March 2018: *Our revised outlook for the UK hotel sector in 2018 reflects relatively lacklustre UK economic growth (despite a strong global economy), a continued squeeze on real incomes, shaky inbound travel trends and a large supply spike in London this year, with more new rooms opening than we saw during the last growth peak in 2012*

Weaker growth checks in?

UK hotels forecast update 2018 and 2019

pwc

Overview

Weaker UK economic growth is expected to persist in 2018, as considerable uncertainty still relates to Brexit. We estimate GDP growth to remain at around 1.5% in 2018, edging up to 1.6% in 2019. In addition, there remain pressures on UK household spending and real income growth is expected to continue to be subdued in 2018. While stronger global growth should help cushion inbound business and leisure travel to the UK, weaker UK GDP is likely to depress ADR growth.

Another issue impacting revenue per available room (RevPAR) growth is the impact of expected high levels of new supply, which we believe will dampen occupancy during 2018, especially in London. A marked supply spike in new room openings in 2018 means London could see over 9,000 rooms opening – more than the 8,000 rooms that opened in 2012, the Olympic year.

Despite strong GDP growth in key inbound markets, there are indications that 2017's boost to inbound holidays from the weak pound may have started to 'fizzle out' towards the end of last year, and a recent survey by UK Inbound reports sliding business confidence in prospects for inbound travel in 2018[1]. London hoteliers confirm some leisure segment weakness since the autumn, especially at weekends. 2017 safety and security concerns have been cited as a factor in 2018 forward bookings cancellations.

Accordingly, our revised forecast model now predicts around 0.6% RevPAR growth for London in 2018, a contrast to the almost double digit growth seen in London in the first half of 2017 and lower than our last forecast six months ago *(UK hotels forecast: As good as it gets? September 2017)* which then anticipated around 2.4% RevPAR growth this year. In the regions, our latest forecast is also for weaker growth than expected six months ago and we now project 1.1% RevPAR growth for 2018. However, in 2019, we expect continued strong global economic growth will help underpin a stronger year and we forecast 1.9% RevPAR growth in London and 1.4% RevPAR growth in the Regions.

The 'shape' of London trading in 2017 versus that expected in 2018 is also an issue to consider. The very strong trading in the first half of 2017 and the much weaker second half of the year will mean some particularly tough monthly comparisons until the end of July followed by easier comparisons for the rest of the year.

Clearly it's not all gloom; there's still some growth. London enjoys very high performance metrics and around the UK, key regional cities are also enjoying solid metrics and in many cases record occupancies. Additional uplift should come from the Royal Wedding in May, Farnborough International Air Show in July and many unique sporting and cultural events around the country, including the European Sports Championships in Scotland, the Gymnastics World Cup in Birmingham and Liverpool welcomes the Terracotta Warriors to the World Museum from February to October 2018. Still, on balance, we feel it's going to be a challenging year.

In terms of deals there has been a significant movement in investor profile, away from the traditional PE groups (who are likely to look towards mainland Europe in search of higher returns) to more institutional investors seeking to invest in long-term, fixed leased hotel assets. Simultaneously we have seen a shift in the preferred operating structure, away from the more traditional owner operated groups or long term encumbrance with brand management contracts, to a rise in the type of investors looking for either long term operator leases or franchising alongside potentially cheaper and more flexible third party operating contracts. Overall we forecast 2018 deal volume in the UK to be around £6.0 billion, up c. 22% from the £4.9 billion achieved in 2017.

Hotels face some strong headwinds but it's not all doom and gloom

[1] *TravelMole February 8 2018, Confidence in UK tourism slides*

London forecast 2018 and 2019: *Clouds on the horizon*

2017 saw absolute **occupancy** remain high, averaging 82%, despite consecutive monthly occupancy declines from June 2017. For 2018 and 2019 we anticipate occupancy growth will remain weak (January 2018 saw a further decline) and we forecast only 0.4% and 0.3% growth in 2018 and 2019 respectively, as weak demand continues and supply weighs down occupancy growth.

ADR growth was strong in much of 2017, driving a 4.3% overall annual gain. Our assumptions for 2018 reflect a falling inflation forecast (which depresses nominal ADR). While January 2018 managed modest growth, we expect only a 0.2% gain in 2018, taking ADR to £149, still a record in nominal terms; in 2019 more robust growth of 1.6% takes ADR up to £151.

