September 2018: *Our revised forecast for UK hotels in 2019 anticipates slower growth reflecting softer economic and demand trends and the impact of high levels of new hotel room additions, particularly in London but also in other UK cities. While the weak pound continues to support inbound leisure travel, protracted negotiations around Brexit are not helping business travel.*

Growing through uncertain times

UK hotels forecast 2019

pwc

Foreword

Times change. Ten years ago, hotels were on the brink of a sharp slump in demand as the financial crisis meant economic growth contracted and businesses and consumers tightened their belts. For hotels, it was a tough trading environment and there was considerable pressure on room rates and discounting meant volume was salvaged at the expense of rate. While London shrugged off the recession after about 18 months, cushioned by a weak pound, in the Provinces it was a more painful and slower recovery as the recession and public sector cuts meant room rates struggled for closer to three years.

But, in recent times, sustained by the rise in demand from business and leisure travel, London and regional hotels have prospered. Provincial hotels have enjoyed monthly ADR growth since April 2013 and we are forecasting further growth in 2018 and 2019 of 1.3% and 1.2% respectively, albeit at a slower pace than of late. Leisure travel continues to be supported by the weaker pound but slowing economic growth and high levels of new supply in many cities are likely to dampen performance. Occupancies are at record highs at 76% and we can't see much more growth in 2018 or 2019.

London continues to operate at a globally high level and our lower growth forecast should be viewed against this backdrop. We are forecasting a marginal occupancy gain in 2018 of 0.1% and a 0.5% fall in 2019 as new supply additions continues to bite and political uncertainty dents corporate demand.

2017 was always going to be a hard year to follow as the weak pound effect reduced and comparisons to the first half of 2017 have been challenging. We predict ADR in London will manage 0.2% growth this year and 0.8% in 2019 driving a 0.3% gain in RevPAR this year with an additional 0.3% growth in 2019.

The UK hospitality sector employs 2.9 million people and represents 10% of UK employment as well as 6% of businesses (UKHospitality 2018). As hotels grapple with rising wage and operating costs, we look at whether Artificial intelligence could offer solutions for some of the productivity and employment issues hotels face.

There is an expectation for continued strong investment from Europe and the Middle East looking for good opportunities and strong returns, although for a variety of reasons, including Brexit related uncertainty, we expect 2019 to see deal activity levels to fall by around 34% to c.£4.5bn.

What will the next ten years bring? After a long period of open and positive relationships around the world, the skies are now darkening in the trade arena, just as Britain seeks to find a way to forge new trade relationships with other countries after Brexit. Andrew Sentance, writing in the Times, on 4 August 2018 warns that a new wave of global protectionism is probably the greatest threat to economic prosperity here in the UK and across the world in the next five to ten years.

David Trunkfield

Head of Hospitality & Leisure, PwC

Dr Andrew Sentance

Senior Economic Adviser, PwC

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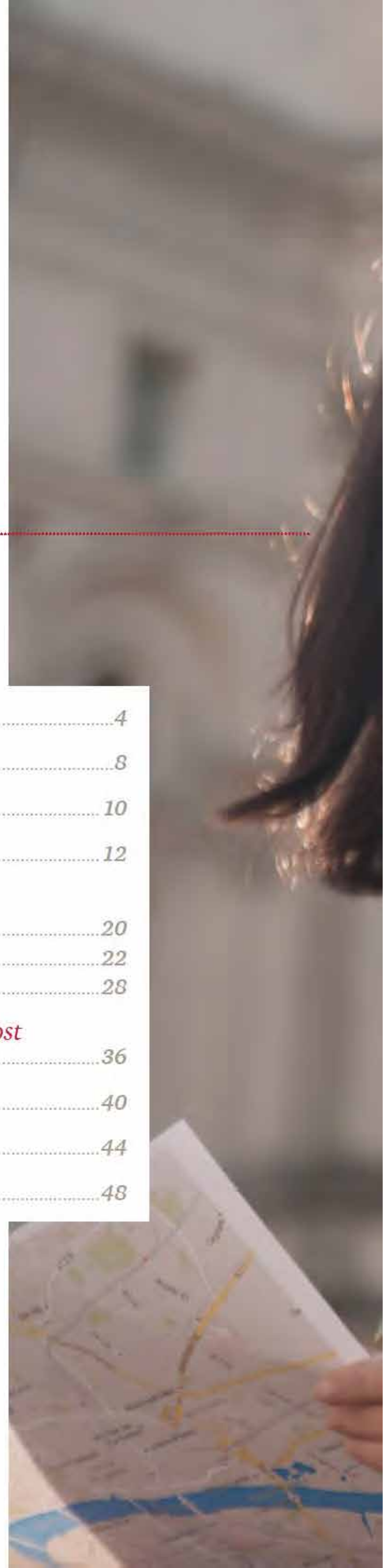


Key messages

London: the capital still operates at a very high level. We predict flattish growth for 2019

2017 was a hard act to follow and 2018 has been held back by uncertainty, slower economic growth, significant supply additions, reported weaker business travel volumes and challenging comparisons from the first half of 2017. This is despite the weak pound buoying up leisure travel, the Royal Wedding and the positive International Farnborough Air Show effect. Next year the ICC Cricket World Cup may help put a more positive spin on demand, although hoteliers we have spoken to believe 2019 will still be difficult.

For the 2018 outturn we predict a marginal occupancy gain of 0.1% and a slight ADR increase of 0.2%, driving a 0.3% improvement in RevPAR.
For 2019 we forecast another flattish year as a marginal occupancy fall and a small ADR gain nudge a further 0.3% RevPAR gain, keeping RevPAR at a very high £122. To put this in context, in 2019 London was forecast to achieve the second highest occupancy and the fourth highest RevPAR in our recent European cities hotel forecast.

Table 1:

PwC 2018 and 2019 UK hotels forecast

Growth slows especially in London

	London			Provinces		
A: Actual F: Forecast	*2017A*	*2018F*	*2019F*	*2017A*	*2018F*	*2019F*
Occupancy %	82%	82%	81%	76%	76%	76%
ADR (£)	148	149	150	71	72	73
RevPAR (£)	121	122	122	54	55	55
% growth on previous year						
Occupancy	0.2%	0.1%	-0.5%	0.5%	-0.3%	0.0%
ADR	4.3%	0.2%	0.8%	3.1%	1.3%	1.2%
RevPAR	4.6%	0.3%	0.3%	3.6%	1.0%	1.2%

Source: *Econometric forecasts: PwC August 2018* Benchmarking data: *STR July 2018*

Provinces: growth slows but hangs in there

While growth is forecast for both 2018 and 2019, the pace is a little weaker than we predicted in our prior forecast in March. A supply spike in 2019 could weaken trading in some cities and a more restrained short breaks market is anticipated. Events such as the ICC Cricket World Cup to be held in England and Wales between the end of May and mid-July may be beneficial.

Overall occupancies are high by historic standards, realising 76% since 2015 (they were 69% back in 2009). In 2019 occupancy is forecast to remain flat but we anticipate that ADR could see further modest growth to £73 (in nominal terms), helping to push up RevPAR by 1.2%.

UK economic prospects: uncertainty has dampened business investment growth but weaker pound has helped tourism

Uncertainty has dampened business investment growth and this may continue, but the weaker pound has been helpful to tourism. Our latest view is for UK GDP growth to remain moderate at around 1.3% in 2018 and 1.6% in 2019. Consumer spending growth is expected to moderate to only around 1% in 2018, but may pick up slightly next year as real wages recover. The stronger global economy should continue to have some offsetting benefits for net exports this year, although there are downside risks in 2019 and beyond if recent US tariff policy changes were to escalate into a wider international trade war. Economic growth combined with the strong dollar and euro relative to sterling continues to be good news for hoteliers.

What will drive travel demand?

Globally, international tourism trends remain buoyant and record numbers of visitors are coming to the UK. The weak pound will also help but the impact is unlikely to see a return to H1 2017's exceptional inbound leisure tourism levels. Economic growth should continue to underpin travel growth and demand for accommodation. Business travel, a vital and profitable sector for hotels, has shown mixed trends which are expected to continue as the Brexit negotiations continue. The consumer income squeeze suggests that domestic short breaks are unlikely to see robust growth this year, although the sizzling summer and a weak pound may help. Civil Aviation Authority data suggest robust passenger numbers at most UK airports in Q1 2018.

Supply: a balancing act

People want to travel and the hotel sector continues to evolve to meet their needs. New supply provides travellers with shiny new accommodation products and brands, but without stronger demand, current levels of new supply are likely to dampen trading performance in some London locations as well as some regional cities where the demand/supply equation becomes unbalanced. The accommodation pool for travellers continues to widen and deepen and other accommodation providers are also upping their game, serviced apartments, hostels and home share products are all evolving. Some hoteliers have started to embrace the shared home market, for example, Marriott's Tribute brand, Hyatt's Oasis, and Accor's onefinestay.

It's a tough operating environment: how can hoteliers plan for the future?

In an industry where EU nationals historically accounted for nearly a quarter of the workforce, the recent news from the ONS that the number of people moving to the UK from EU countries in 2017 has fallen to the lowest level for four years, only serves to confirm the struggle that UK hoteliers have faced in retention and recruitment. Almost 90,000 vacancies were recorded each month on average in the quarter to June 2018 a position largely unchanged over the past year (UK Labour Market Survey, July 2018).

1.3%
RevPAR growth in 2018

For an industry that relies so heavily on people to deliver its products and services, the shortfall in availability of EU nationals in 2018 has pushed up the cost of attracting and retaining staff. When combined with other operating cost increases such as the weak pound pushing up the cost of imported goods used by the industry, business rate increases and below inflation revenue growth, annual profit growth in 2018 and 2019 appears likely to be difficult to achieve. Following a number of years of strong revenue growth when there was not the imperative to focus on costs, prudent operators and owners need to adopt a stringent approach to operating costs growth in 2019 to preserve profitability.

Could AI help solve cost and productivity issues?

Five years ago Artificial intelligence (AI) sounded like science fiction (Yuval Noah Harari, 21 lessons for the 21st Century). Today, some of the ways hotels can use AI include personalising the customer experience through AI and related technologies; supplementing the pace and efficiency of back office processes and Robotic Process Automation (RPA) augmented by AI; improving workforce productivity through better allocation of staff and predicting customer churn. Realising the opportunities presented by AI is all the more important at a time when – as PwC's forecast shows – the hotel sector faces slowing RevPAR growth and substantial headwinds from a wide variety of sources, ranging from Brexit to shifts in consumer confidence to trade wars. While AI certainly doesn't present a panacea for these challenges, it's one of the major tools at hotels' disposal to counter the headwinds and drive efficiencies and a recovery in margins.

