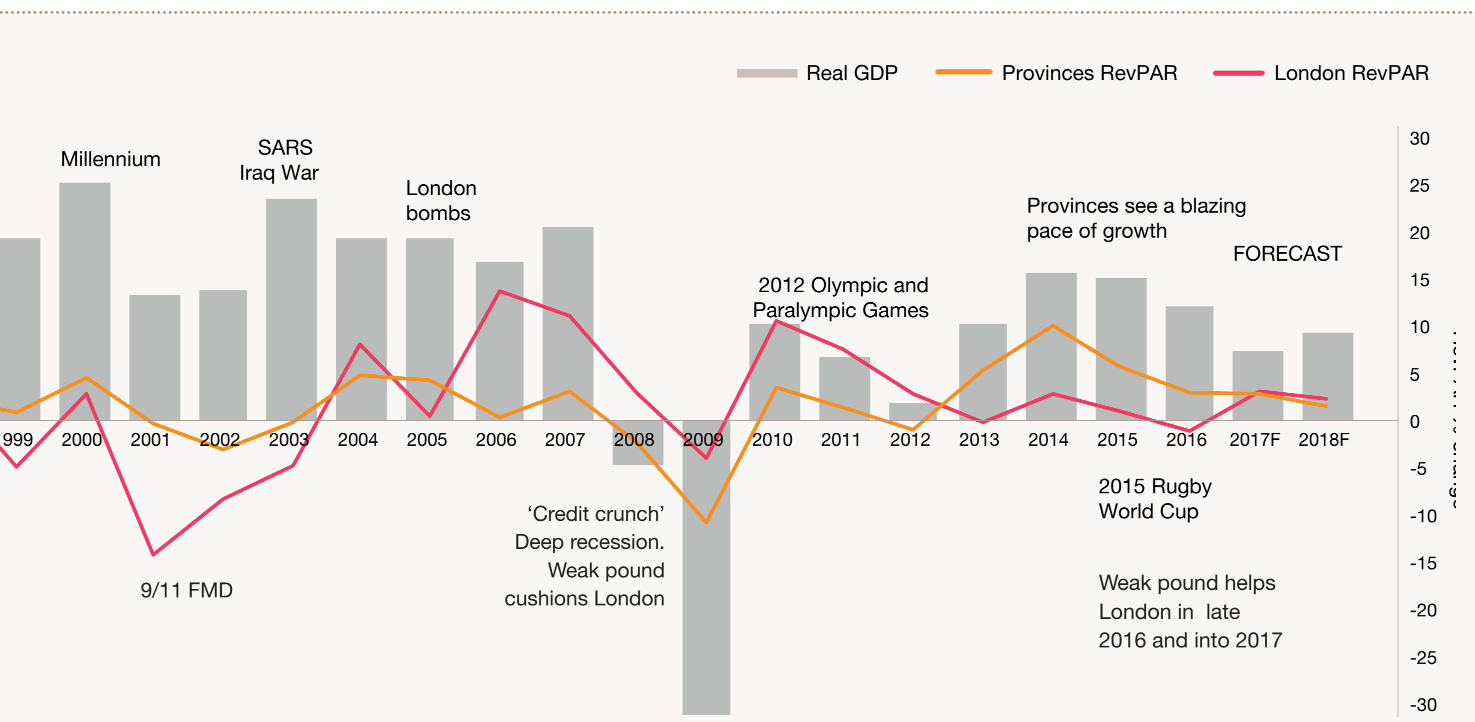
The weak pound has made the UK more affordable for inbound tourists and at last appears to be making an impact on the number of holiday visitors to the UK from abroad. In November and December 2016 these rose by 32% and 15% per cent year on year respectively, according to the British Hospitality Association's Travel Monitor, with growth driven by visitors from America and Europe. However, business travel growth was weak (- 10%) in December. VFR remains high (+24%). Overall, 2016 inbound visits to the UK were up by 3% to 37.3 million. In 2016, London saw its second highest summer period on record.

In terms of outlook, the World Travel & Tourism Council (WTTC) as well as the Global Business Travel Association are generally positive and forecast more travel growth for key European countries. VisitBritain's forecast for inbound visits for 2017 is also positive with an expectation for 38.1 million visits, an increase of 4% on 2016; and an 8% increase in spending. Tourism Economics forecast a potential 6.7% growth in visits to the UK in 2017. Separate analysis from Forward Keys, a company that predicts the number of overseas travel agent bookings to London, is also supportive of a good 2017 and they forecast that in the first three months of 2017 bookings from American and Chinese tourists could rise significantly when compared to the same period in 2016. Staycations are expected to be boosted as holidays abroad become more expensive and this should help regional travel, although BHA analysis shows the number of Britons travelling abroad continues to rise.