RevPAR saw 4.6% growth in 2017 but is forecast to see only 0.6% growth in 2018, taking RevPAR to £122, and to see a 1.9% gain in 2019, taking RevPAR to £124.

Developers have been making hay while the sun shines and **above average supply growth** is expected with a particularly sharp spike in new supply openings in 2018 (+6%) with a potential 9,000 rooms opening their doors – more than the 8,000 that opened in 2012, the Olympic year. An additional 5,000 new rooms could open in 2019. While London always soaks up new supply (eventually) there can be imbalances for a while and weaker demand trends could make this the case this year. Even if all the rooms don't get built it's a lot of new rooms to fill, especially if demand weakens, and comes on top of over 5,000 new rooms in 2017. Over the past five years we've seen a particularly vigorous volume of openings in the economy segment, as well as strong growth in the upscale and upper upscale segments.

See Table 1 and Figure 1.

Table 1:
London and Regions hotels forecast
Clouds on the horizon

	London			Provinces		
A: Actual F: Forecast	*2017A*	*2018F*	*2019F*	*2017A*	*2018F*	*2019F*
Occupancy %	82%	82%	82%	76%	76%	77%
ADR (£)	148	149	151	71	72	72
RevPAR (£)	121	122	124	54	55	56
% growth on previous year						
Occupancy	0.2%	0.4%	0.3%	0.6%	0.5%	0.2%
ADR	4.3%	0.2%	1.6%	3.1%	0.6%	1.2%
RevPAR	4.6%	0.6%	1.9%	3.7%	1.1%	1.4%

Source: *Econometric Forecasts: PwC February 2018;* Benchmarking data: *STR January 2018*

A sharp spike in new room openings is expected in London in 2018

Provinces forecast 2018 and 2019:
A slower pace of growth

Actual **occupancy** has continued to nudge up slowly since 2012 (70%) to reach a high of 76% in 2017, despite 2017 experiencing 6 months of occupancy declines. We forecast further marginal growth of 0.6% in 2018 and 0.5% in 2019, taking occupancy to 77% by 2019.

Strong **ADR** growth of 3.1% in 2017 took ADR to £71 but we don't expect the pace of growth to continue in 2018, and we expect a more modest 0.6% this year, climbing to 1.2% in 2019 and taking nominal ADR to £72 in 2018.

RevPAR saw solid overall RevPAR growth of 3.7% in 2017 boosting nominal RevPAR to £54. We forecast a further 1.1% growth this year, taking RevPAR to £55 and an additional 1.4% in 2019 which would lift RevPAR to £56.

Developers have been busy outside London too, where above average **supply growth** is also expected in 2018, however oversupply issues emerge primarily at the local level. Manchester expects around 1,250 new rooms this year on top of over a thousand new rooms in 2017; Edinburgh's 2018 pipeline totals 830 rooms in 2018 and a further 1,300 rooms next year; Belfast and Glasgow expect over a thousand new rooms each this year and Glasgow anticipates the same again in 2019. While the branded budget hotel sector has driven much of the increased supply in the UK hotel sector and comprises around half of the UK's pipeline, new research suggests Edinburgh could see fewer budget rooms opening. This is due to possible new planning controls being introduced to attract more luxury hotel operators as a means of bringing high spending overnight visitors to the city[2].