Deal talk

UK hotel deal volume totalled c. £3.8bn in the first half of 2018, up over 80% from the volume experienced in the first six months of 2017. By year end 2018, we forecast total hotel deal volume to be c. £6.8bn, nearly a 40% increase on the total deal volume experienced in 2017, and the second highest volume of investment in the UK after the record levels of £9.3bn in 2015

While we anticipate continued strong inward investment from European and Far Eastern investors, we expect a slowdown in portfolio deal activity during 2019. This is due to a recent wave of new longer-term investors entering the UK hotel market compared to the previous generation of US Funds with a typical 5 to 7 year investment horizon. For those few US Funds still holding UK hotel portfolios, we have also seen a tranche of refinancing over the last 12-18 months, taking advantage of the favourable low-cost debt terms currently available. As a result of these factors, together with forecast investor uncertainty around UK's upcoming departure from the European Union at the end of March 2019, we are forecasting 2019 deal activity levels to fall by around 34% to c. £4.5bn.

At a glance

PwC's 2019 UK hotels forecast

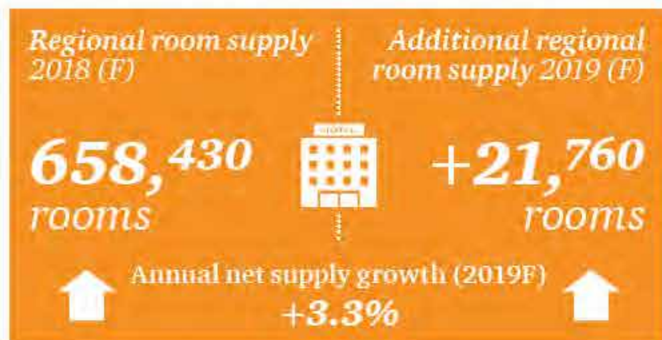
Occupancy

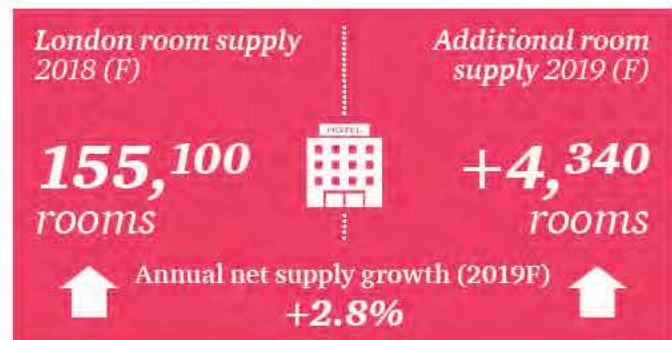
ADR

RevPAR

New supply growth

A balancing act for London and many regional cities





Source: *PwC; STR; AM PM*

Charts show absolute trading and % change year-on-year

The latest 2018 and 2019 London forecast

The capital still operates at a very high level. Flattish growth expected in 2018 and 2019.

Recap:
a mixed H1 2018 as supply outguns demand

London hotel performance to June, from the STR Destination Report, shows a 0.4% drop in occupancy and a 0.9% fall in ADR, driving a 1.3% decrease in RevPAR, compared to the same period in 2017. While supply has increased 2.2% year on year, demand growth was weaker at 1.8%.

On a monthly basis, demand has been weak with occupancy growth negative from June 2017 to May 2018 despite the Royal Wedding in Windsor on 19th May. While occupancy performance picked up in June, ADR saw growth declines in the four months from March to June 2018.

June's improved occupancy performance likely reflects some large events held in London and the hot weather, as well as a shift in Ramadan timing (Ramadan was from 27 May to 25 June in 2017 and from 16 May to 14 June in 2018).

There have of course been challenging comparisons with the first half of 2017 – a period which saw performance metrics positive at the half way point, buoyed up by the record 19.8 million tourists that visited London. Hotels benefitted with a strong first half and some double digit RevPAR growth in March and April. The strong inbound travel trends benefitted high-end hotels rather than the budget segment which is more dependent on domestic market demand.

Farnborough uplift helped July performance

Preliminary July 2018 data suggests July was a much more positive month for London hotels, indeed record breaking ADR and RevPAR results have been reported (Hotels 10th August 2018). Strong London weekend demand around mid-month was partly due to uplift from the biennial Farnborough Air Show (16-22nd July) as well as easier London weekend demand comps. The hot weather may also have encouraged visits. We expect stronger trading to continue into August. The Middle East market is reported robust which should support West End trading in particular. The comps for H2 2019 are less challenging as from August 2017 the initial weak pound effect waned and business travel volumes faltered.

What will support demand in the rest of 2018 and 2019?

One of the largest global hotel groups told us that in 2017, they (and the London market) had benefited from increased demand from financial institutions and government as a result of Brexit activity, but that demand had now slowed down. Ongoing economic and political uncertainty could continue to slow business travel in 2019. In addition, the recent slowdown in the Eurozone economy (PwC Economic Outlook July 2018) and any escalation of international trade tensions may also mean less strong business travel trends. Hoteliers we have spoken to already report some resistance to rate increases during the RFP process this year.

On the other hand, for holiday tourists from our key inbound European markets, the weaker pound (by historic standards) means London remains affordable for many leisure groups and compares well to competitor cities such as Paris, and this should support inbound tourism and higher end tourist hotels. But, there will be no hotel uplift from the biennial Farnborough International Airshow in 2019. And while 2019 is the 75th Anniversary of the D-Day Landing, events are expected to be more Caen than London focused.

"For the time being London's magnetic attraction to international tourism appears to be immune"

Melvin Little, Crystal Holidays, July 2018

What else will support demand?

Clearly London has a wealth of theatres, attractions and festivals attracting global visitors throughout the year. Demand for international conferences and meetings and corporate events is also strong and should support demand. Still to come in sport in 2018 is the Track Cycling World Cup at Lee Valley Velo Park and three American football games. In January 2019, the NBA London Game returns to the O2 when the New York Knicks and the Washington Wizards draw in the crowds. In terms of major events, the Cricket World Cup is taking place in 2019 and will see games played in England and Wales. In London, there are five games apiece at the Oval and Lords with the final on 14 July at Lords.

Europe's largest infrastructure project Crossrail is almost complete and is now expected to open in 2019, further linking-up west, central and east London. The line could bring an extra 1.5 million people to within 45 minutes of central London and link and transform London's key employment, leisure, tourism and business districts – Heathrow, West End, the City and Docklands. The impact will enable further economic development, which will support hotel demand in the future.

Supply pluses and minuses

New supply additions are likely to be a challenge for 2019 performance. Around 5,000 rooms will be added in total in 2018 and a further 4,300 rooms in 2019. This is on top of the 38,000 rooms added in the previous five years.

On the positive side, London has more modern, in some cases innovative products, to help attract travellers from all price segments. It also depends on location as not all areas of London have been impacted, for example the West End appears to have been less impacted, according to a leading hotel operator. A shortage of hotel rooms should not be a factor holding back tourism growth in the future. Tourism visits are already at record levels and forecast to grow further. However, the increased competition is a headache for some hoteliers in the short term and serviced apartments and a growing Airbnb inventory add to the mix.

It's a tough operating environment: how can hoteliers plan for the future?

According to the UK Labour Market Survey in July 2018, the hotel and restaurant sector had the highest vacancy rate of any sector, with almost 90,000 vacancies recorded each month on average in the quarter to June 2018 a position largely unchanged over the past year.

For an industry that relies so heavily on people to deliver its products and services, the shortfall in availability of EU nationals in 2018 has pushed up the cost of attracting and retaining staff.

In addition, the weak pound has adversely affected the cost of imported goods used by the industry.

In real terms, London RevPAR will be around 1% below 2007's rate

When combined with other operating cost increases such as business rate increases following the recent revaluation and below inflation revenue growth, annual profit growth in 2018 and 2019 appears likely to be difficult to achieve. Following a number of years of strong revenue growth when there was no imperative to focus on costs, as the hotel annual budgeting season approaches in Q3 2018, prudent operators and owners may be inclined to adopt a stringent approach to operating costs growth in 2019 to preserve profitability.

Our latest forecasts sees high trading levels but lower growth than we predicted in March 2018

While we forecast fairly benign UK and key source markets GDP growth, economic and political uncertainty as well as global trade tensions could slow business travel growth; at the same time high new supply growth and a lack of mega events in 2019 means that our London forecasts for 2018 are more negative than we envisaged at the time of our last forecast in March this year. However trading in absolute terms remains extremely high by historic and global standards. In PwC's recent European cities hotel forecast 2018, London leads the occupancy league and remains in the top four for ADR and RevPAR, after Paris, Geneva and Zurich.

For 2018, we are now forecasting a marginal gain in occupancy of 0.1% (compared to 0.3% in March) and a 0.2% ADR gain (the same as in March) driving 0.3% growth in RevPAR for 2018 (compared to 0.6% RevPAR growth predicted in March).

(See Table 1, Figure 2).

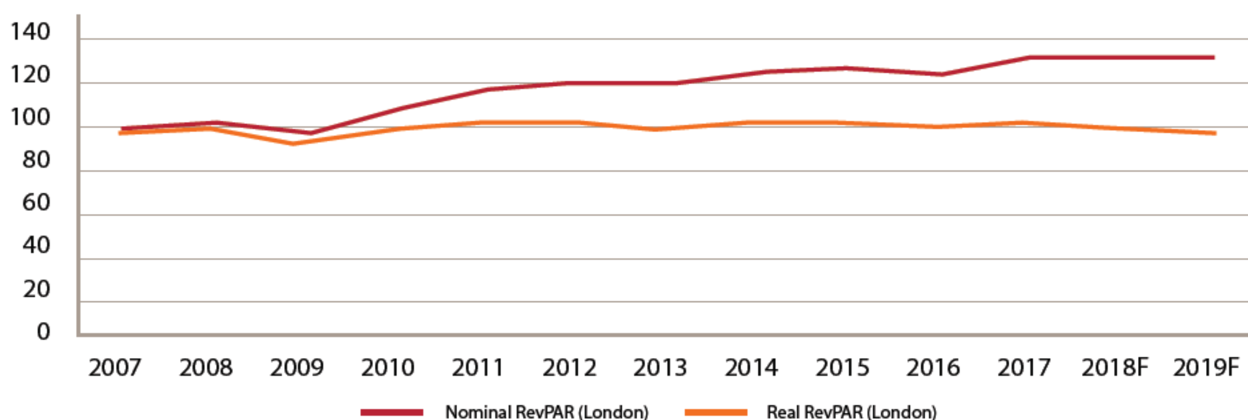
These declines means that occupancy stays at at 82% in 2018, ADR nudges up to £148.6 and RevPAR at £122 is very high.

