Turn disruption into opportunity

UK Hotels Forecast 2019-2020

pwc

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Contents

Executive summary

The outlook for 2020 is for slower global economic growth (of about 2.8%) as the global economy is affected by the US-China trade war, the risk of a no-deal Brexit, the threat of a sharp Eurozone slowdown and debt default risks in emerging economies. In August, investors sought safer havens for their money as fears for the global economy intensified. There has also been increasing talk around the inversion of the yield curve (often cited as a predictor of recessions).

Nevertheless, assuming a Brexit deal is achieved, our revised forecasts for UK GDP expect the economy to continue to grow, but at a slower pace than seen recently, averaging around 1% in 2019 and 2020, below its long-term trend rate of 2%, and with risks skewed to the downside.[1]

International tourism is on the rise and 2018 saw a record 1.4 billion international tourist arrivals. But, the UNWTO World Tourism Organisation reports a slower pace of growth than seen in recent exceptionally strong years. Nevertheless, so far, tourism growth exceeds the rate of global economic growth and in the UK, the weak pound has provided an upside for inbound leisure travel.

This latest UK Hotels Forecast reflects these trends with weaker business and leisure confidence and continued high new supply additions. More reliant on UK GDP, regional hotel market conditions are expected to get tougher. While one-off Cricket World Cup related demand probably helped slow regional declines in the summer, it wasn't enough to balance an overall decline in the regional business market and stop a fall in RevPAR for the second consecutive quarter of 2019. Overall, it's been a difficult year so far and 2019's trading performance looks like turning out worse in terms of ADR and RevPAR than we anticipated in March 2019. Our forecast for the regions for 2020 is a -0.6% decline in occupancy growth, a slight gain in rate but a drop in RevPAR of -0.3%.

In London, we forecast some modest growth next year, buoyed by international tourism. Despite our earlier fears in our March update, we expect London will hold on to growth for the rest of 2019, quite a feat given a relentless supply of new rooms. Maintaining the growth will get harder in 2020. While we anticipate occupancy growth to slip into negative territory in 2020, we still forecast 1% growth in RevPAR. However, inflation increases put London's forecast of modest ADR gains under strain.

The hotels industry is at a pivotal point. Looking ahead to 2020, while UK performance will vary widely by geography, segment and business model, we remain more cautious in our outlook. Global and UK political and economic uncertainty, high industry cost inflation, and possible difficulties in recruitment and retention of staff mean that companies need to adopt tech-enabled solutions to increase efficiency, reduce processes, manage data and enhance the customer journey.

NB: Brexit Assumptions

The forecast model, in line with the Bank of England and IMF, assumes a smooth exit from the European Union. Any projections are uncertain given the lack of clarity around Brexit – and a disorderly 'no deal' Brexit could lead to a significantly less favourable outcome for growth, which, in turn, would impact the hotels and leisure sector negatively.

[1] PwC Economic Outlook July 2019. Forecast updated in August

At a glance: our 2020 UK Hotels Forecast

We forecast a weaker and uncertain macroeconomic outlook as factors such as Brexit continue to impact business confidence and bookings. 2020 hotel performance will vary by geography, segment and business model but tougher market conditions are already taking hold in the regions and new supply will exacerbate this for at least 18 months. London is expected to hold on to some growth.

Occupancy

Regions

-0.6%

75.5%

Historically high but new supply and weaker demand are starting to bite.

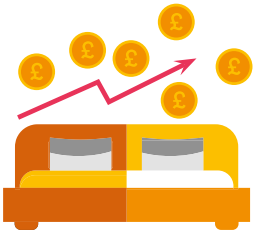
London

-0.3%

84.0%

Not much headroom as the capital is already pretty full. The weak pound has helped buoy up leisure travel so far.

RevPAR



Regions

-0.3%

£54.2

Tougher conditions and a competitive market mean leaner pickings.

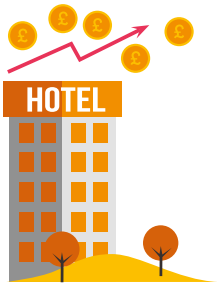
London

+1.0%

£128.9

Modest growth in the face of cost inflation and other concerns.

ADR



Regions

+0.3%

£71.8

Business travel uncertainty and a soft meetings and conference market isn't helping.

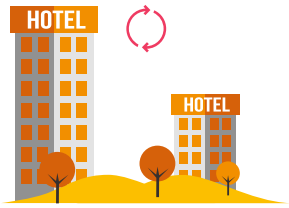
London

+1.3%

£153.4

ADR uplift is driving our forecast RevPAR growth. Farnborough International Air Show and UEFA Euro 2020 will help.

Supply



Regions

+1.6%

Big supply numbers will mean a hangover across some UK cities.

London

+1.7%

Will greater supply mean greater growth?

Source: Econometric forecasts: PwC July 2019, Benchmarking data: STR June 2019

Spotlights

In this year's forecast, we also look at several areas of increasing interest for hoteliers and investors. We explore what disruptions are affecting the hotels sector and look at how hoteliers can capitalise on new challenges to create opportunities, as well as focus on the changing trends in deals and what it means for investors.