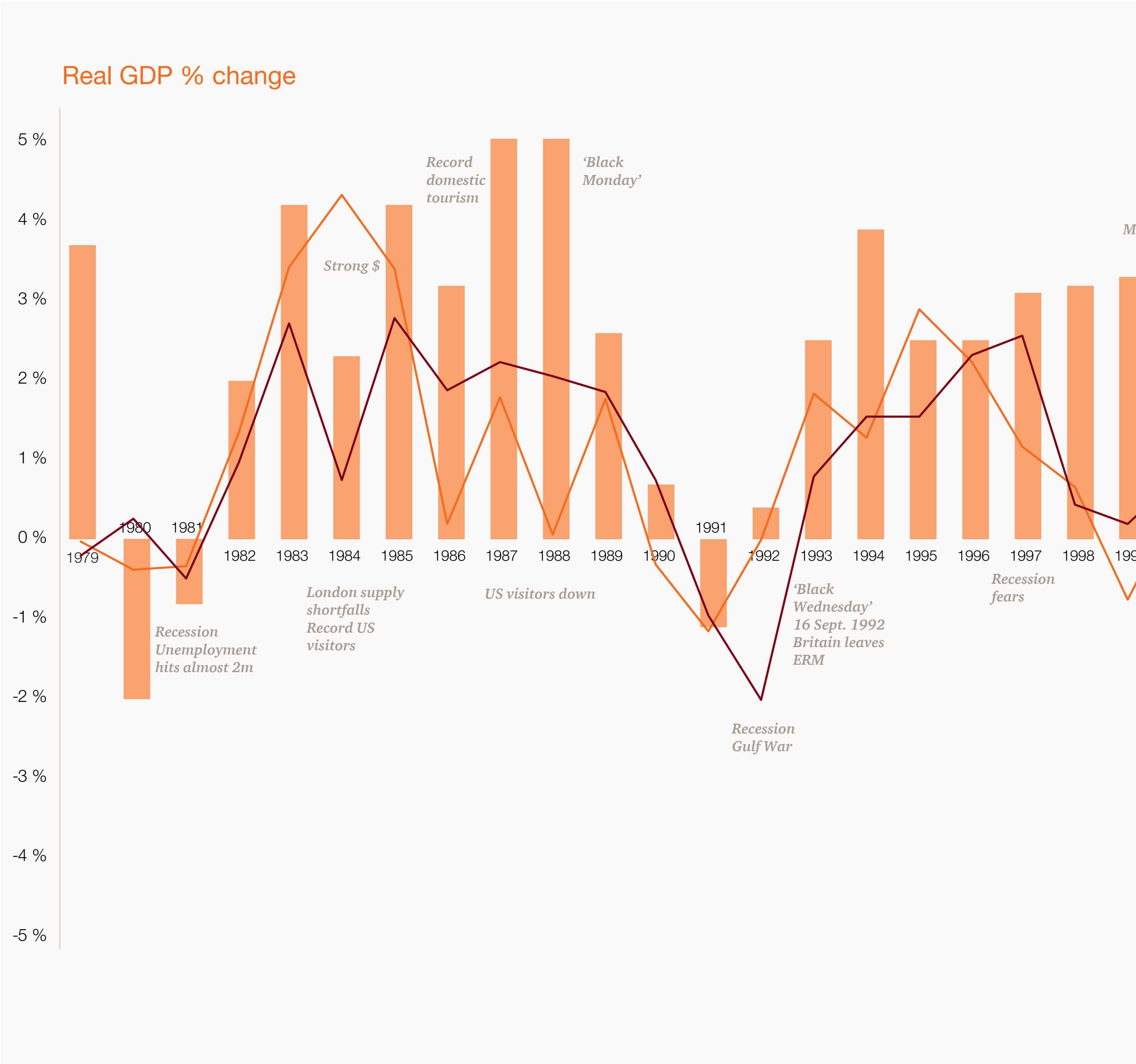
See Table 1 and Figure 1.

[2] *The Scotsman, 9 February 2018, Edinburgh budget hotels could be curbed to encourage luxury hotel chains*