In 2019 we also forecast a less optimistic result than anticipated in March this year. We predict an occupancy fall to 81.2%, the lowest since 2012. A slight upturn in ADR of 0.8% takes ADR to £149.8 and we predict RevPAR lifts by 0.3% to £121.9 – both new records in nominal terms.

In real terms, London RevPAR will be around 1% below 2007's rate by the end of 2019, after peaking at around 3.6% above that rate in 2017.

(See Figure 1 below).

Figure 1:
London RevPAR growth rates (Nominal vs Real – Index = 2007)



Source: *PwC*

The 2018 and 2019 Provinces forecast

Growth slows but hangs in there.

Our main scenario assumes real GDP growth of around 1.3% in 2018 and 1.6% in 2019, somewhat below the UK's estimated longer term trend growth rate of just over 2%. In terms of regional prospects, all parts of the UK are likely to see moderate economic growth in 2018-19. Slower economic growth is likely to challenge travel demand, although the weak pound should continue to support inbound international travel. High levels of new hotel rooms in many cities will dampen occupancies. Holidays are important to us all, but hotels rely heavily on discretionary spending. As David Smith explained in the Times on 18 July, squeezed pay packets barely compensating for rising prices, will mean even staycations are expensive.

Recap: *H1 2018 in line with out previous forecast*

Across the Provinces, performance metrics to June from STR Destination Report reveal an overall 0.4% occupancy gain which together with a 1.5% ADR increase drove RevPAR growth of 1.9%, compared to the same period in 2017. Occupancy averaged almost 74%, ADR reached £70 and RevPAR just over £52.

The record volumes of inbound tourists that boosted London's hotels in 2017, together with corporate demand has also lifted hotel performance in many cities across the UK, and data suggests some continue to outshine. Glasgow reported its best May on record with more than 22,000 conference delegates, meaning a strong ADR gain boosted RevPAR by 8.2%: in Liverpool, occupancy and ADR gains drove an 8.1% RevPAR lift; in the Brighton Area occupancy growth pushed up RevPAR by 7.7%; Belfast, Aberdeen and Birmingham also saw almost 5% RevPAR growth (albeit driven by a different occupancy/ADR mix).

The sun didn't shine for all regional cities though and RevPAR declines were recorded in Manchester where new supply increased by 4.1% in H1 2018 and the city saw a 1.1%RevPAR fall, as occupancies suffered; Bristol saw RevPAR fall-2.4%; Leeds (-2.3%), Edinburgh (-1.6%) and Sheffield (-2.5%) among others.

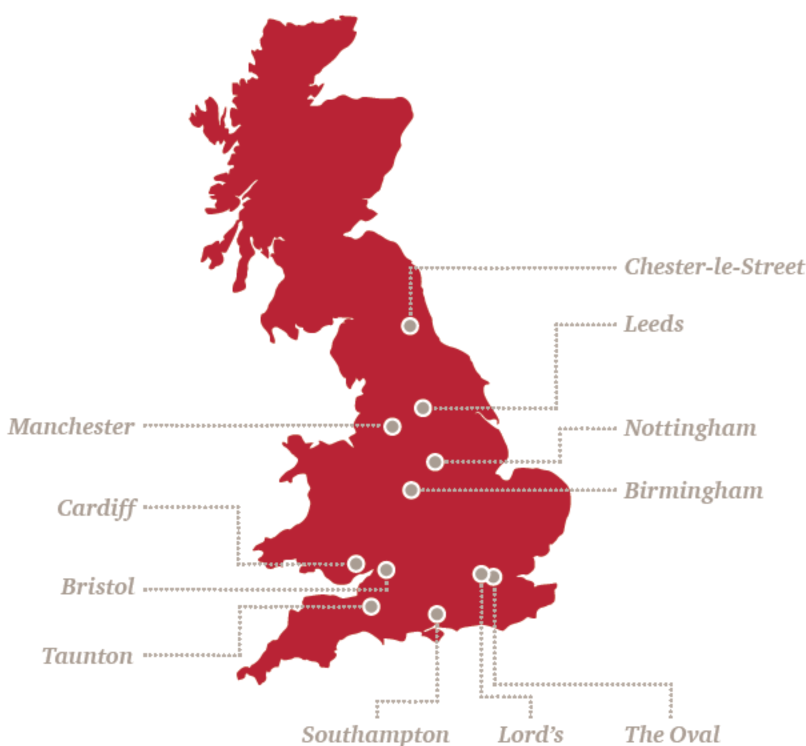
Where will demand come from in 2019?

The slowdown in UK economic growth should be offset in part by planned increases in public investment and some easing of austerity over the next two years as announced in the November 2017 Budget. Business travel, including meetings and conferences, and continued investment in regional cities should continue to support demand. Leisure travel buoyed by the weak pound should sustain cities with an international tourism base. For example, between June 2016 and June 2017 Northern Ireland welcomed 2.2m visitors and 6% more visitors are forecast for 2018.

Domestic tourism will also continue to support demand although researchers (BDRC holiday intentions survey) suggest that the number of domestic short breaks may decline this year, although longer domestic holidays could increase. They forecast that the majority of UK destinations are likely to see fewer UK visitors this year and they also suggest movement in the types of cities people are planning to visit. For example densely populated cities such as London, Edinburgh and Liverpool may see a drop in visits whereas less populated heritage cities such as York, Bath and Chester are likely to see more UK visitors.

There are numerous events, festivals, exhibitions planned around the country in 2019. A selection of sporting events of note include the ICC Cricket World Cup which will see 10 teams play 48 matches in 11 locations around England and Wales (see inset map) between 30 May and 14 July. Other events include the Open Golf championship in July in Portrush, Northern Ireland; the 2019 Gymnastics World Cup in March in Birmingham; the World Taekwondo Championships in Manchester in May and the UCI Road World Championships in Yorkshire in September.

ICC Cricket World Cup venues



Supply pressures likely to bite in more cities

Supply additions are likely to put pressure on occupancy in existing hotels in some UK cities. Over 40k rooms are likely to be added in 2018 and 2019. 2019 in particular sees a spike in regional openings and a 3.3% annual increase in rooms.

Occupancies have been on the up since the last recession but are expected to be fairly flat in 2018 and 2019

Occupancy rates remain a crucial benchmark for profitability for the hotel sector. Regional occupancies have recovered significantly since the last recession and have been creeping up from 66% in 2009, averaging around 76% since 2015. We forecast occupancy at 76% again this year despite the new room additions. Indeed, the trend is driven partly by a continuing structural supply shift towards a greater proportion of budget rooms which traditionally operate at high occupancy levels.

1.2%

forecast RevPAR nominal growth in 2019

Further modest ADR growth forecast for 2018 and 2019

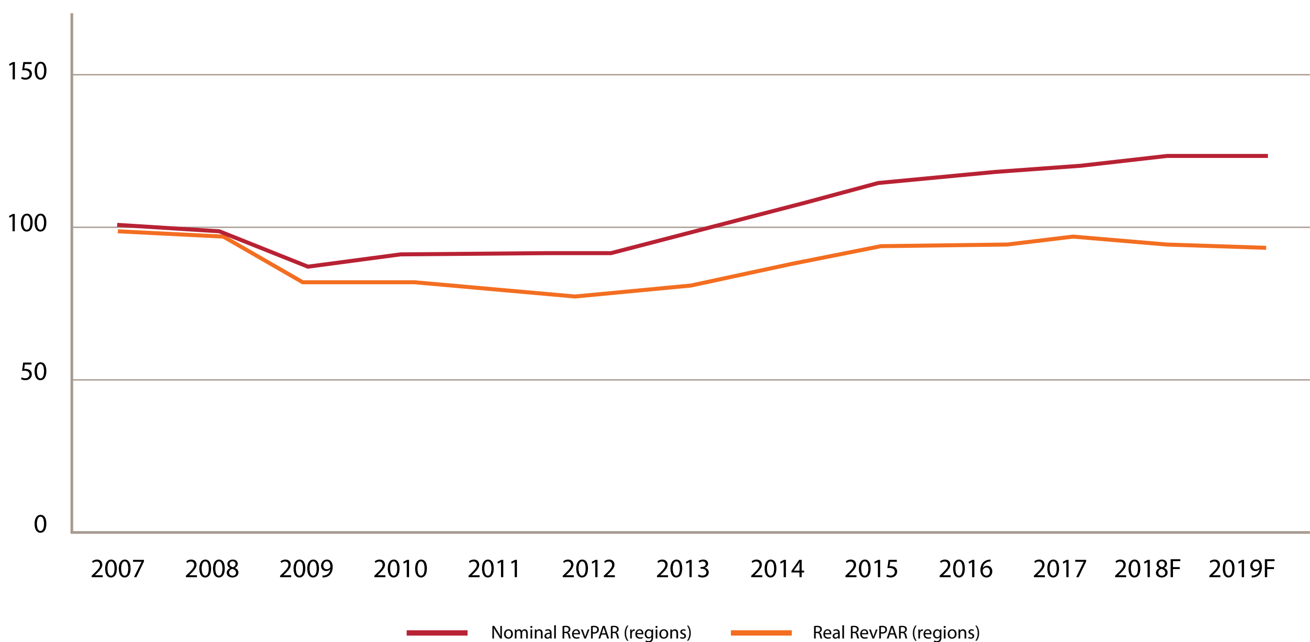
With average occupancy at 76% last year, Provincial hotels continue to be able to drive price. There still remains some scope for further recovery in ADR in real terms as real ADR still lags pre-recession peaks, however we forecast slower growth overall, anticipating ADR growth in 2018 of 1.3% and a further 1.2% in 2019 (taking ADR to £72 in 2018 and £73 in 2019).

RevPAR growth each year but still remains 7% below 2007 in real terms

Provincial RevPAR is forecast to end 2019 23% ahead of pre-recession peaks in nominal terms but lags by 7% in real terms. The gap was at its narrowest in 2017 when RevPAR was only about 4% below in real terms. We forecast nominal growth of 1% in 2018 and 1.2% in 2019 which nudges RevPAR from £54 in 2017 to £55 in 2018 and 2019.

(See Table 1, Figure 2 and Figure 3).

