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March 2016

UK hotels forecast update for 2016 and 2017

Cheerful but fearful

Spotlight on 2016: Cheerful but fearful

Occupancy

+1.2% At record levels

Regions **77%**

London **83%**

+0.9% Highest level in PwC's Euro cities forecast 2016

Average daily rate (ADR)

+3% Room for further growth

£144 London

£69 Regions

+1% Creeping upwards

Revenue per available room (RevPAR)

+4.2% Modest growth

London **£120**

Regions **£53**

+1.9% Solid but weaker growth

Supply

Regional room supply 2015* **472,850 rooms**

New rooms to open in 2016 **+9,120 rooms**

Growth over 2015 +2%

Hotspots include Edinburgh, Glasgow, Birmingham, Bath

London room supply 2015 **139,880 rooms**

New rooms to open in 2016 **+6,970 rooms**

Growth over 2015 +5%

More than double 2015; bumper choice for travellers

* All the supply data is after room closures are accounted for
Charts show absolute trading and percentage change on pervious year
Net room supply (after closures) Source: AM:PM

Sources: PwC; STR Global; AM:PM Hotel Database (supply), February 2016
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2016 is expected to see solid but weaker growth in the regions and slightly healthier, but modest growth in London.

PwC's March 2016 update reflects our more cautious thinking on prospects for hotels across the UK, the Provinces and London in 2016 and provides our first thoughts and forecasts on performance in 2017. While we remain positive we are less optimistic than we were a few months ago, at the time of our forecast in September 2015.

So far the year has not got off to a good start in London, as STR Global's preliminary data for January suggests a 3.8% decrease in occupancy to 66.6%, while ADR (average daily rate) was down 1.7% and RevPAR (revenue per available room) fell 5.4% to £81.04.

We acknowledge that there are reasons to be both fearful and cheerful with considerable uncertainty and risk. The UK economy has slowed and our projections have been revised down to reflect this. The inflation outlook is also weaker than six months ago, restricting the need and ability of hoteliers to increase rates. The international picture has also darkened, with slower growth in emerging markets such as China, weak global trade and geopolitical tensions (particularly the refugee crisis, the Middle East and the so called Brexit referendum now set for June). Furthermore, supply additions in London have been above normal levels putting pressure on occupancy rates.

Nevertheless, despite the gloom, we think this hotel cycle has some room for more growth and the year will pick up.
Whilst the economy is slowing we are still expecting growth in both the UK and our key European inbound travel markets; a record 35.8 million foreign visitors came to the UK in 2015 and more records are expected to be broken in 2016.

Rising pay levels (including the living wage) and improving disposable income in the UK (with a helping hand from lower oil prices) are helping drive up consumer confidence and spending. The pound, having moved against the sector since 2014, has recently fallen from recent highs against the euro which will also help buoy up inbound demand.

In terms of our latest revised forecast, following a buoyant Provincial performance in 2015, we see room for weaker growth in 2016 in the regions. London had a more mixed year in 2015, and we forecast a slightly healthier year in 2016 for London compared to 2015, where the Paris terrorist attacks in November cast a long shadow over performance at the end of the year and the beginning of 2016.

Accordingly, our latest forecast for the Provinces in 2016 expects RevPAR growth of 4.2% taking RevPAR to £53, driven by a consistent occupancy gain – enough to nudge occupancy to a record 77% for the year – and a 3% additional ADR gain. In 2017 we anticipate RevPAR growth slowing further but still demonstrating additional 3.2% growth, supported by both occupancy and ADR improvements. Our latest forecast for London in 2016 anticipates modest RevPAR growth of 1.9% taking RevPAR to £120, aided by modest occupancy and ADR growth; in 2017 we anticipate a further 2.2% growth supported by only a little occupancy growth and a 1.5% ADR growth, taking it to £147 in nominal terms.