Guest-centric transformation

In recent years, the hotels sector has seen guest expectations around experience evolving, and an increasing digitisation of guest services. As these trends continue to merge, hotels are starting to realise they have gaps in their strategies that present new challenges for which they are not adequately prepared. We look at how, by understanding the needs and desires of current and future guests, hoteliers can lead successful guest-centric transformation.

Deals outlook

Protracted Brexit uncertainty, ongoing volatility in economic growth and weakened market sentiment have all contributed to investor nervousness. We look at what this means for future deal activity and some of the emerging trends for leases across the sector. In such an uncertain UK market, investors are seeking risk-adjusted returns: either by minimising the risk of potentially volatile income through leasing their hotels to operators, or from seeking enhanced returns by taking advantage of the competitive pricing being offered on ground leases by long income funds.

Cyber security

As hotels become increasingly dependent on technology and move to embrace the efficiencies of digital, they need to be aware of potential weak spots in a hotel's cyber security. Any data breach or cyber attack – whether through the hotel's systems or third-party applications – can have significant financial and regulatory implications. We look at how hoteliers can securely protect their assets from the many opportunities that systems present for hackers.

What does the future hold for EU nationals?

An on-going concern around Brexit for the hotels industry is the status of EU nationals workers' rights. Depending on circumstances, an EU national currently resident in the UK for 5 years or more will obtain a form of permanent residence known as 'Settled Status'. Those who have been resident for less time will initially be granted 'Pre-Settled Status', which they can later convert to 'Settled Status'. Future immigration changes will depend on which Government will be in place and whether there is a 'deal' or 'no deal'. We look at what proposed immigration system may come in place and what this means for EU workers.

Key themes

Tougher market conditions, especially outside of London

Trading conditions are getting tougher, especially in the regions outside of London, where operators are seeing reduced demand. This is reflecting weaker business and leisure confidence and continued high new supply additions. This weaker demand trend is coinciding with higher costs, which cannot be passed on to guests.

Cost inflation and other concerns increase

The costs of operating hotels continue to increase above UK inflation rates in 2019, and operators find it difficult to pass these increases on to guests through a higher room rate due to the competitive nature of the market.

The devaluation of the pound has pushed up the cost of importing raw materials such as food and drink for hotels. Low UK unemployment rates, a reduction in EU nationals recruitment due to Brexit concerns, and above-inflation increases in the minimum wage have all contributed to increased costs associated with acquiring, training and retaining staff. In addition, as in 2018, utilities bills continue to increase at around 3 times the UK inflation rate.

The net result is that the potential drop through from any increases in top line revenue is likely to be reduced in 2019. In the regions, gross operating profit has continued the negative growth trend seen in 2018, while London has been less impacted in H1 2019 because of higher revenue growth.

Weaker sterling supporting international leisure visits

The pound has been plumbing new depths over the summer. While its slide might be a silver lining for tourists, it could also show that the markets are judging that Britain's economic prospects may worsen as a result of Brexit.

> "Weaker trading conditions are settling in across the UK, especially in the regions. Softer demand together with cost inflation will impact profit margins and create a nightmare scenario for hoteliers.
>
> Shane Harris, CEO Jupiter Hotels, August 2019[2]

Business demand concerns remain

Lower consumer confidence and business investment appear to be already having an effect on corporate travel trends. Whitbread reported a marked slowdown in their short-lead business bookings in Q1 2019.[3] Overseas tourism data suggests business visits are in decline over the longer term. For the domestic market, meetings and conference demand remains volatile, with recent evidence of fewer conferences per venue and fewer delegates attending those conferences. Meetings of all sizes make up a good portion of many cities' hotel business and currently this market remains soft.

Cricket anyone? (or tennis or rugby)

Sporting events have had a positive effect on London and several regional destinations this summer. UEFA Euro 2020 should boost London and Glasgow in 2020. However, our research does show sports events have a relatively minor impact on ADR over a full year.

Will staycations come into their own?

The falling value of sterling may increasingly make the UK look like a bargain destination for inbound visitors, but for UK tourists considering heading abroad, with the more expensive foreign currencies, many may see the benefits of a staycation.

No end to high levels of new supply (yet)

There has been no sign of a pipeline slowdown. London and the regions are still seeing high levels of new supply continuing to open. Perhaps the slowdown story will be in 2021? Given the tougher trading environment, supply will dampen trading growth over the next 18 months.

[2] In an interview with PwC August 2019

[3] Whitbread Q1FY20 Trading Update, 19 June 2019

Deal volume slows

UK hotel investment volumes have seen a decline in 2019 compared with the higher than average levels in 2018 due to uncertainties of Brexit becoming more acute, ongoing volatility in economic growth and weakened business sentiment. Investor appetite will remain cautious until there is further clarity on the outcome of Brexit but with an expectation for continued inward investment from Europe and the Far East in 2019. We predict 2020 hotel transaction volumes to continue to marginally fall to c. £4.85 billion even if a Brexit deal is secured. In such an uncertain UK market, some investors are looking to protect their returns with the income stability offered by leasing their hotels to operators; while other investors are seeking to enhance their returns by taking advantage of the increasingly competitive pricing arbitrage offered on ground leases by long income funds. We expect this trend to continue for investors in 2020.