Figure 2:
Regions RevPAR Growth Rates (Nominal vs Real – Index=2007)

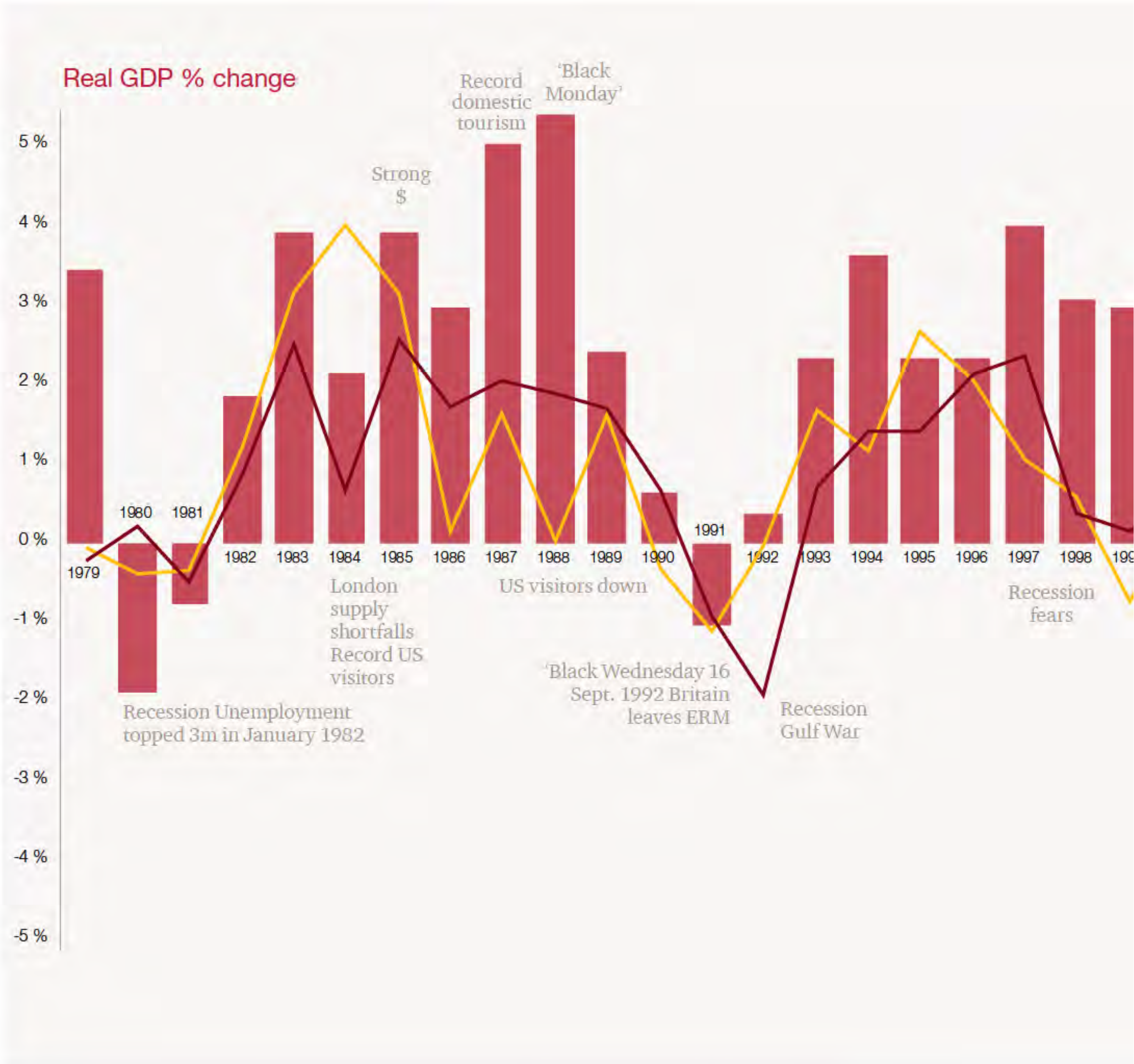


Source: *PwC*

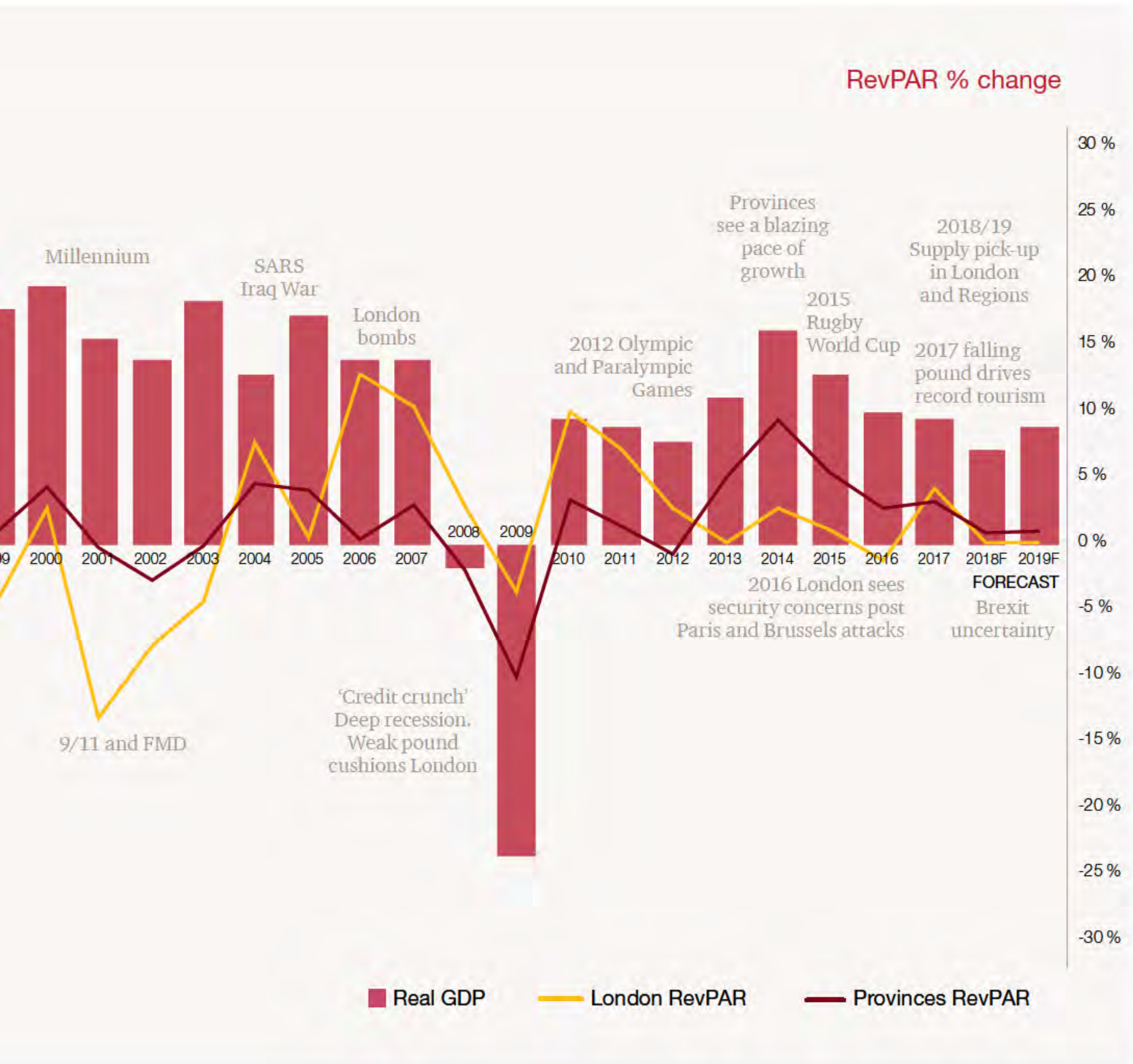
Figure 3:

Lessons from the past 30 years

Real GDP growth, revenue per available room (RevPAR) 1979-2019F



Source: *Econometric forecasts: PwC June 2018 Macroeconomic data: National Statistics Benchmarking data: HotStats, Supply data STR July 2018*


RevPAR % change
30 %
25 %
20 %
15 %
10 %
5 %
0 %
-5 %
-10 %
-15 %
-20 %
-25 %
-30 %
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
2017
2018F
2019F
FORECAST
Millennium
9/11 and FMD
SARS
Iraq War
London bombs
'Credit crunch'
Deep recession.
Weak pound
cushions London
2012 Olympic
and Paralympic
Games
Provinces
see a blazing
pace of
growth
2015
Rugby
World Cup
2016 London sees
security concerns post
Paris and Brussels attacks
2018/19
Supply pick-up
in London
and Regions
2017 falling
pound drives
record tourism
Brexit
uncertainty
Real GDP
London RevPAR
Provinces RevPAR

Beyond Brexit – Time to act: *scenario planning for the future*

The current PwC UK hotel forecasts for 2018 and 2019 are based on the likely impact on the UK economy of achieving a Brexit deal. We have not modelled the impact of a no deal scenario. Whatever happens after midnight (in Brussels) on Friday 29th March, scenario planning to identify the commercial impact of alternative outcomes and the development of contingency plans should definitely feature at the top of the agenda of UK Hospitality businesses large and small to ensure business continuity and mitigate the impact on profitability whatever the actual outcome.

Short term planning and actions

At PwC we're working with clients to identify, prioritise and address the most important issues facing their business, including:

- Prioritising actions and developing a plan.
- Managing treasury, including working capital and liquidity.
- Communicating with employees and stakeholders.
- Reconsidering investment decisions and budgets.

"For many businesses our future relationship with the EU feels too uncertain to take action. But we're clear that there are only three possible scenarios at the end of the negotiations. A deal similar to Canada, a deal similar to the Government Whitepaper or no deal."

Andrew Gray, Chair of PwC Brexit steering committee

UK economic prospects after Brexit

Brexit uncertainty has dampened business investment growth but the weaker pound has been helpful to tourism

The UK economy held up well in the six months after the EU referendum, but growth slowed from early 2017. This slowdown continued into early 2018, although early signs are that GDP growth was somewhat stronger in the second quarter of this year as the weather improved.

Higher inflation has squeezed real household incomes and this has taken the edge off consumer-led growth, together with a slowdown in the housing market.

On the positive side, UK exports have been boosted by the upturn in global growth over the past two years. The weaker pound, although bad for UK consumers, has been helpful to exporters and inbound tourism. Jobs growth has remained strong, with the employment rate at record levels. Fiscal policy has also been somewhat relaxed since the Brexit vote, particularly as regards public investment.

UK GDP growth assumptions

Our latest view is for UK GDP growth to remain moderate at around 1.3% on average in 2018 and 1.6% in 2019. Our views on growth and inflation are broadly similar to the latest consensus and OBR forecasts and this central view does not factor in the possible economic effects of disruption should no deal be reached in the Brexit negotiations.