2016 and 2017 forecasts

London 2015 recap

The year was characterised by weak occupancy growth and despite trading at a very high level, occupancy registered a 0.9% decline over 2014. ADR declined in only three months and overall ADR growth of 2.4% took rates to £143. PwC's 2.7% RevPAR forecast for 2015 looked achievable until November and December's poor performance meant a final RevPAR growth figure for the year of 1.5%. The decline in RevPAR growth in December was almost 5% and reflects the impact of the Paris terrorist attacks. It was a sharp contrast to 2014's 9% growth (the highest RevPAR growth of any December since 2001). All in all 2015 saw a variable performance against an active supply schedule. See Chart 3.

Our latest forecast for London 2016 and 2017

This forecast update reflects our revised views on 2016 as well as our first thoughts on 2017.

London saw high visitor numbers last year despite a weak euro and we expect continued demand from overseas and domestic tourism in 2016. The pound has fallen more than 10% so far this year against the Euro which could potentially provide a boost for inbound travel. Between July and September last year, there were more than 5.2 million visits to the capital, according to the latest data from the Office for National Statistics International Passenger Survey, an increase of 5.9% compared to the same period in 2014.

We forecast continued growth in 2016 and 2017 with 1.9% and 2.2% RevPAR growth respectively in each year. This lifts RevPAR to £120 in 2016 and to £122 in 2017.

Table 1: UK hotels forecast 2016 and 2017

	London			Provinces		
	2015A	2016F	2017F	2015A	2016F	2017F
Occupancy %	82%	83%	83%	76%	77%	78%
ADR (£)	143.00	144.00	147.00	67.00	69.00	70.00
RevPAR (£)	118.00	120.00	122.00	51.00	53.00	55.00
% growth on previous year						
Occupancy	-0.9%	0.9%	0.7%	1.2%	1.1%	1.7%
ADR	2.4%	1.0%	1.5%	5.0%	3.0%	1.4%
RevPAR	1.5%	1.9%	2.2%	6.1%	4.2%	3.2%

Econometric Forecasts: PwC February 2016
Benchmarking Data: STR Global February 2016
A: Actual F: Forecast

We expect growth to be driven by a balanced mix of occupancy and rates. Occupancy growth of 0.9% could take occupancy to 83% this year, and an ADR gain of 1%, takes rates to £144. With occupancy already at 83%, we anticipate only a further 0.7% gain which will keep occupancy at 83% in 2017. Above average supply growth continues and potentially could inflict pressure on existing hoteliers. In 2017 RevPAR growth will be driven by 1.5% ADR growth, taking ADR to £147. See Table 1 and Charts 1 and 2.

Provinces 2015 recap

Another very good year for the Provinces as a continuing rates recovery underpinned more RevPAR growth. Our last bullish PwC forecast proved accurate, we forecasted 6.3% RevPAR growth for the year, while the actual achieved figure was 6.1%, taking RevPAR to almost £51. During 2015 occupancy growth decelerated and some cities saw actual declines, the most severe were in Aberdeen where the oil and gas sector continues to suffer, but also in Newcastle and York. Overall, occupancy growth slowed to 1.1% for the year as a whole, taking occupancy to 76%.

ADR continued to support trading and ended the year up 5%, taking rates to around £67. Many cities around the UK saw double digit growth in RevPAR, for example Cardiff boosted by the Rugby World Cup, Belfast, Birmingham, Bristol and Coventry all benefited. Supply growth perked up in 2015 with 1.8% growth over 2014.

Our latest revised forecast for Provinces 2016 and 2017

We anticipate continued strong growth in the next two years (albeit at a slower pace to 2014). Given already high occupancy levels (76% in 2015) we think hoteliers will be able to raise ADR to drive 4.2% and 3.2% RevPAR gains in 2016 and 2017. ADR growth of 3% in 2016 is expected to moderate to 1.4% in 2017 and will continue to help rates recover to a respectable £69 and £70 in 2016 and 2017 respectively. Occupancy is forecast to increase by almost 1.2% to 77% in 2016 nudging up to 78% in 2017. Growth in new supply could reach 2% this year as over 9,000 new rooms open, with a further 1.7% growth in 2017. See Table 1 and Charts 1 and 2.

Economic outlook and assumptions

UK GDP is expected to continue to grow

UK GDP has slowed a little in 2015 but domestic demand growth remains relatively strong, helped by lower oil prices. In 2015, UK GDP grew by 2.2%. We expect UK GDP growth to average around 2.2% in 2016 and 2.3% in 2017. Consumer spending and business investment will be the main drivers of UK growth in these years. All UK regions are expected to benefit although London and the South east lead.