In terms of downsides, it's unclear how long the beneficial effect of the weak pound may last; and while holidays remain a top priority for UK consumers it's worth noting that they are easy to cut spending on given their big ticket nature; terrorism continues to cast a potential shadow over many major European cities including London; a lack of events won't help either but 2017 will see the ICC Cricket Champions Trophy, the World Athletics and Para-Athletics Championships as well as Cardiff hosting the UEFA Champions final in June.

Chart 1: Defying the odds

Real GDP growth, revenue per available room (RevPAR) trends 1979-2018F.



Deals outlook

Total deal volume for 2016 reached £3.7 billion, over 60% down from the record £9.3 billion invested in UK hotels in 2015. This decline was experienced across most UK real estate sub sectors and was primarily driven by the uncertainty regarding Brexit. We anticipate this uncertainty will remain as the UK looks to negotiate its exit from the European Union.

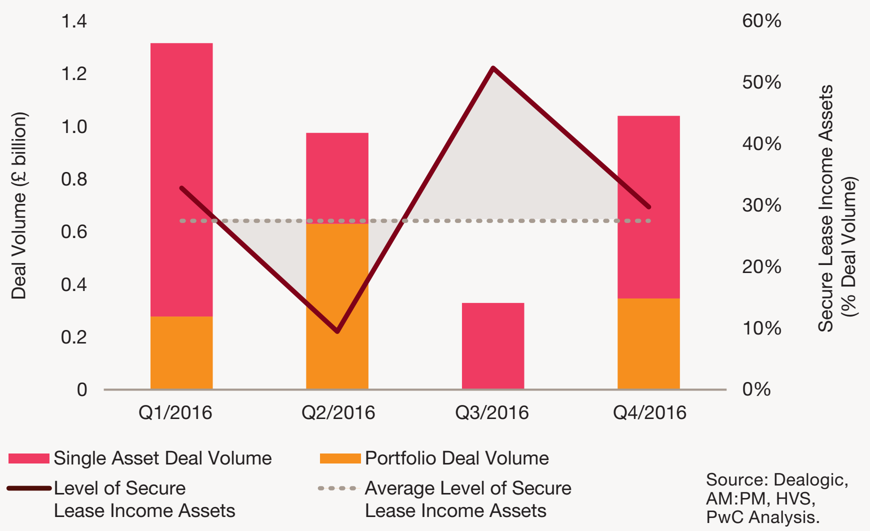
The major deals that concluded in H1 2016 prior to the EU referendum vote on 23rd June were portfolios Atlas Hotels (c. £530m) and Club Quarters, London (c. £180m); and London-based single asset deals the War Office hotel development (c. £350m), Hilton Wembley (c. £100m), and a 50% stake in the InterContinental O2 (c. £100m).

Following the outcome of the EU referendum vote, there was an immediate impact on deal activity, with H2 2016 down 40% on H1 2016 deal volumes. However there was an encouraging rebound in investor sentiment in Q4 2016 towards both secure prime London assets and more resilient secure leasehold income assets.

The only significant portfolio sale that completed in H2 2016 was the 55 Travelodge freeholds from the Grove portfolio (c. £196m); and significant London-based single asset sales

Chart 3: Clear impact of Brexit vote on hotel deals.

Quarterly hotel deal volumes & proportion in secure lease income assets.



Source: Dealogic, AM:PM, HVS, PwC Analysis.

DoubleTree by Hilton, Tower of London (c. £300m) and a 50% stake in the Peninsula Hotel development (c. £108m).

Heading into 2017, we expect investment activity to build on the momentum it gathered in Q4 2016. Current deals rumoured in the market include portfolios Generator Hostels, Qhotels, London and Birmingham Hilton Metropole hotels and a further 99 Travelodge freeholds from the Grove portfolio; and single assets Grosvenor House Hotel, London, DoubleTree by Hilton, Westminster London and Stoke Park Golf and Country Club. In the first quarter 2017, there continues to be investor focus on secure leasehold income assets with the sale and leaseback of 2 Premier Inn sites for a total c. £205m.

Taking into account both current deals in the market and improved UK economic forecasts (following better than expected GDP growth in 2016), we forecast deal volume in the UK to be c. £5 billion for 2017, up from £3.7 billion in 2016.

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