Cost savings, disruption and alternatives

Unsurprisingly, hotels are seeking to maximise guest spend while mitigating costs and improving operational and staffing efficiency. In addition, some hotels want to move to more flexible and leaner operating models and brands, matching products to what consumers value. Flexible, harder-working lobby spaces have become an opportunity to increase guest spend, often with smaller guest rooms. Dual branded joint sites, such as the Moxy/ Marriott Residence Inn, Slough, for example, offer cost savings for brands and owners, as well as land and construction cost savings and possible premium pricing opportunities. The recent Hotel Alternatives Conference heard that ever-rising costs were forcing hoteliers to adopt innovative approaches to retaining and training staff, making sure staff are engaged and invested in the business.

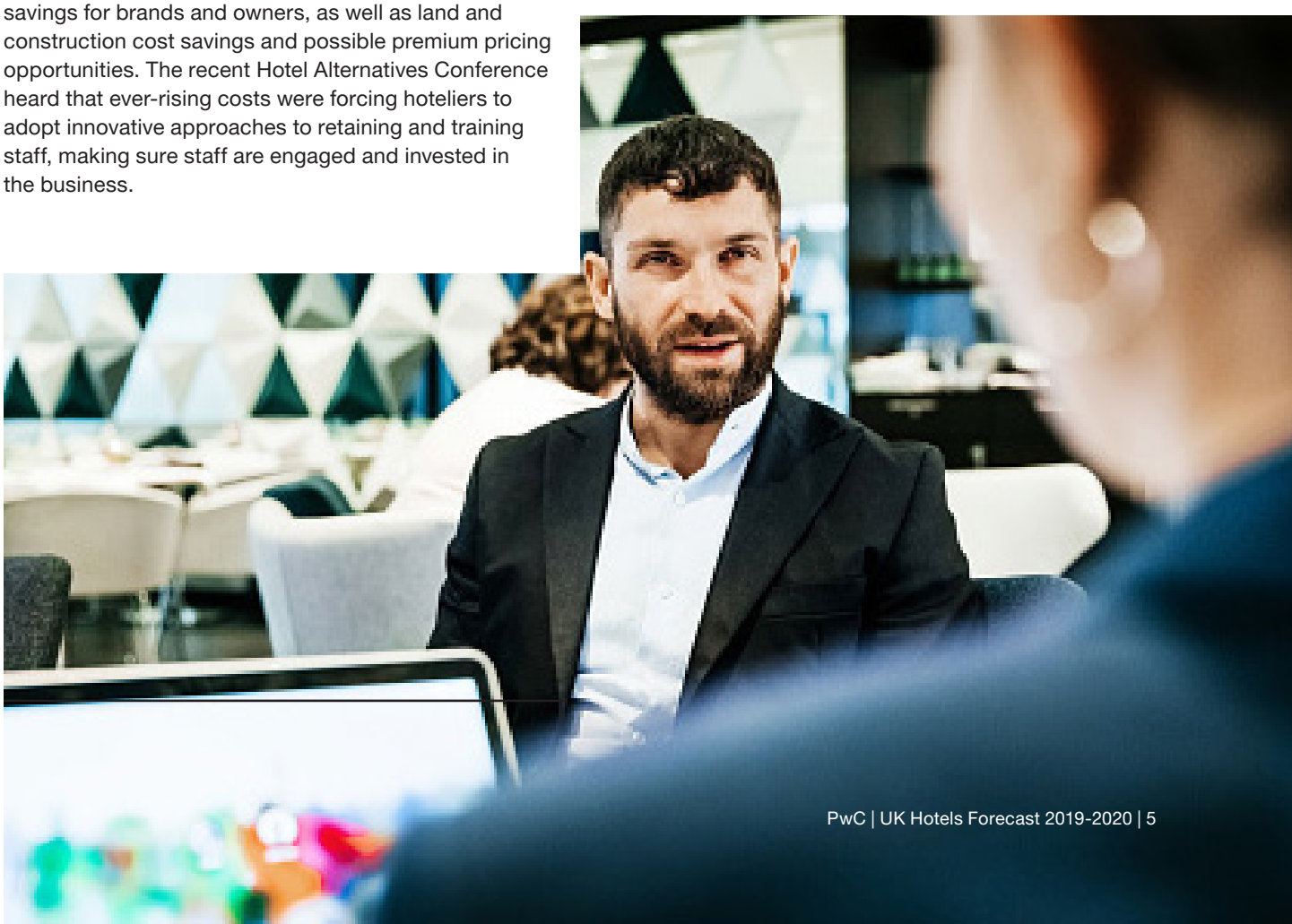
> **“We think a lot about Google, we think a lot about Facebook. Any time someone sits on a broader mountain than you, you have to be careful.**
>
> Mark Okerstrom, CEO Expedia Group (asked by Sebastien Bazin, CEO Accor what keeps him awake at night, at the IHIF, March 2019)

In the future we expect to see more blurring of the lines and hotels adopting ideas from ‘alternatives’ such as the experience sector, hostels, serviced apartments, home share and even co-working spaces.

Innovate to keep growing

To continue to grow successfully the sector needs to innovate. Today, as we have seen, costs remain a big issue for all hotels, but there are plenty of ideas for innovation: AI technology; no front desk to check in; better design; in-room technology; efficient construction techniques and so on.