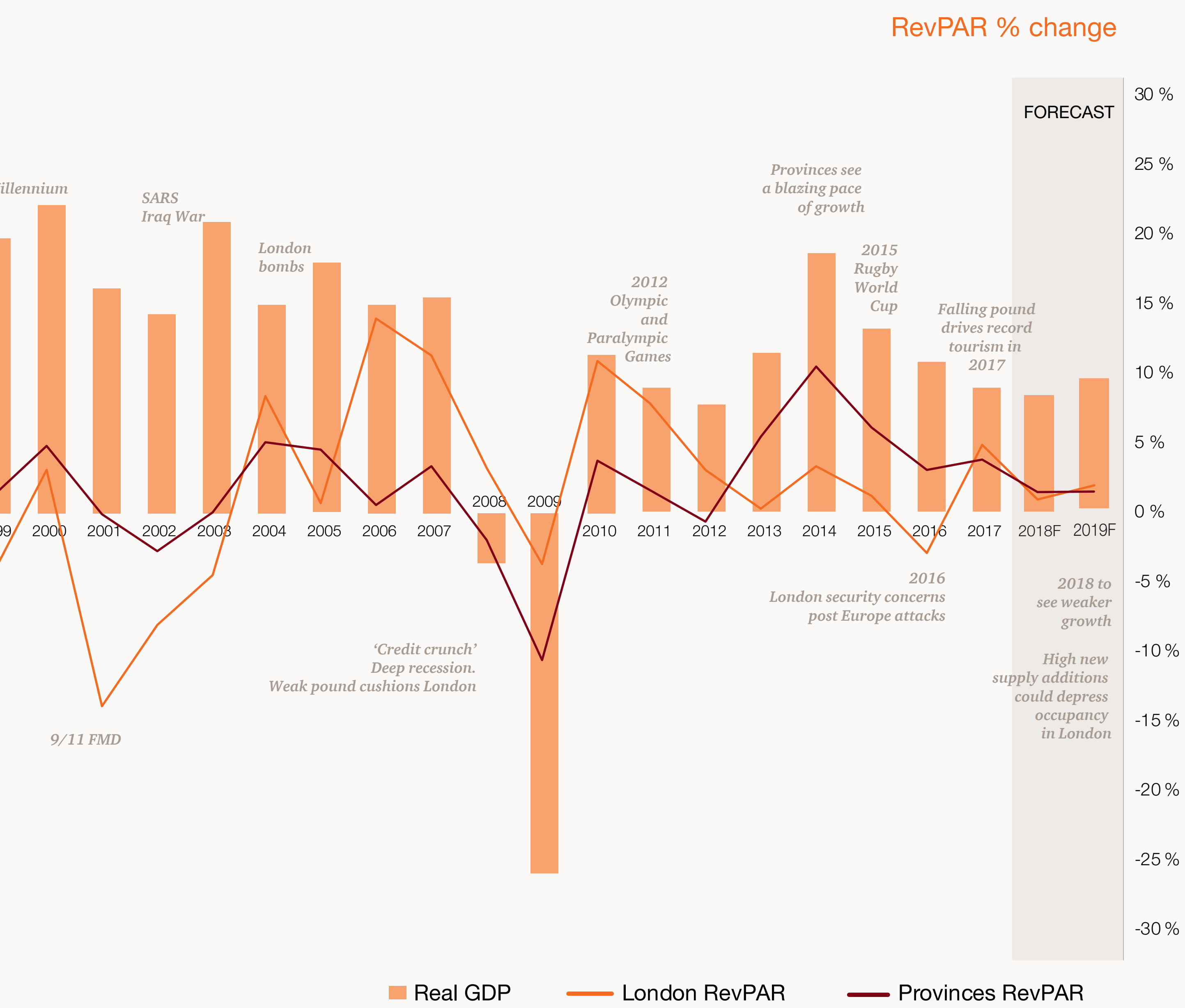
Figure 1:

2018 could see stronger headwinds

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



Source: *Econometric forecasts: PwC February 2018;* Macroeconomic data: *National Statistics;* Benchmarking data: *HotStats, STR;* Supply data: *AM PM*


RevPAR % change
FORECAST
30 %
25 %
20 %
15 %
10 %
5 %
0 %
-5 %
-10 %
-15 %
-20 %
-25 %
-30 %
illennium
SARS
Iraq War
London
bombs
9/11 FMD
'Credit crunch'
Deep recession.
Weak pound cushions London
2012
Olympic
and
Paralympic
Games
Provinces see
a blazing pace
of growth
2015
Rugby
World
Cup
Falling pound
drives record
tourism in
2017
2016
London security concerns
post Europe attacks
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growth
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2017
2018F
2019F
Real GDP
London RevPAR
Provinces RevPAR

Economic backdrop:
Slower growth and Brexit uncertainty

The UK economy slowed during 2017 despite an improving global economic environment. This was due primarily to rising UK inflation and a consequent squeeze on real household spending power. Business investment has also been relatively subdued given Brexit-related uncertainties.

With continued inflationary pressures in the economy, Mark Carney has signalled that further interest rates rises may come in the spring. However, we expect any further increases over 2018 to be gradual.

Real income growth is expected to remain subdued in 2018 and there are limits to how much further household borrowing can rise, particularly with interest rates starting to edge up and the housing market losing momentum.

Our main scenario is for UK GDP growth to slow to around 1.5% in 2018, with real consumer spending growth easing to around 1%. But the stronger global economy should help offset continued Brexit-related uncertainties.

Travel backdrop:
A bumpier landing in 2018?