More confident UK consumers

Over the past three years, UK consumer spending has grown at 2.5%, faster than inflation, despite very modest real increases in average earnings until recently. This reflects rising employment, low inflation and mortgage rates, and a decline in the household savings ratio as consumers grew more confident about borrowing and spending in the light of stronger economic growth, sustained house price increase and lower oil prices.

Inflation, interest rates and real disposable income growth

Inflation has been close to zero in 2015 but seems likely to rise back towards its 2% target by the end of 2017, so, assuming no major adverse global shocks, we expect the Bank of England to begin to raise interest rates gradually at some point during 2016, reaching 1% by the end of the year. Businesses and households should still plan for rates to be back to around 3-3.5% by 2020. As inflation returns to normal levels in 2016 and 2017 we expect real disposable income growth of around 2.3% in 2016 and just under 2% per annum on average in 2017-2020. As a result of the above, we envisage real consumer spending growth remaining relatively robust at around 2.5-3% in 2016, but then moderating to just over 2% per annum in the rest of the decade, similar to trend GDP growth.

Risks to GDP growth are weighted somewhat to the downside in the short term due to international risks, particularly in relation to emerging markets. But there are also upside possibilities if the global environment improves and productivity growth rates accelerate in the UK.

Global economic challenges

The global outlook remains mixed with continued growth in the US and the Eurozone, but a slowdown in China, recessions in Russia and Brazil, and increased volatility in emerging markets more generally.

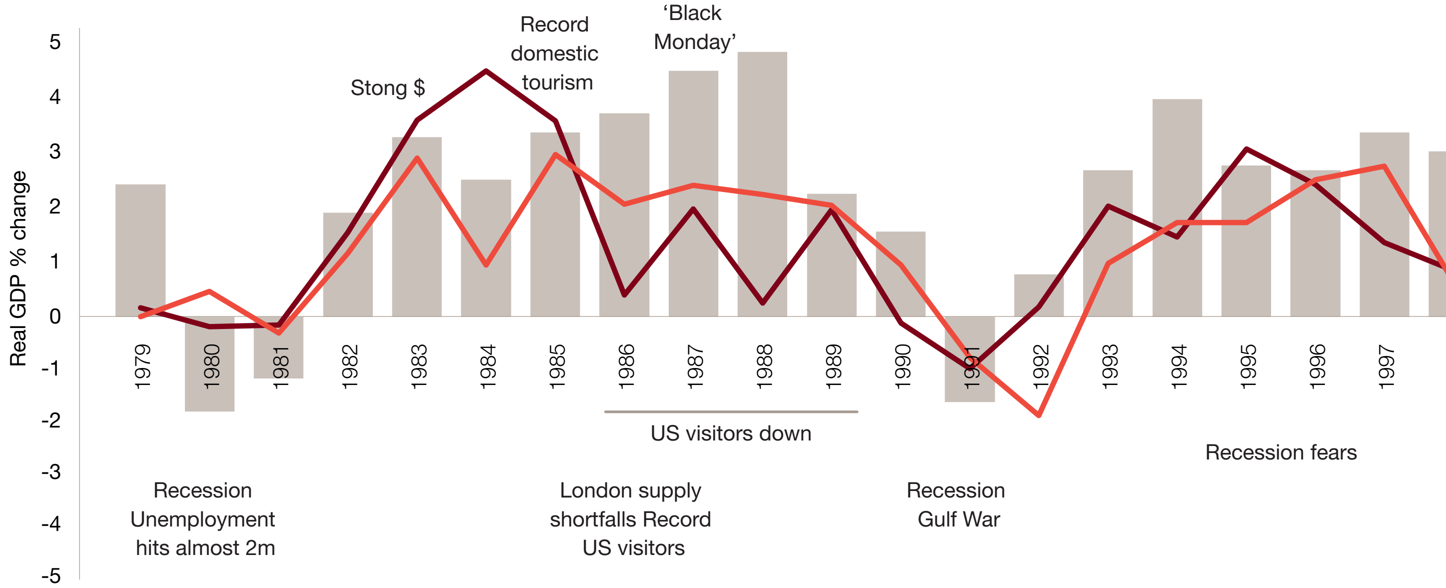
The ***Eurozone economy*** is forecast to grow moderately by 1.6% this year and 1.7% next year and inflation creeping up from 0.1% in 2015 to 1.1% in 2016 and 0.9% in 2017. The peripheral economies will grow faster than the core economies in 2016, the second year in a row, which should mark the end of the wider Eurozone financial crisis. On a positive note, the ***US economy*** will grow by almost 3% this year with the UK remaining its main rival in terms of growth. The growth in the Eurozone is good news for supporting inbound tourism from key travel markets.