Our guest-centric transformation spotlight covers some of these innovations in more detail (see page 29).



The London 2020 forecast: still sparkling

Sport and meetings brought in the crowds in H1 2019

It seems extreme performance metrics are becoming more common. For example, London saw the highest ADR and RevPAR metrics ever recorded in STR's London database in March and June 2019. And overall, the first half of 2019 saw a strong performance, despite continuing high new supply additions. On average, London has seen occupancy gains of around 1.1% in the six months to June, to average 80.7% – a high metric at the half-way stage; ADR increased by 3.4% to reach £145.17 and RevPAR was boosted by 4.7%, to reach £117.91. Supply to date has seen a 2.2% increase against a 3.3% improvement in demand.

London luxury hotels saw RevPAR leap by 21.5% in June, mainly driven by a 16.5% rise in ADR, while for the first six months of the year, RevPAR increased by almost 8%. The midscale/economy segment also saw a growth spike in June of around 11% but more modest growth overall in the first half of the year, albeit against some weak comps in 2018.

What has been driving demand? Despite no uplift for hotels from the biennial Farnborough International Airshow this year, the ICC Cricket World Cup (30 May-14 July) helped uplift hotel occupancy in London, with matches held at the Oval and Lord's. Hoteliers also tell us they enjoyed a better than 'normal' Wimbledon (1 July-14 July). Continuing the sports theme, Major League Baseball also came to London Stadium in June, contributing to the uplift in hotel performance.

A variety of large meetings and conferences also helped drive demand. STR analysts note that multiple events contributed to higher ADR levels in June, including the European Association of Geoscientists & Engineers Conference (3-6 June), IFSEC International (18-20 June) and Global Offshore Wind 2019 (25-26 June).

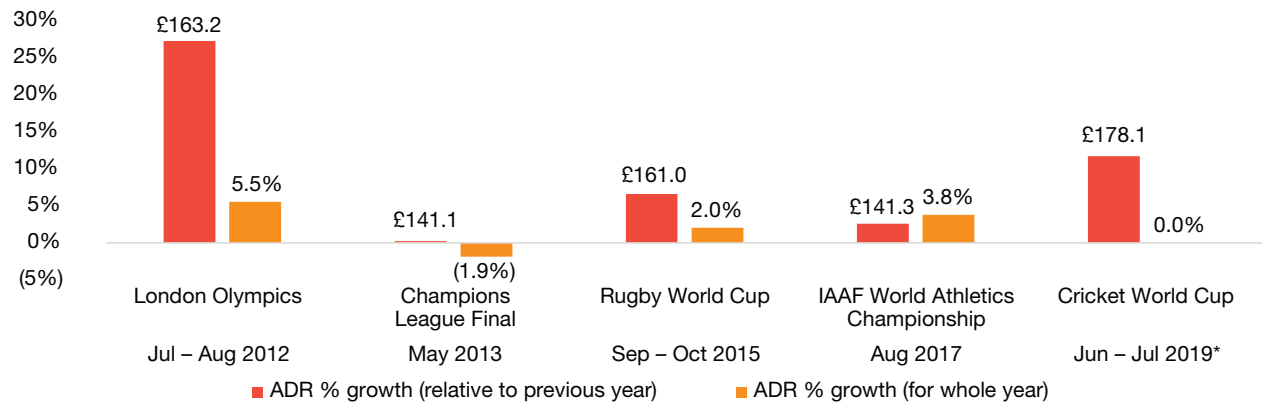
But, how much can sports events help lift ADR in 2020?

Figure 1 shows that sports events can have a pronounced impact on ADR. This is true during the event, but the annual impact is often relatively moderate. Event timing and the demographic and spending power of the sport's followers make a difference. Some events may also impact the year negatively, displacing existing traditional business patterns as travellers fear disruption or high prices and avoid a destination. The sport this summer helped make June a very successful month for hoteliers this year.

Supply: onward and upward

London continues to see high levels of new supply growth. Currently, London has around 141,000 rooms (May 2019, AM PM database). Around 22,500 new rooms have been added to London's existing hotel room supply in the five years since 2015, and 2019 is set to see approximately 6,500 further rooms open, the highest total since the Olympics room bonanza in 2012. In 2020, a further 6,400 are set to open. With weaker demand, trading in less centrally located areas may suffer.

Figure 1: The impact of sporting events on London ADR



Source: STR data; PwC analysis.
Note: *Cricket World Cup only reflects June data as July isn't yet available

Latest London forecast

Strong demand lifts the capital

In this latest remodelling of our forecast, we have analysed the latest demand and supply trends and spoken to hoteliers to gauge the most likely forward trajectory.

This time, we predict further 2019 H2 growth, albeit less robust than seen in 2019 H1, as the comparable in Q4 are likely to prove challenging. We expect incremental growth in 2020. With London so full, our forecast for 2020 is driven by ADR uplift from the Farnborough International Airshow, as well as football demand from the seven UEFA Euro 2020 games (including the final) at Wembley. The weak pound should also continue to underpin leisure demand.

At this stage of the cycle, it's a remarkable performance against high supply additions and demonstrates why London is the darling for many investors, owners, operators and brands.

Occupancies: almost full?