Consumer spending growth is expected to moderate to only around 1.3% in 2018, but may pick up slightly next year as real wages recover. The recent increase in interest rates by the Bank of England to 0.75% may also have a slight dampening effect on consumers who may see their interest costs on loans, mortgages and credit cards rise.

The stronger global economy should continue to have some offsetting benefits for net exports this year, although there are downside risks in 2019 and beyond if recent US tariff policy changes were to escalate into a wider international trade war. Brexit negotiations may also continue to hold back business investment in the UK.

2.9%

economic growth in the US this year

Regional prospects

In contrast to previous years where London has generally had one of the strongest growth rates of any UK region, our latest projections suggest London's growth rate may fall to only just above the UK average in 2018-19. This is partly due to the greater exposure of some London activities (e.g. the City) to adverse effects from political uncertainty, as well as growing constraints on the capital in terms of housing affordability and transport capacity.

Most English Provinces, as well as Wales, are projected to expand at close to the UK average of around 1.3% in 2018, although the North East, Scotland and Northern Ireland are predicted to lag behind somewhat with growth of only around 1% this year before recovering somewhat next year.

It is important to note that regional output data are published on a much less timely basis than national data. As a result, the margins of error around these regional output projections are even larger than for the national growth projections, so they can only be taken as illustrative of broad directional trends.

Europe – key source markets for tourism

Ten years on from the global financial crisis of 2008, the Eurozone is exhibiting signs of broad-based growth. Last year, for example, the bloc grew at an estimated 2.3% – the fastest rate of growth recorded since the financial crisis.

The latest breakdown of the national accounts shows a more detailed picture of the sources of growth, which include:

- Household consumption held up as a key source of economic growth throughout the period, but there are signs that households remain cautious in their spending habits. This was reflected in the gradual uptick in the savings ratio from 11.9% in the last quarter of 2016 to about 12.2% in the fourth quarter of 2017 – despite about a million jobs being created in the Eurozone since the first quarter of 2016.
- The contribution of gross fixed capital formation (or investments) was the biggest driver of economic growth in 2016.
- Other sources of growth like government consumption held steady as austerity has eased and government budgets are now growing in line with economic performance.

However, it is also becoming clear that the Eurozone is increasingly reliant on external demand as a key source of GDP growth. This could make the bloc more susceptible to uncertainties in the international trade arena and could explain some of the softening of the survey data which came out recently.

US

The US economy has continued to perform well into 2018, supported by steady inflation, low unemployment, strong consumer spending and increasing wages. The latest figures for the second quarter of 2018 showed the economy expanded at an annualised rate of 4.1%, the strongest for four years. Whilst wage growth has been slow to follow the overall economic pick up (wages were only 2.0% higher than a year ago) there are signs that the buoyant economy and low employment are starting to put pressure on wages.

Overall we are projecting 2.9% economic growth in the US this year. Combined with the strong dollar relative to sterling, this is continued good news for UK hoteliers.

Table 2:
Key economic projections

	2018	2019
Real GDP growth	1.3%	1.6%
Consumer spending growth	1.1%	1.3%
Inflation (CPI)	2.5%	2.3%

Source: *PwC main scenario July 2018*

What factors will drive travel demand?

Globally, tourism continues to grow and international tourist arrivals were up 6% in the first four months of 2018, compared to the same period last year, not only continuing the strong 2017 trend, but exceeding the United Nations World Tourism Organization's (UNWTO) forecast for 2018. Growth was led by Asia and the Pacific (+8%) and Europe (+7%). Africa (+6%), the Middle East (+4%) and the Americas (+3%) also recorded sound results. Earlier this year, UNWTO's forecast for 2018 was between 4-5%.

In the UK, global, European and UK economic growth should continue to underpin travel growth and support demand for accommodation. The weak pound will also help but the growth lift is unlikely to see a return to H1 2017's exceptional levels. Business travel, has shown mixed trends which are expected to continue until the Brexit negotiations are resolved. The consumer income squeeze suggests that domestic short breaks are unlikely to see robust growth this year, although the hot weather may help encourage trips.

Will more tourism records be broken in 2018 and 2019?

The UK remains a leading global tourism destination with almost 40m overseas visits in 2017, 3% more than in 2016. A record 284.8 million nights were spent in the UK, up 3% on 2016. Scotland performed particularly well, with visits growing by 17% and spend by 23%. London still dominated expenditure in England, while Wales struggled to capitalise on the success of the rest of the UK, experiencing no increase in visit numbers and a decline in overseas spending by 17% (UKInbound, 2017 shows another record breaking year for inbound tourism).

Will 2018 and 2019 repeat this success?

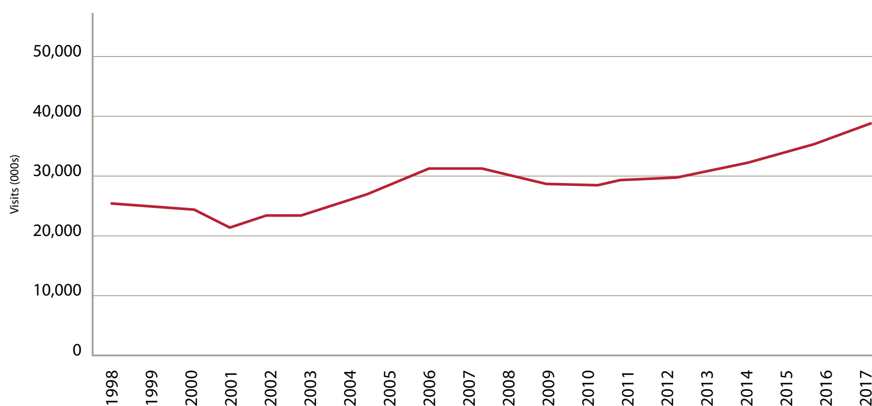
While strong global growth should, in theory, help cushion inbound business and leisure travel to the UK, the last 3 months of 2017 saw some of the weak pound boost subside and a decline of -6.8% for total inbound visits and -8.5% for holiday visits.

Travel data for Q1 2018 data will be released by the Office for National Statistics (ONS) on 5 September 2018 until then we will not be sure if weaker trends from the end of last year continued into Q1. We do know that air passenger statistics from the Civil Aviation Authority (CAA) show that passenger numbers at UK airports increased by over six per cent in 2017, and the number of actual flights increased by 37,000. They report that 265m passengers passed through UK airports last year and they conclude that 2018 will follow a similar trend. Q1 statistics certainly show most airports saw robust levels of passenger traffic (although inbound and outbound).

So far, demand in 2018 has been helped by the Royal Wedding, a strong Farnborough International Airshow and the RAF 100 celebrations, as well as many unique sporting and cultural events around the country, including the European Sports Championships in Scotland and the Gymnastics World Cup in Birmingham.

For 2018 overall, Visit Britain (the national tourism body) remain positive, suggesting data on flight booking patterns as well as anecdotal feedback from the industry mean that the second half of 2018 should see growth on 2017. Furthermore, data shows healthy growth in passenger numbers at most UK airports for the last 12 month. In total 41.7m visits are forecast for 2018 according to official data (Visit Britain website 16 July 2018 # 2018 Forecast).

Figure 4:
Overseas visits to UK continue to grow



Source: *ONS 2018*

Weaker pound continues to support inbound leisure tourism

The fall in the pound and euro helped drive record visitor numbers in 2017, which benefitted hotels in London and other major cities. While the exchange rate 'effect' has now worn off a bit, London still remains good value regarding hotel rates when compared with some other European destinations such as Paris.

High value business travel impacted

Strong global and European economic growth should support business travel but inbound international business visits to the UK saw year-on-year growth declines in 2017, falling by 4% to 8.8m. due possibly to uncertainty over Brexit, continued cost conscious corporate policies as well as difficult comps with 2016. It's a high value segment for hotels and it's estimated that the overseas business traveller spends up to three times as much as a domestic business traveller.

Less buoyant outlook for domestic short breaks expected

While research from the World Travel & Tourism Council (WTTC) together with Oxford Economics, suggests more people are opting to take staycations instead of travelling abroad on holidays recently (Travel Weekly, 22 March 2018), this does not necessarily benefit hotels and increasingly holiday villages, caravans and home share are popular accommodation choices.

Furthermore, separate holiday intentions research from industry specialists, BDRC concludes that most UK destinations will actually see fewer UK visitors this year, as the proportion of Briton's considering a staycation holiday within the UK in 2018 is set to decline. Fewer than seven in ten of those interviewed earlier in 2018, intended to take a UK break – a fall from the three-quarters that intended to do so in the last three years of their research. The fall is driven by a fall in planned short breaks. Balancing this they predict that holidays of four or more nights are set to increase, supporting the WTTC research suggesting Britons are trading their overseas breaks for a domestic holiday and taking a longer holiday in the process (Jon Young BDRC in the Tourism Society Journal, Summer 2018).

Meetings and events sector continues to recover slowly

Meetings and conferences are a key element of hotel demand but are often the last demand segment to recover. Demand was badly impacted by the recession and recent years have seen the sector struggle to find ways to maximize revenues.

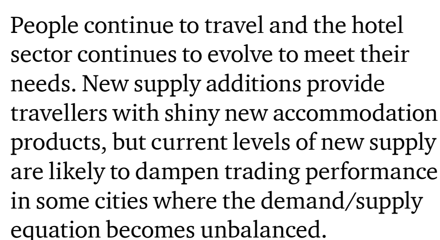
The latest UK Conference and Meetings Survey 2018 (UKCAMS) shows 2017 was another difficult year. In 2017, there were 1.29m overall conferences and meetings held in the UK, an almost 11% decline on 2016's 1.45m. UKCAMS shows that the number of conferences was almost on a par with the average over the last decade of 1.31m. In terms of events, venues hosted an average of 373 conferences and meetings in 2017 compared to 419 in 2016, but the average size of the events was 72 delegates compared to 67 in 2016.

More encouragingly, recent data from the Meetings Industry Association (MIA) reported that the UK meetings sector had a strong start to 2018. Their data for enquiry levels, numbers of meetings and average rates for the first five months of the year are all higher than the corresponding period in 2017, according to MIA's quarterly update. The average number of meetings held between January and May of 2018 were 10% higher than the same period in 2017 and 25% higher than 2016, while the average daily delegate rate (DDR) has also grown steadily by 10% over the last three years to £43.50.

No mega events in 2019

While there are a variety of events scheduled for the UK (and we discuss some of these in the London and Provinces demand sections) apart from the ICC Cricket World Cup, there are no mega events planned for 2019. Also, the biennial Farnborough International Airshow, will not return until 2010. The Show alternates with the Paris Air Show, which is held in odd numbered years.