The economic outlook will also be highly dependent on how key geopolitical issues play out during the year. Three geopolitical issues will continue to dominate the news headlines. First, the migrant crisis in Europe, which may slow down in the winter, but could flare up again in the spring. Second, the response of the international community to the crisis in the Middle East. Third, the referendum on the fate of the UK's membership of the European Union. Both UK and global economic growth remain subject to these considerable uncertainties over the next couple of years.

Exchange rates are clearly a big issue for London hotels as well as some other international destinations and have been a major challenge recently.

Chart 1: Still more cheerful than fearful

Real GDP growth and revenue per available room (RevPAR) trends 1979-2017F



Source: Econometric forecasts: PwC February 2016 Macroeconomic data: National Statistics Benchmarking data: Hot Stats and STR Global

The pound has fallen more than 10% so far this year against the Euro which could help boost inbound travel. But while the recent fall in the value of sterling this year is good news for hotels, sterling is likely to remain volatile.

Travel outlook - Solid travel growth

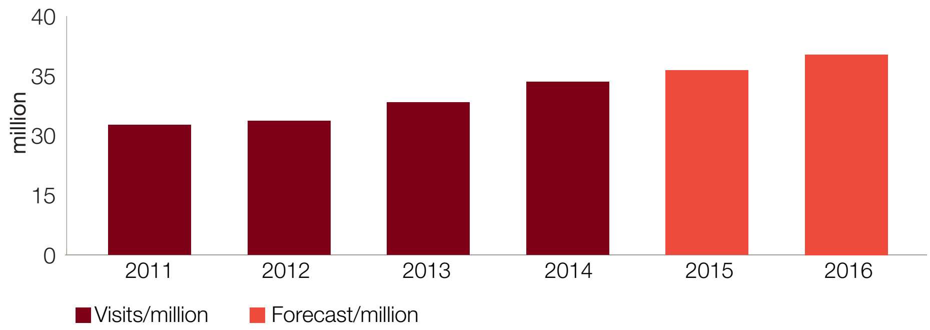
Continued economic growth continues to drive business travel growth and help support midweek demand in hotels. International business trips to the UK were up 6% in 2015. The World Travel & Tourism Council (WTTC) as well as the Global Business Travel Association are generally positive and forecast more growth for key European countries, including the UK. Increased consumer confidence is expected to support leisure travel and short city breaks remain a key driver of leisure demand. While the terrorist attacks in Paris in November cast a shadow over other major European cities, including London, some hoteliers we speak to have reported a pick up forward bookings, while others wait.

In 2015 there were a record 35.8 million overseas visitors to the UK, up 4% on 2014. Visit Britain's forecast for 2016 is positive with an expectation for 36.7 million visits, an increase of 3.8% on 2015.