We anticipate weaker occupancy growth than we forecast in our March 2019 update. Already, London occupancies have slipped in April, May and July 2019. With occupancy levels just over 84% this year, we anticipate a marginal decline of -0.3% in 2020, to 84%. These levels of occupancy are very high by global standards. The higher proportion of budget hotels operating in the capital, with their high levels of occupancy, helps to drive overall occupancy skywards.

ADR drives growth, but inflation impacts

With London occupancies so high, we look to rate gains for growth. We anticipate 2019 will see around 2% ADR growth to £151.5. In 2020, we expect rates to nudge up by 1.3% to £153.4.

RevPAR forecasts

Together, occupancy and ADR drive 3% growth in RevPAR this year to £127.7. A further 1% growth in 2020 pushes up RevPAR to £128.9. With record levels of occupancy and ADR, it's no surprise that London RevPAR also reaches new heights.

However, our inflation assumptions of 2% in 2019 and 2.1% in 2020 mean that hoteliers are barely keeping up this year and falling behind next year.

Table 1: PwC 2020 UK hotels forecast, Growth gets harder to find

	London			Regions		
A: Actual | F: Forecast	**2018A**	**2019F**	**2020F**	**2018A**	**2019F**	**2020F**
Occupancy %	83.5%	84.3%	84.0%	75.9%	75.9%	75.5%
ADR (£)	£148.5	£151.5	£153.4	£72.1	£71.6	£71.8
RevPAR (£)	£124.0	£127.7	£128.9	£54.7	£54.4	£54.2
% growth on previous year						
Occupancy	2.0%	1.0%	(0.3%)	0.2%	0.0%	(0.6%)
ADR	1.0%	2.0%	1.3%	1.1%	(0.7%)	0.3%
RevPAR	3.1%	3.0%	1.0%	1.3%	(0.7%)	(0.3%)

Source: Econometric forecasts: PwC July 2019; Benchmarking data: STR June 2019

The regions 2020 forecast: leaner pickings

A disappointing year for the regions

Overall, it's been a difficult year so far and 2019's trading performance looks like turning out worse in terms of ADR and RevPAR than we anticipated in March 2019.

The UK hotel forecast reflects weaker business and leisure confidence, including sluggish meetings and conference demand, as well as continued high levels of new supply.

While Cricket World Cup-related demand probably helped slow regional declines, it wasn't enough to stop the regional fall in RevPAR for the second consecutive quarter of 2019. At the half year, regional RevPAR performance was down 1.9% on the same period in 2018, driven by a 0.6% decline in occupancy to 73.0 % and a 1.3% fall in ADR, to £69.29.

Large regional hoteliers we have spoken to say they noticed the turning point back in Q3 2018 and although there have been pockets of good trading around the country this year, business is already moving backwards.

Britain's largest hotel group, Whitbread, reported a Q1 2019 RevPAR decline of -6.3%.[4]

Industry fears that if these declines continue it could herald a price war and a challenging environment for hotels. Branded budget hotels are some of the most efficient and recession resilient of any hotel business model, so the difficulties inflicted on Whitbread by the current slowdown in regional business demand will be viewed with apprehension.

> "We have delivered a resilient performance in the first quarter despite more challenging market conditions and we continue to make good progress with our efficiency programme, which is helping to partially offset another year of high industry cost inflation
>
> Alison Brittain, Whitbread PLC Chief Executive[5]

Cricket success

Looking at the first half of 2019, the ICC Cricket World Cup helped boost the fortunes and particularly the ADR of hotels around the UK. Industry benchmarkers, Hotstats, reports that June profit performance hit a peak for the year as the typically strong month of June was boosted by Cricket World Cup demand.[6]

Cities benefiting from the cricket included Manchester, host to four matches at Old Trafford in June and three matches in July. These helped lift RevPAR by 6.6% in the month of June to £80.97 and occupancy to 88.3%. RevPAR grew by 3.3% over the six months to June. Edgbaston, Birmingham, hosted matches in June and July and saw a 5% increase in ADR push up RevPAR by 8.2% to £70.34 and occupancy exceed 78%. Southampton's Hampshire Bowl hosted five matches in June, when an ADR gain of 11.1% supported RevPAR growth of almost 16%, to £77.18 and a H1 performance +6.2%. Trent Bridge hosted matches in May and June and Nottingham enjoyed a 13.5% boost to RevPAR in the month of June and +4% lift to the city's half year performance. Headingley, Leeds, hosted four matches in June, helping Leeds secure an 11% gain in RevPAR in June.

However, while a few other destinations posted positive gains, including York (+2.6%), there were many more RevPAR declines, including Belfast, affected by record numbers of openings in 2018 (-15.4%), Heathrow Airport (-10.3%), Newcastle (-3.7%), Cardiff and Coventry (-2.8%) and Edinburgh (-2.3%). Liverpool RevPAR was down 3.2% but the Netball World Cup helped performance in July with a 4.6% RevPAR gain driven by rate growth. July saw an improvement for Belfast, too, as the city enjoyed a very positive 27% gain over the same month in 2018, but for the seven months to July 2019 Belfast is still experiencing a 9.3 % RevPAR fall.

In terms of winners and losers, the midscale/economy sector has underperformed the market during 2019, as new supply and extensions continue to open.