Supply: a balancing act



People continue to travel and the hotel sector continues to evolve to meet their needs. New supply additions provide travellers with shiny new accommodation products, but current levels of new supply are likely to dampen trading performance in some cities where the demand/supply equation becomes unbalanced.

For the brands it's all about market share and having a full range of products in their portfolios so customers never have to leave their brand site. To do so they are acquiring, building, extending and rebranding. For example, IHG's Kimpton and Voco brands are coming to the UK; and Marriott has launched its Tribute home share brand.

London, in particular remains a focus for developers and continues to contend with high levels of new supply and this is set to continue into 2019. The total number of hotel rooms in London will increase by around 9,500 rooms in 2018 and 2019 bringing London's supply to around 160,000 rooms by the end of 2019. In addition serviced apartments and shared accommodation adds to consumer choice.

Outside London, new supply pressures are also building in a number of cities. Overall, we could see over 40k rooms added in 2018 and 2019. Cities with large pipelines include Manchester, Belfast, Edinburgh and Liverpool.

Budget hotels, for so long one of the most dynamic segments of the UK hotel market, continue to build and add extensions. In 2018 and 2019 around 15k rooms opened/will open. Brands opening new rooms include; Premier Inn, hub by Premier Inn, Travelodge, Ibis, HI Express, Hampton, Moxy, Sleeperz, Tune, Yotel, easyHotel, Z, Days Inn and Marston's Inns.

London

Figure 5 shows the pattern of London's pipeline to the end of 2019. The Central, East and West zones of the capital will see most of the pipeline development, with around 3,500 new rooms apiece, while the North sees none and the South only around 540 rooms. Could Crossrail already be shaping some of this pattern? When it opens (now estimated to be in 2019) it will link up west, central and east London as well as key employment, leisure, tourism and business districts – Heathrow, West End, the City, Docklands – enabling further economic development including, no doubt, potential hotel developments.

Figure 5:
London's pipeline: still finding the opportunities

Feast in the East, Central and West zones

North	
Rooms in pipeline	0
% of total London pipeline	n/a
Budget rooms as a % of this new pipeline	n/a
No growth planned in any of the four boroughs	

South	
Rooms in pipeline	541
% of total London pipeline	5%
Budget rooms as a % of this new pipeline	52%
Most growth from Bromley and Sutton	

East	
Rooms in pipeline	3,454
% of total London pipeline	32%
Budget rooms as a % of this new pipeline	36%
Highest growth in Tower Hamlets and City of London	

Central	
Rooms in pipeline	3,498
% of total London pipeline	32%
Budget rooms as a % of this new pipeline	7%
Highest growth by far in the City of Westminster but also Southwark and Islington	

West	
Rooms in pipeline	3,437
% of total London pipeline	31%
Budget rooms as a % of this new pipeline	14%
Highest growth in Hillingdon and Hounslow	

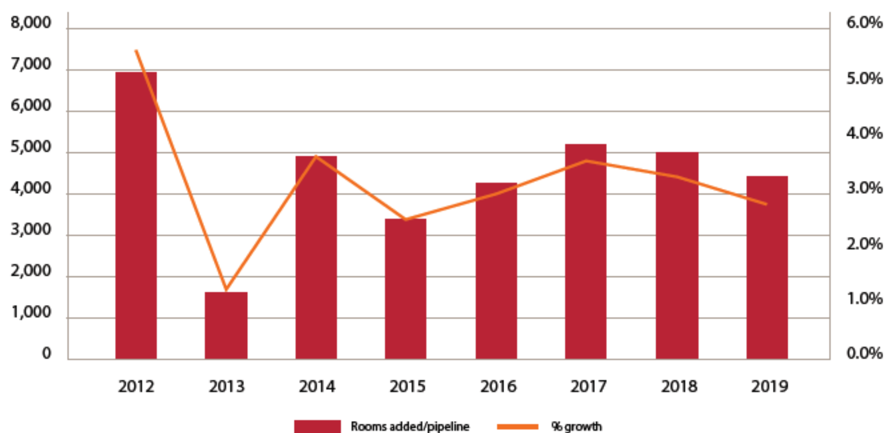
Source: *Pipeline from July 2018 to December 2019 PwC analysis; STR*

Almost **38,000 new rooms** will have been added in London **in the past eight years**

In 2018, London's supply growth will be above the average for the last five years 2013-2017. In 2019 it will be on a par with the average. While London always absorbs new supply in the end, it's not always a smooth process and can cause some pressures for a while.

(See Figure 6).

Figure 6:
London: how many rooms at the inn?



Source: *PwC analysis/STR July 2018*

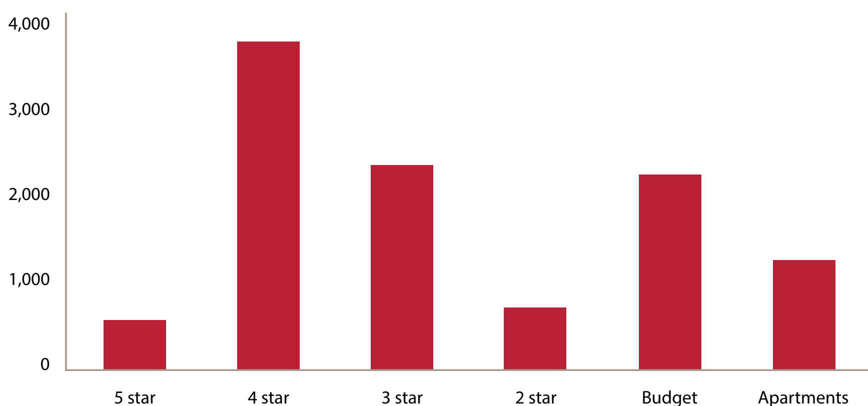
If you can't beat them: hotels embrace the home share space

The supply landscape is increasingly more crowded and competitive as hotels vie with each other, as well as with serviced apartments and shared accommodation providers like Airbnb. This is true across the UK and not just in London.

In terms of the segments developers are focusing on, the capital is seeing more upscale developments with 4 star hotels dominating the rooms pipeline (34% of all rooms), followed by 3 star hotels (21%) and budget (20%). Serviced apartments account for around 11% of the pipeline.

(See Figure 7).

Figure 7:
Four star hotels dominate London's room pipeline



Source: *PwC analysis/STR*

However it's not really that simple anymore. Individual travellers as well as corporate buyers are seeking out longer stay accommodation products. Airbnb's inventory continues to grow by as much as 30-35% in London as well as across the regional cities. And, unsurprisingly, some hotel groups have entered the home share space too. Marriott International and Hostmaker recently debuted the home-sharing platform Tribute Portfolio Homes adding some 200 home offerings across the London area. In addition there is Hyatt's Oasis, Accor's onefinestay, Stay One Degree, Homestay, Homestayin and Love Home Swap. But, on a cautious note, Bjorn Hanson (Professor at NY's Tisch Center for Hospitality & Tourism and ex global PwC Hospitality & Leisure Leader) recently pointed out in Hotels Magazine, that it's challenging for hotels to find an economic model that works in the sharing economy.

Members only clubs further widen consumer choice, for example, White City Soho House is set to open in the former BBC headquarters in White City later this month, featuring a cinema, rooftop pool and bar, screening room, gym, club space as well as 45 bedrooms.

Provinces

A geographically diverse area, but in general new hotel development activity remains strong across the Provinces, which is not surprising given the sustained stronger trading we are seeing in many cities. Some cities are taking the brunt of the new supply. Hoteliers we speak to report supply concerns across a number of markets.

Around the country, cities are seeing significant room additions. For example, Belfast will see upwards of a 1,000 new rooms available during 2018, a 25% increase in the city's capacity over 2017 (BBC News 6 Jan. 2018) and a further 80 rooms are due to open in 2019. New rooms include the Grand Central on Bedford Street and Marriott at City Quays. In Scotland, Edinburgh will see around 500 new rooms open this year and a further 1,549 rooms in 2019. Glasgow sees 200 rooms open this year and around 915 in 2019. Even Aberdeen, so long a difficult market, sees over 900 new rooms in total added in 2018 and 2019. Manchester will add around 900 new rooms in 2018 and 1,200 in 2019. Liverpool increases its hotel stock by 600 new rooms this year and 960 rooms in 2019.

Newer brands include Marriott's budget lifestyle brand, Moxy. In 2018 and Chester and Edinburgh will see new properties in 2019. A new 224 bedroom Moxy hotel is set to launch at the National Exhibition Centre in Solihull in 2020.

Change through rebranding

Intercontinental Hotels Group (IHG) has revealed the debut UK locations for its boutique Kimpton Hotels and Restaurants and upscale Voco Hotels brands following a deal made with Covivio in May. Covivio (formerly known as Fonciere des Provinces). IHG agreed with Covivio to rebrand and operate 12 existing hotels and one in the pipeline. Now, IHG has revealed which brands the hotels will operate under.

The flagship Principal London in Russell Square will become the capital's first Kimpton Hotel later this year, while the Principal Manchester will rebrand to Kimpton in 2019, along with the Principal Edinburgh Charlotte Square and the Principal Blythswood Square Hotel in Glasgow.

Marking the Voco Hotels debut in the UK, the Principal St David's Hotel in Cardiff will rebrand later this year. Further Voco properties are expected to be announced soon. The Principal Grand Central Hotel in Glasgow, De Vere Oxford Thames and the Principal Oxford Spires Hotel are expected to join IHG's portfolio in Q3 this year.

"Hotels are extending portfolios so they can win the traveller loyalty across their entire hotel lifecycle –moving from economy, select service, long stay, home share, and boutique to luxury… they want you to never leave…"

Samantha Van Leeuwen, Head of Hotels and Venues, PwC

Can Artificial Intelligence help boost productivity and reduce costs for hotels?

Rob McCargow, Director of Artificial intelligence at PwC spells out how, from reducing costs to providing highly personalised experiences, AI is key to the future of hotels.

Picture the scene.

It's a few years from now. You arrive after a long flight in a city you've never visited before and travel to your hotel.

As you walk through the hotel's front door, facial recognition software captures your likeness and matches it with the photo on your account. Using this biometric data, the hotel's systems check you in automatically, and allocates you a room. The room number appears instantaneously on your mobile.

You go straight up in the lift, which knows which floor you're heading to. When you arrive at your room, the facial recognition panel on the door is already programmed to identify you and let you in. Once inside, you find everything is configured to your needs – with your linen and minibar contents, and a hot bath filling up for you.

You ask the room's digital assistant to book you a table for dinner that evening and a taxi to your meeting in the morning. Next day, after a great night's sleep, you tell the digital assistant you're checking out – and walk straight out of the hotel, having paid the bill without even having to go to the desk.