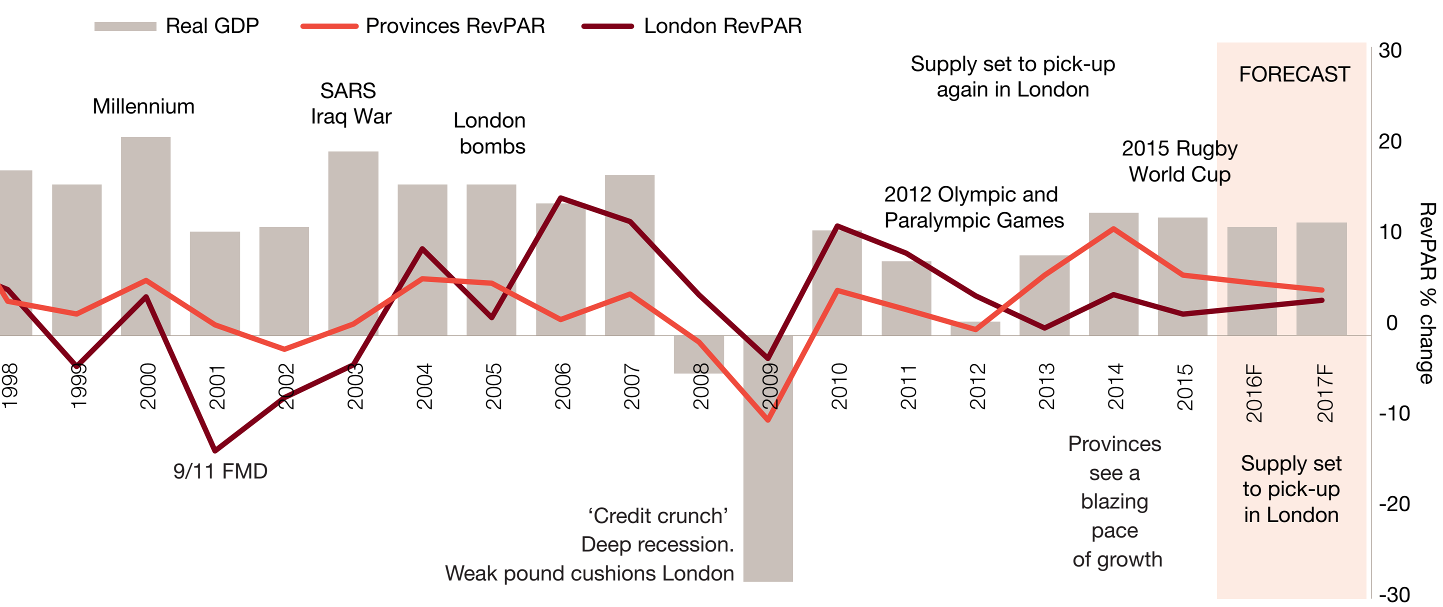
London has also recorded a rise in the number of domestic visits to the city, with 9.3 million trips to London during the first nine months of 2015 - a 10% increase compared to the same period in 2010.

Events: 2016 sees the Olympics in Rio and the 2016 UEFA European Championship (Euro 16) in France but no major international sporting event held in Britain (apart from those held annually). Despite this, the year is still expected to be busy, with plenty to attract record tourism numbers. Among much else, there will be some large conferences and association meetings; events to celebrate including the International Festival for Business in Liverpool (the organisers expect in excess of 30,000 delegates to descend on the city from across the UK and around the world); the 400th anniversary of Shakespeare's death; Scotland's Year of Architecture, Innovation and Design; the National Museums of Scotland will open ten new galleries; the new Tate Modern will open in June; and the highly anticipated play 'Harry Potter and the Cursed Child' debuts in July.

Number of overseas visits to Britain trend and forecast



Source: VisitBritain 2016 Forecast



Supply outlook

Is it getting harder to soak up the new supply?

This year will see 16,000 rooms added to UK hotel supply, up from 10,000 in 2015. Of these, 7,000 will open in London, more than double the figure added in 2015, according to AM PM. This could cause a headache for hoteliers in the capital. Some cities around the country are also seeing high pipeline figures. The high proportion of budget rooms continues to prop up the supply figures.

London: Overall hotel capacity is set to rise by 12% over the next three years and to exceed 150,000 rooms during 2018, according to research by London & Partners and AM:PM. For 2016 around 90 hotels, plus extensions are now in the pipeline, meaning almost 7,000 rooms, could open in the capital, a 5% increase over 2015. The budget boom continues with around 3,000 new rooms in the budget category (on top of the 3,700 new budget rooms which opened in 2014 and 2015) and budget rooms comprise about 20% of all rooms in London and 33% of the rooms in the active pipeline. That's a lot of budget rooms to fill. A further 3,000 rooms will open in the 4 and 5 star sector, including the Four Seasons Ten Trinity Square, Lincoln Plaza, the Nobu Shoreditch and the Grange Tower Hill. The lion's share of new development is concentrated in the City, Lambeth and Hackney although Hillingdon and Islington will each see over 400 new rooms. Add in the serviced apartments and sharing economy products and it's a lot of capacity.