[4] Whitbread Q1FY20 Trading Update 19 June 2019

[5] Whitbread Q1FY20 Trading Update 19 June 2019

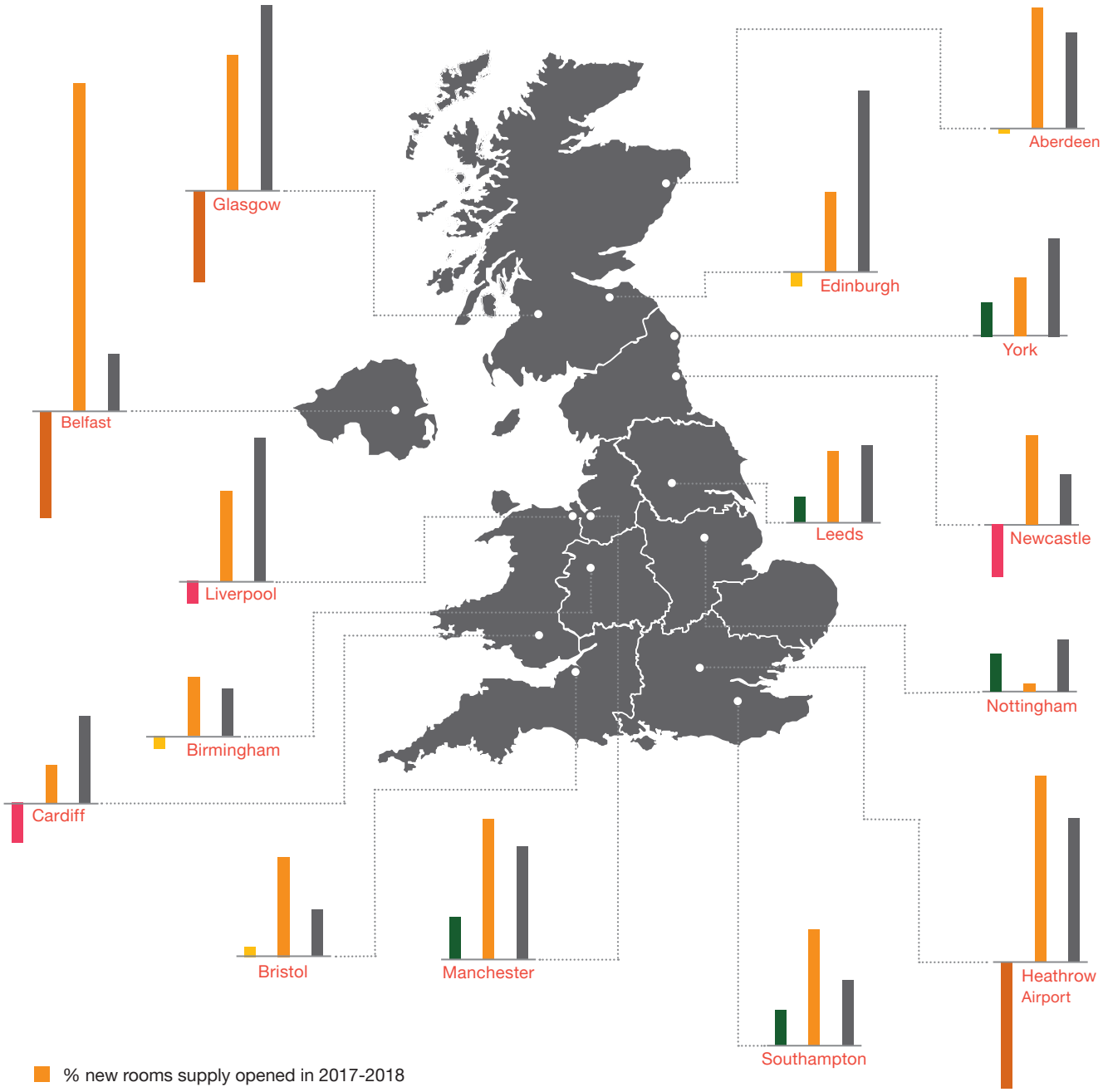
[6] Cricket World Cup Swings UK Hotels to GOPPAR Highs, HOTSTATS, Monthly trends insights, 26 July 2019

Gung-ho supply

Hotel development pushes on across the regions. The UK Hotel Market Tracker from Alix Partners reports that the regions saw a 2% increase in supply over the past 12 months and that the regional active pipeline accounts for 6% of current room supply.[7]

The heat map below clearly shows how factors such as supply have contributed to a challenging performance in some markets around the UK so far this year. With more supply due to open in 2019 and 2020 this is likely to exacerbate difficult conditions.