Sounds like science fiction? Far from it. Using Artificial intelligence (AI) including sensory intelligence (e.g. user access); Profiling/preference (e.g. room set up) and Voicebot (e.g. room assistant), all of this is achievable today. And given the scale of benefits that AI can deliver, the question is not whether this investment will be made, but when – and what your future vision is for your hotel.

Why it's important the sector embraces AI

This need to embrace AI applies across virtually all industries and the UK economy as a whole. A recent PwC study found that UK GDP will be up to 10.3% higher in 2030 as a result of AI – the equivalent of an additional £232bn – driven by a combination of productivity gains, consumption-side enhancements to products and services, and new entrants stimulating demand. Significantly, the uplift will be felt across all of the UK, boosting average spending power per UK household by between £1,800 and £2,300 a year.

Realising the opportunities presented by AI is all the more important at a time when – as PwC's forecast shows – the UK hotel sector faces slowing RevPAR growth and substantial headwinds from a wide variety of sources, ranging from Brexit to shifts in consumer confidence to trade wars. While AI certainly doesn't present a panacea for these challenges, it's one of the major tools at hotels' disposal to counter the headwinds and drive efficiencies and a recovery in margins.

It's true that AI and related technologies such as robots, drones and driverless vehicles are likely to displace many jobs formerly done by humans over the coming decades. But at the same time, they will also create many additional jobs, as productivity and real incomes rise and new and better products are developed.

For the accommodation industry – and the food service sector in particular – research shows they will be among the biggest beneficiaries in terms of profit growth resulting from AI adoption. More generally, the sectors benefiting most are those that combine strong underlying demand growth with a relatively high propensity to see benefits from application of AI and related technologies, based on the detailed use case analysis in our 'Sizing the Prize' report.

How can hotel companies benefit?

Hotel companies realise the uplift from AI in a number of ways. One is that they'll benefit indirectly as AI boosts economic growth. But they'll also be able to generate substantial direct impacts on their businesses through their own use of the technology.

This is why management teams and investors in the UK hotels industry are increasingly coming to see investing in AI as vital to long-term growth, brand differentiation and improved returns in the sector. But they're not looking for businesses to dive in headfirst and simply throw money at AI projects. Instead, hotel businesses need to ensure they have the right fundamentals in place, and then invest the money in the right way while targeting the right opportunities.

The fundamentals for the right AI investment:

The clearest requirement is far-sighted leadership with a strong commitment to AI. But to turn this commitment into reality, companies will also need AI skills in the workforce, and an ability to build transparency and trust in AI engines among both customers and employees. The final piece of the jigsaw is data, the crucial fuel without which AI cannot function. To support and enable AI, hotels businesses must ensure they have high-quality, relevant data that's readily available and of sufficient scale. Hotels already have data on customer purchases, travel choices, journey patterns, location preferences, ratings and payment methods – and given this wealth of information, there are clear opportunities to use it to differentiate their brands and enhance guests' experiences.

A good way to check whether all these fundamentals are in place is to conduct an AI maturity assessment across the business. If this finds the organisation is ready to press ahead with investment in AI, a further key factor is the way those investments into AI are made. Implementing shiny new AI technologies – such as putting digital assistants in rooms – may well help to win over customers and increase revenues over time. But in today's capital-constrained environment, with myriad competing priorities, it's hard to justify any new investment without a fast and visible effect on margins.

This means it will be vital to use AI not just to boost consumption, but also to reduce costs – thereby freeing up capital to invest.

What AI-enabled opportunities can hotels pursue?

Armed with the right fundamentals and a balanced investment strategy there are three opportunities spring immediately to mind – collectively blending the cost and consumption sides of the equation:

- **Personalisation of the customer experience through AI and related technologies.** As in the scenario outlined earlier, AI enables the creation of far more tailored, bespoke and convenient service experiences for guests, helping to increase their satisfaction and propensity to choose one hotel over another. AI is increasingly offering the huge potential to enhance the service from call centres, by making online interactions more responsive and relevant to the individual, thus improving engagement and revenues. At the same time, in seeking to increase customer satisfaction by installing digital assistants in rooms, it seems that hotels are pushing against an open door: PwC research shows that 42% of consumers already use digital assistants in their homes – rising to 53% among millennials, and 72% among business executives. We've also found that 42% of millennials would pay a premium for a hybrid human-bot customer service channel. As such figures underline, today's consumers expect technology and AI to support their interactions in hotels, just as they do in other areas of their daily lives – and growing numbers of hotel groups are reflecting this expectation in their service experiences. For example, Yotel has self-service check in/out and a robotic concierge called YOBOT and Hilton has developed Connie the Hilton robot. Meanwhile, Marriott has partnered with Amazon to provide guests with access to amenities with the Alexa digital assistant through its voice-controlled Echo device, and IHG has collaborated with Baidu to create 'AI Smart Rooms' in China.

However, an important touchstone in all AI initiatives in the sector is the need to ensure that they don't compromise the personal touch that is so crucial to a positive guest experience.

- **Augmenting the pace and efficiency of back office processes RPA, augmented by AI.** With staffing remaining a key issue for many hotels, – as it is in other industries – there is huge clear potential in the hotels sector to use AI – and especially robotic process automation – to enhance functions such as HR and Finance, as well as back-of-house tasks like food preparation and cellar management. By using AI in these areas, hotel businesses can simultaneously improve productivity and speed while relieving staff of mundane or routine tasks, enabling them these to be reallocated to more value-adding activities, while also reducing costs to free up funds for investment in further innovation. AI can make more efficient recommendations of resources, and can create better pricing models and targeted personalized advertising.
- **Improving workforce productivity through better allocation of staff.** Having the right people in the right place at the right time is key – but how do you match your supply and demand for human resources in the most intelligent way? One answer is that AI can do this faster and more effectively than any human could. In addition this is a huge cost saving factor too, not just productivity. Think about seasonal workers and being able to predict better how many workers you need. At PwC, we are already using AI to help us allocate the right people to the right projects at the right time – and hotels can do the same, realising benefits around both costs and consumption.

No time to lose: AI could transform the hotel sector

Clearly, adoption of AI is likely to vary by sector and geography. But opportunities like the ones we've described underline the transformational impact that the hotels sector – in common with other industries – is set to experience from rising adoption of AI. In looking to exploit such opportunities, it's important to be aware that they don't need to be tackled through large, monolithic projects or massive 'moonshot' investments. A clear lesson from other industries is that the most effective and cost-efficient approach for AI implementations is through small, agile iterations or 'sprints' and a 'fail-fast' mindset – quickly shutting down those initiatives that don't work, and rapidly scaling up those that do.

What matters today is that – if they haven't done so already – hotel companies should start this iterative, ongoing cycle of AI investment and innovation. Going forward, effective use of AI will become ever more pivotal to hotels' ability to grow revenues by differentiating themselves through more personalised services, and sustain margins through faster, lower-cost processes – all adding up to a sharper competitive edge. Put simply, using AI is not an option, but an imperative.

The message is clear. Investing in AI isn't the only way to counter the headwinds facing the hotels sector. But it will be a vital component of the successful hotels business of the future. Those that fail to embark on their AI journey today could well find themselves struggling to catch up with their more forward-looking competitors in the years to come. So when it comes to scoping out the opportunities that AI presents, there's no time to lose.

Deal talk

UK hotel deal volume totalled c. £3.8bn in the first half of 2018, up over 80% from the first six months of 2017. By year end 2018, we forecast total hotel deal volume to be c. £6.8bn, nearly a 40% increase on the volume experienced in 2017, and the second highest volume of investment in the UK after the record levels of £9.3bn in 2015.

Figure 8:
UK Hotel Deal Volume

Source: *RCA, Dealogic, PwC analysis*

The UK hotel market has generally shown deal volumes closely tracking RevPAR growth over the past decade. However with a swathe of significant portfolio deals having completed during H1 2018, and with more portfolios and some large single hotel deals currently in progress, total 2018 hotel deal levels are expected to buck this trend. This will mark only the second year where deal volumes are expected to exceed RevPAR growth, the other being the standout year of 2015.

We anticipate a slowdown in portfolio deal activity during 2019. This is due to a combination of the recent trend of longer term investors entering the UK hotel market, plus a tranche of refinancing by any remaining US fund hotel portfolio owners, taking advantage of the favourable low-cost debt terms currently available. As a result of these factors, together with forecast investor uncertainty around UK's upcoming departure from the European Union at the end of March 2019, we are forecasting 2019 deal activity levels to fall by around 34% from the 2018 forecast deal volume to c. £4.5bn.

2017 rebound on strong H2

2017 deal transaction volume reached c. £4.92bn, up 34% on the year prior, but still down from the record £9.3bn in 2015. The 2017 improvement was driven by a series of large portfolio deals which closed in the second half of the year, coinciding with an increased sense of macroeconomic stability.

The most significant deals which transacted in H1 2017 were all single assets in London – the Grosvenor House Hotel (c. £600m), Doubletree by Hilton Westminster (c. £190m) and Park Plaza Waterloo (c. £160m).

H2 2017 saw three substantial portfolios trade; Jury's Inn acquired by Pandox (c. £800m); Q Hotels acquired by Aprirose (c. £525m); and Tonstate's UK Hilton Metropole hotel portfolio acquired by Henderson Park (c. £500m).

Portfolio deals continue to dominate into 2018

Total deal volume for H1 2018 was at £3.8bn, c. 80% higher than in H1 2017, with hotel investors not yet seemingly deterred by the UK's impending Brexit at the end of March 2019. Portfolio transactions accounted for £3.1bn (c. 81%) in H1 2018, compared to just £0.2bn for the equivalent 6 month period for H1 2017, with large ticket transactions becoming more commonplace as the competition for stable, high quality hotels intensified. Noteworthy portfolio transactions closing in H1 2018 all represented further significant exits by US funds from the UK hotel market – including Starwood's Principal Hotels portfolio (c. £860m), Apollo's remaining Ribbon hotel portfolio (c. £750m), Lonestar's remaining Amaris portfolio of Mercure and Hilton hotels (c. £600m) and Oaktree's Saco Apartments business (c. £430m).

Single asset deals totalled only c. £0.6bn during H1 2018, the most notable being the hotel development site at 5 Strand (c. £90m), the Waldorf Astoria Edinburgh – The Caledonian (c. £85m) and the Premier Inn Kings Cross (c. £80m). The Wanda hotel development site at Nine Elms was also acquired for c. £59m with the buyer also agreeing to repay c. £160m debt.