While continued global and UK economic growth clearly remains an encouraging factor underpinning international and domestic business and holiday demand, there are indications that last year's boost to inbound holidays from the weak pound may have started to 'fizzle out' towards the end of last year. A recent survey by UK Inbound supports this view and reports sliding business confidence in prospects for inbound travel in 2018[2]. Terror attacks and security issues in London and Manchester were cited by the UK Inbound survey of inbound tourism businesses as contributing to a slump in business in the second half of 2017 as clients cancelled existing and future bookings, following the attacks. London hoteliers we have spoken to also confirm some leisure segment weakness, especially at weekends.

Looking at the inbound data, passenger numbers in October 2017 (the latest data available) saw inbound tourism numbers decline -6% year on year, a significant slowdown compared to growth of +9% in the first half of the year, and a slowdown on the -1% seen in September. Holiday inbound passengers declined -5% y/y, and -9% on a 2-year view.

Which segments will demand come from this year? Business travel remains important to hotels but we saw 2017 inbound business travel volumes were volatile and while remaining an important hotel demand stream, it's hard to see what would invigorate demand in 2018. Looking to staycation prospects, while they will provide some demand, squeezed consumer spending may mitigate the benefits in 2018. Holiday visits remain vital and Visit Britain forecast that overseas visits to the UK could still break through the 40 million mark for the first time in 2018, reaching 41.7 million, up 4.4% on 2017 which is expected to see 39.9 million visits.

Additional uplift should come from the Royal Wedding in May, Farnborough International Air Show in July and many unique sporting and cultural events around the country, including the European Sports Championships in Scotland, the Gymnastics World Cup in Birmingham and Liverpool welcomes the Terracotta Warriors to the World Museum from February to October 2018.

Has the weak pound effect 'fizzled out'?

[2] TravelMole February 8 2018, Confidence in UK tourism slides

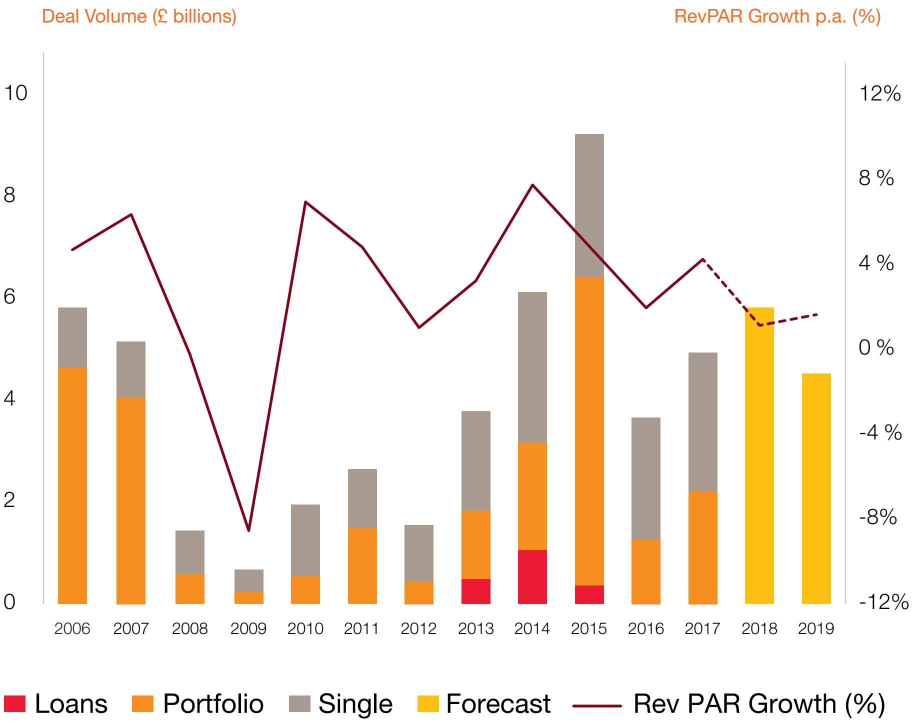
Deals outlook:
A strong pipeline of portfolio deals expected for 2018

Total deal volume for 2017 reached £4.9 billion, up 34% from 2016's figure of £3.7 billion. This rebound from 2016, which saw a cross sector decline in transactions due to Brexit uncertainty, was driven by several large portfolio sales in the second half of the year and an increased sense of macroeconomic stability.