Figure 2: New rooms supply and RevPAR growth heat map



% new rooms supply opened in 2017-2018

% new rooms supply due to open in 2019-2020

2019 RevPAR growth

+2% and higher

-1% to +1%

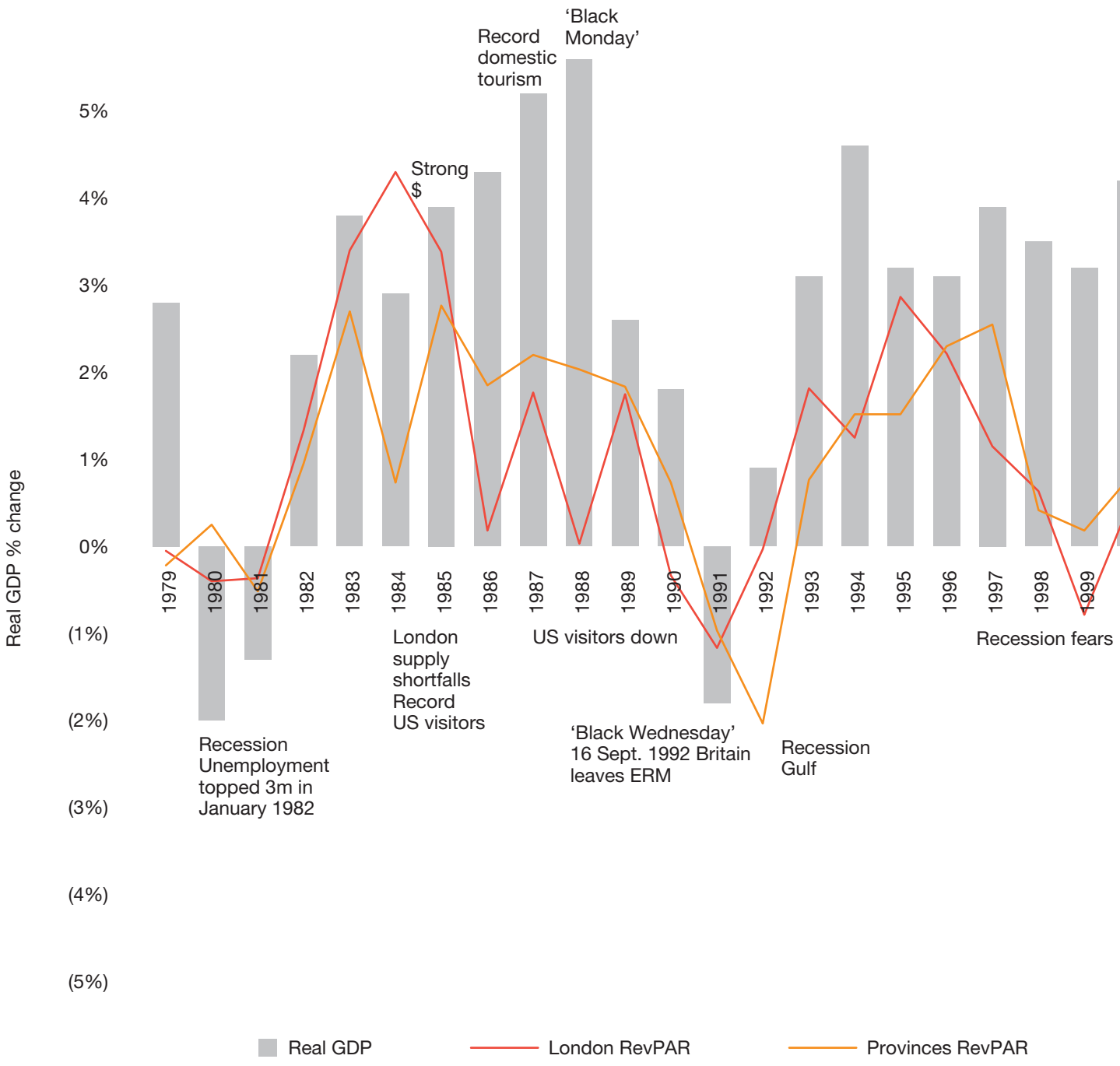
-5% to -2%

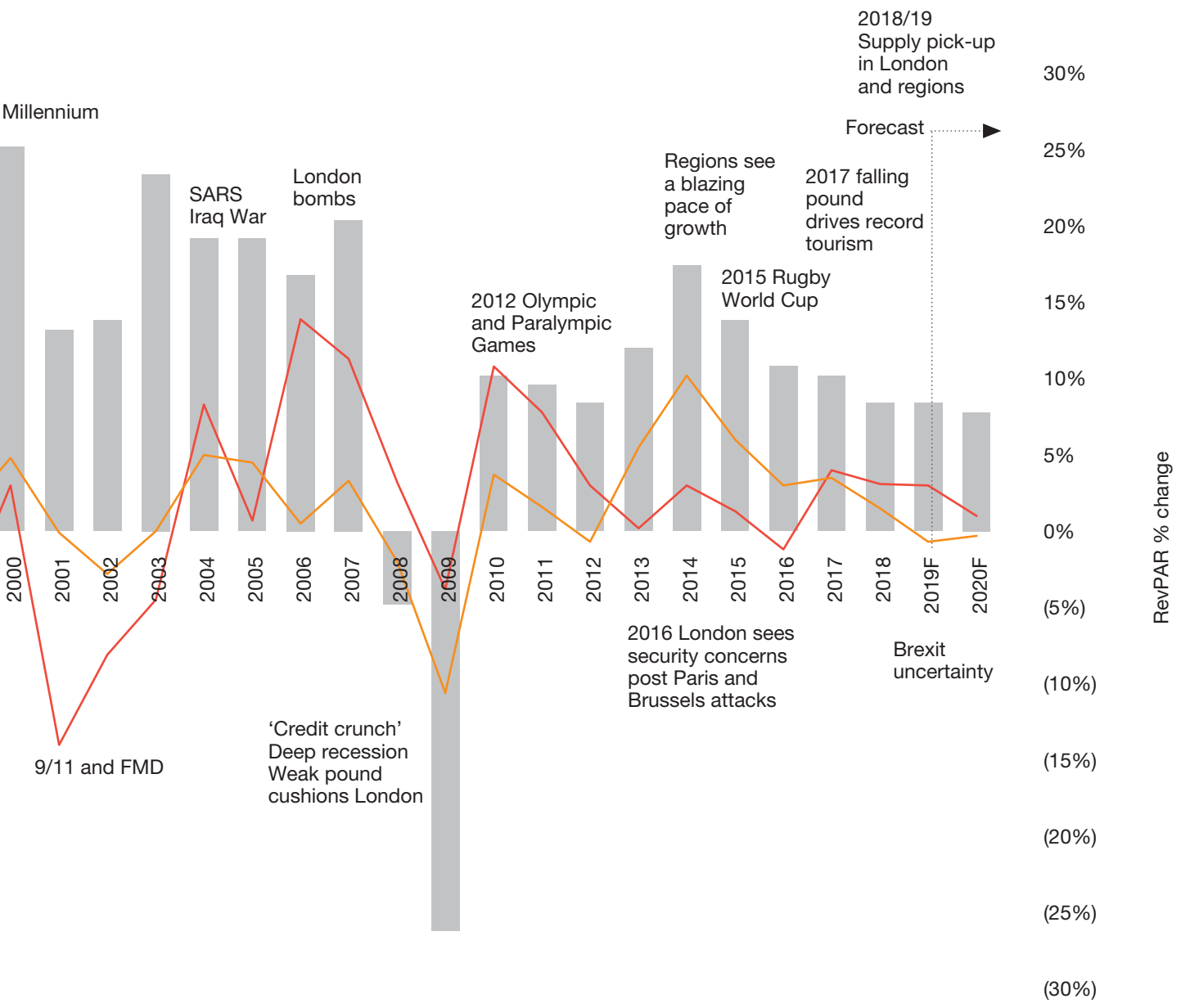
-5% and lower

Source: STR, AM PM and PwC Analysis 2019

[7] Alix Partners, HVS, STR, UK Hotel Market Tracker: Q2 2019

Figure 3: Growth slows Real GDP growth, revenue per available room (RevPAR) 1979-2020F





Source: Econometric forecasts: PwC July 2019
NB: Dual axis GDP on left and RevPAR on right
Macroeconomic data: National Statistics
Benchmarking data: Hot Stats STR Supply data STR July 2019

Our latest forecast for 2020 anticipates softer trading continues

Regional hotel performance is more tied to the strength of the UK and regional economies than London, where international demand is a key driver of travel. While our base economic scenario assumes an orderly Brexit, growth is still proving weaker than we have seen lately. Uncertainty and prospects of weaker economic growth are likely to impact domestic business demand and consumer expenditure on holidays and hotel accommodation. Meetings of all sizes make up a good portion of many cities' hotel business and currently this market remains soft.

In terms of economic growth, the South East and Scotland could be the best-performing regions this year, while most other English regions are projected to expand at close to the UK average rate of 1.4%. The North East and Northern Ireland are predicted to lag slightly with growth of only around 1% in 2019.[8]

Occupancies remain high but hover below 76% occupancy level

Our latest forecast anticipates regional hotels enjoying an occupancy level of around 75.9% in 2019, flat compared to 2018, but high historically. For 2020, we expect a marginal slip of -0.6% to 75.5%.

ADR growth falters a little – was 2018 the peak?