London seems to soak up the new supply but competition is very much a local issue, for example, there could be pressure ahead in the Shoreditch/Aldgate/Tower Hill area, which is looking a bit crowded. For 2017 there are already approaching 6,000 rooms in the pipeline making potential growth of around 3.9% on the cards, although it's still some way out and the pipeline is likely to change as the year progresses. Around half of these rooms are budgets.

Regions: Overall hotel capacity could expand by 9,000 new rooms in 2016, meaning a 2% growth rate, a notch higher than 2015. Growth plainly varies across the country with Scotland forecast to see around 3% growth but the East Midlands only 1.3%. For 2017 there are currently over 13,000 rooms in the pipeline. This would suggest growth of 1.7%, but it's a long way out and projects can slip or new ones come into the mix. Looking around the country at where developers are busy, Edinburgh could see an additional 1,140 rooms open in 2016 and a further 877 in 2017; Glasgow's pipeline comprises over 1,000 rooms that may open in 2016 and 2017, including the first Hampton by Hilton in Scotland; Manchester continues to see a resurgence in retail, hotel and leisure development, led by the completion of two major leisure destinations within the city centre and 14 hotels. Over 2,000 new rooms could be added during 2016 and 2017, above the long term average.

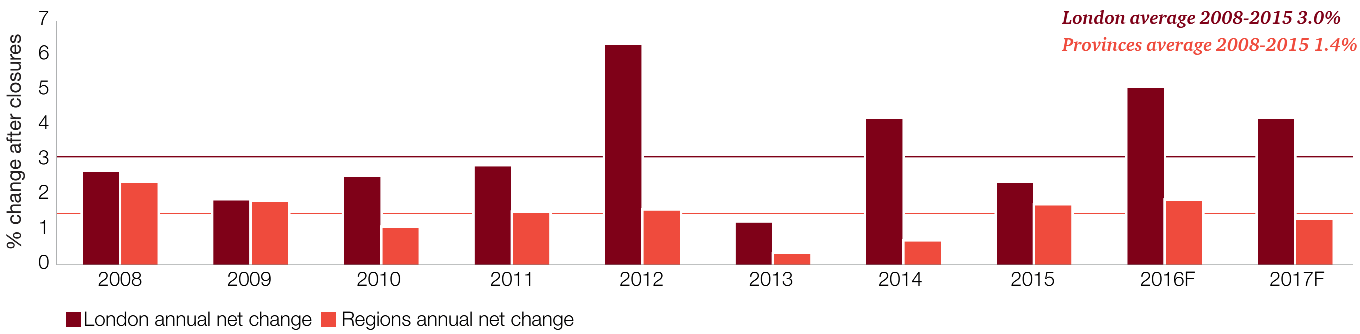
Hotel deals update

2015 proved to be a record year although deal volume finished marginally behind our original forecast of £10 billion at £9.3 billion due to some portfolio deals extending beyond year end i.e. Travelodge and Q hotels. Some major transactions that completed in Q4 2015 included Holiday Inn Kensington Forum for c.£400 million and LRG Group C for c.£1 billion.

2016 has started strong with c.£400 million transacted to date including 2 Club Quarters properties in London for c. £180m. We anticipate 2016 deal volume to be active with current deals including the Grosvenor House Hotel, London and Birmingham Hilton Metropole Hotels, Rosewood Hotel and M by Montcalm (tech city) together with potential portfolio disposals including Atlas Hotels and the London collection of Shiva Hotels. Taking into consideration these current deals in the market and the continued investor demand in the sector we forecast deal volume in the UK to exceed our original forecast of c.£6 billion for 2016.

Chart 2: UK room supply growth

Annual net change in supply (% change after closures)
Figures as at 29 January 2015



Source: AM:PM

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