The standout deal from the quieter H1 17 was Blackstone's sale of the Doubletree, Westminster (c. £190m); while key deals concluding in H2 17 included Swedish hotelier Pandox's acquisition of the Jury's Inn portfolio (c. £800m), the QHotel UK portfolio (c. £525m) and Tonstate's UK Hilton Metropole hotel portfolio (c. £500m); with notable single asset transactions including the Grosvenor House Hotel (c. £550m), Park Plaza London Waterloo (c. £161.5m) and the Hilton London Olympia (c. £115m).

There was a substantial push from overseas investors to deploy capital with nearly £2.7 billion (c. 55%) of total investment, despite the expected surge in Chinese inflows failing to come to fruition due to state restrictions being implemented in August 17 on international hotel investments, with Singaporean and other East Asian investors posting more significant investment growth.

Figure 2:
Forecast deal volume 2018 and 2019



Source: *RCA. Dealogic, AM:PM, PwC analysis 2018*

There has been a significant movement in investor profile, away from the traditional PE groups (who are likely to look towards mainland Europe in search of higher returns); to more institutional investors seeking to invest in long-term, fixed-leased hotel assets which provide secure, index-linked cash flows backed by a strong covenant.

Simultaneously we have seen a shift in the preferred operating structure, away from the more traditional owner operated groups or long term encumbrance with brand management contracts, to a rise in the type of investors looking for either long term operator leases or franchising alongside potentially cheaper and more flexible third party operating contracts.

Similar levels of hotel deal activity continued into this first quarter of 2018, with the completion of portfolio sales: Saco serviced apartments (for c. £430m) and Park Hotels & Resorts' 7 UK Hiltons (for c. £135m) as well as the sale of the Caledonian Hotel, Edinburgh (for c. £85m). Other deals reported to be currently in progress include Lonestar's final tranche of 23 UK hotels (a mix of Hilton and Mercure branded hotels) and Starwood Capital's Principal / De Vere hotel portfolio. There will also likely be some trade of the Zinc Hotel portfolio (10 Hilton-leased hotels) which entered into administration earlier this year.

Our forecast for the remainder of 2018 is a strong pipeline of portfolio deals, with owners considering whether the number of exits in H2 17 might signal that the end of current cycle could be in sight. Overall we forecast 2018 deal volume in the UK to be around £6.0 billion, up c. 22% from the £4.9 billion achieved in 2017. [See Figure 2]

For 2019, we anticipate future investors into the UK hotel market becoming even more vigilant in their due diligence when considering the longer term potential impact from Brexit; we consider long-term holders and family offices looking for a multi-generational freehold being a more prominent buyer profile. Our forecast for 2019 is therefore a c.25% drop from the higher 2018 deal volume to around £4.5 billion.

Owners are considering whether the number of exits in H2 2017 might signal that the end of the current cycle is in sight

[1] PwC Analysis, Hotel Analyst, AM:PM, HVS, Dealogic, STR Global, Real Capital Analytics

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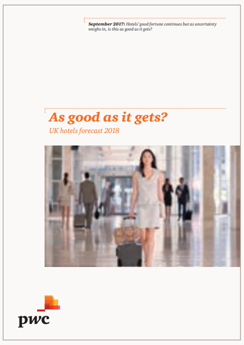
More PwC research:

Women in Hospitality, Travel and Leisure

We joined forces with Tea Colaianni - Chair of Women in Hospitality 2020, Korn Ferry, People 1st, Oxford Brookes and others to assess how equipped the industry is to achieve 33% female representation across boards and executive committees by 2020, a target set by the Hampton-Alexander Review.

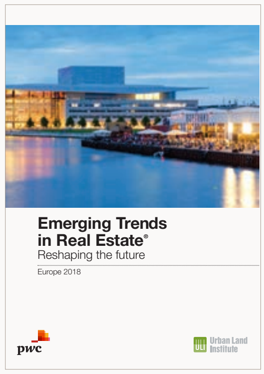
In addition to the review, the first of its kind for the sector, a Diversity in Hospitality, Travel and Leisure Charter has been developed which we are asking companies to sign. Visit our website for the key findings of the research and to find out more about the Charter.

Women in Hospitality, Travel and Leisure 2020



UK hotels forecast Sept 2017 – As good as it gets_

European cities hotel forecast – Standing out from the crowd



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