Forecast for 2018 a large uplift on 2017

Despite the larger portfolio deals which closed in the second half of 2017, this year's deal volume is forecast to be around 39% higher than the prior year. This is primarily due to the additional boost of significant portfolio deals in 2018, which has resulted in portfolio deal volumes already reaching 38% more by the end of H1 2018, than the total level of portfolio deal activity for the whole of 2017.

In H2 2018, we have already seen a portfolio deal of seven Hilton hotels complete for c. £100m. In addition, there are further number of large transactions rumoured to be currently in progress including the Zinc hotel portfolio, the Midland Hotel, Manchester and the Beaumont Hotel, London. With these deals assumed to complete this year, plus a number of other large London assets rumoured to be coming to market, we expect a degree of continuation of the level of activity seen in the first half of the year. This has informed our expectation for a further c. £3bn of deals to close in H2 18, resulting in a forecast total 2018 deal volume of £6.8bn.

What to expect for 2019?

There is an expectation for continued strong inward investment from Europe and the Far East looking for good opportunities and strong returns, especially given relative low value of the pound. Activity in part is being fuelled by the availability of cheaper finance including ground leases which are now becoming more commonplace across the hotel sector. Long term fixed leases themselves have become far more common into 2018 with more hotels returning to this structure of leasing.

There is also a continuing rise in investor appetite in alternative accommodation such as serviced apartments, hostels and aparthotels.

We anticipate however a slowdown in portfolio deal activity during 2019. This is due to a combination of factors: There has been a recent wave of new longer-term investors entering the UK hotel market compared to the previous generation of US fund with a typical 5 to 7 year investment horizon. For those few US funds still holding UK hotel portfolios, we have also seen a tranche of refinancing over the last 12-18 months, taking advantage of the favourable low-cost debt terms currently available. As a result of these factors, together with forecast investor uncertainty around UK's upcoming departure from the European Union at the end of March 2019, we are forecasting 2019 deal activity levels to fall by around 34% to c. £4.5bn.

Emerging Trends in Real Estate 2017-2018

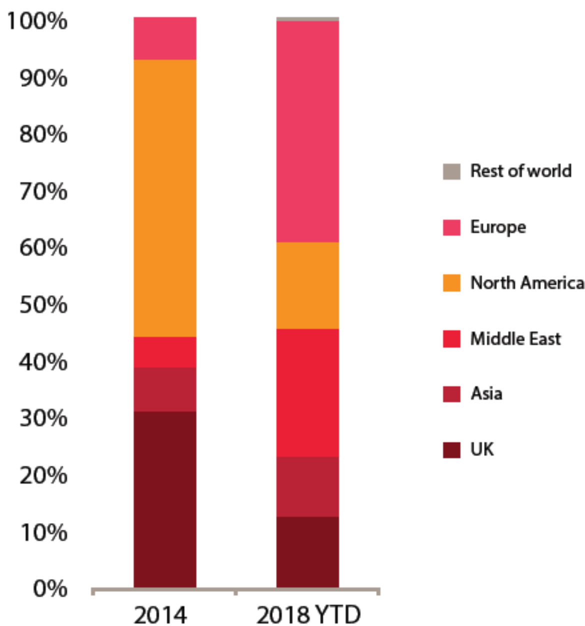
PwC's Emerging Trends in Real Estate Report (ETRE) Europe 2018 (produced jointly with UTI) found that alternatives continue to dominate the list of sectors being considered for investment, with Hotels ranking second among such niche sectors and Serviced Apartments fourth with 28% and 17% of respondents indicating interest respectively.

Over 50% of industry leaders were considering niche sectors as a whole, with the most popular reasoning being the change in demographic drivers in recent times. Besides, hotels and serviced apartments, it is private rented residential and student housing which have gained the greatest traction with investors and both are now firmly established markets in the UK.

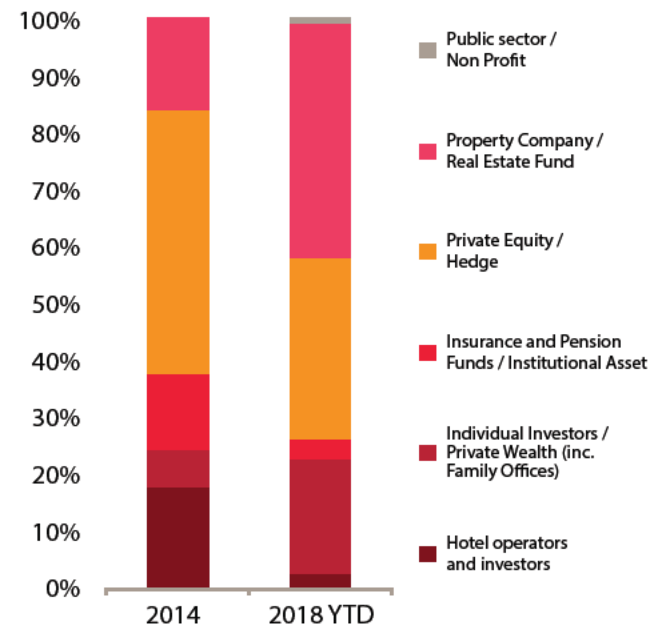
Among all Real Estate Sectors, Hotels and Serviced Apartments were ranked 12th & 9th of 23 sectors for overall prospects in 2018, both equating to a 'generally good' investment score. In terms of development prospects Hotels ranked 14th and Serviced Apartments 10th again equating to 'generally good' development scores.

Figures 9 and 10: ***Where is investor appetite coming from?***

Origin of investor (% share of value, by region)



Type of investor (% share of value, by type)



Source: *RCA, Dealogic, AM:PM, PwC analysis*

There has been a considerable shift in investor source over the last four years, away from the significant North American and UK investor base towards mainly European and Middle Eastern based investors. There has also been a large rise in both property company/ real estate fund, and private/family office types of investors over the same four year period.

This has been due to the larger portfolio transactions, with the primary European investors including Covivio's (formerly Foncière des Régions) acquisition of Principal Hotels (for c. £860m) and LRC Europe's acquisition of the remaining Amaris portfolio (for c. £600m), and the Middle Eastern based Dayan family acquiring the Ribbon hotel portfolio (for c. £750m).

Appendix 1

Annual hotel statistics for London and Provinces 2016 – 2019 (F)

	Actuals		Forecast	
London				
	2016	2017	2018	2019
Occupancy	82%	82%	82%	81%
ADR (£)	142	148	149	150
RevPAR (£)	116	121	122	122
% change on previous year				
Occupancy	-0.9%	0.2%	0.1%	-0.5%
ADR	-0.1%	4.3%	0.2%	0.8%
RevPAR	-1.0%	4.6%	0.3%	0.3%
Provinces				
	2016	2017	2018	2019
Occupancy	76%	76%	76%	76%
ADR (£)	69	71	72	73
RevPAR (£)	52	54	55	55
% change on previous year				0.3%
Occupancy	-0.2%	0.5%	-0.3%	0.0%
ADR	3.2%	3.1%	1.3%	1.2%
RevPAR	3.0%	3.6%	1.0%	1.2%

Econometric Forecasts: *PwC July 2018*
Benchmarking data: *STR July 2018*

Appendix 2

Methodology for the forecasts

This section outlines in detail the PwC model used to forecast hotel occupancy, Average Daily Rate (ADR) and Revenue Per Available Room (RevPAR).

Data

Our hotels dataset provided by STR contained ADR, hotel room supply, demand and occupancy on a monthly basis. Macroeconomic variables such as GDP growth, unemployment and CPI were obtained from the Office of National Statistics (ONS) and GDP data for key tourist markets were obtained from the OECD; and these were available on a quarterly basis.

Econometric model

We developed a 2-stage least squares (2SLS) instrumental variables approach that projects hotel demand and price (ADR) using a two-stage process with the specifications set out in the table below.

Table 3:
Final specifications of the London and Provinces models

	London	Provinces
1st stage	***Dependent variable*** Growth in London hotel demand ***Explanatory variables*** • Country-weighted GDP growth in the previous year • Growth in London ADR in the previous year • London hotel demand in the previous quarter • USD exchange rate in the previous quarter • Quarterly dummies	***Dependent variable*** Growth in Provinces hotel demand ***Explanatory variables*** • UK GDP growth • Growth in Provinces ADR in the previous year • Growth in demand in the previous year • Quarterly dummies
2nd stage	***Dependent variable*** Growth in London ADR ***Explanatory variables*** • Growth in London hotel demand • Quarterly dummies	***Dependent variable*** Growth in Provinces ADR ***Explanatory variables*** • Growth in Provinces hotel demand • Growth in Provinces ADR in the previous year • Quarterly dummies

[1] Growth weighted by GDP growth in main origin countries of London hotel guests, which include North America (US and Canada), Europe (Belgium, France, Germany, Ireland, Italy, Netherlands, Spain and Poland) and the UK.

Advantages of our econometric modelling approach

For the current forecasts, we conducted a literature review of academic research and tested several model specifications as part of an ongoing process to improve model performance. Based on our findings we used the 2-stage least squares (2SLS) instrumental variables approach.

The 2SLS approach has several advantages. It does not require any distributional assumptions for explanatory variables, e.g. variables may take a binary or non-normal form. It is also computationally simple and allows the use of diagnostic testing procedures for problems such as heteroscedasticity, unit roots and specification error. In addition, the two-stage approach also allows us to estimate demand and price separately rather than projecting occupancy rates directly, recognising that these are driven by different factors.

However, the challenge of producing robust estimates using the 2SLS approach is the selection of 'instruments' or variables that are sufficiently exogenous to price, but have an influence on hotel demand.

Our model specifications includes quarterly dummies, the lag of GDP growth, the lag of demand, the lag of price growth, and the lag of exchange rates as instruments. Results from the Hansen J statistic suggest that the instruments are exogenous and the model is valid at the 5% confidence level. Similarly, the t-tests in the first regression suggest that the variables are significant at the 5% level. This suggests that the instruments are both relevant and independent of the dependent variable.

Forecasts

Forecasts for ADR growth and hotel demand were generated using PwC forecasts of macroeconomic variables, supplemented by additional forecast data for hotel supply for London and the Provinces provided by STR to produce forecasts for occupancy rates. Adjustments were made to ensure the comparability of STR data and an attrition factor was applied to simulate periodic drop-offs in rooms supply. RevPAR forecasts were constructed using ADR, demand and supply forecasts.

This model was used to generate forecasts through to Q4 2019, and these were generated separately for London and the provinces, with forecasts for the UK as a whole constructed from a weighted average of the London and Provinces forecasts. These weights were generated using the share of London and Provinces hotel room demand as a percentage of total (London + Provinces) demand.

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