A rule of thumb that is often cited is that when occupancy rates are over 72% operators can leverage rates. So, with regional occupancy levels above 72% since 2013, it's easy to see why ADR has been rising.

RevPAR remains high by historic levels

We forecast small declines in RevPAR growth in 2019 and 2020. RevPAR could fall by -0.7% this year with an additional decline of -0.3% in 2020, taking regional RevPAR to £54.4 in 2019 and £54.2 in 2020.

[8] PwC Economic Outlook, July 2019

Key drivers

UK economic outlook: uncertainty rules

Economic growth has been volatile in recent quarters. Consumer spending growth has remained relatively strong, and government spending has picked up somewhat, but business investment contracted for four consecutive quarters in 2018 as uncertainties around Brexit have increased. UK exports have also been held back by a slowing global economy over the past year.

Investment rose slightly in the first quarter of 2019, and stock building jumped, but this was only a temporary increase owing to contingency plans for a possible 'No Deal' Brexit at the end of March.

This was confirmed by preliminary estimates showing that GDP growth fell to -0.2% in Q2 2019 as business investment fell back again and firms ran down stock levels. Growth is likely to remain volatile from quarter to quarter as we approach the next Brexit deadline at the end of October. In our projections, we still assume that a deal will be struck at some point, but the timeline for this is unclear.

On the brighter side, the UK jobs market has generally remained strong, with the employment rate at record levels and unemployment down to its lowest rate since the mid-1970s. Over the past year, the scarcity of workers has finally lent them some bargaining power, which has fed through into increased real wage growth. But this will be difficult to sustain in the medium term, unless productivity growth also picks up from the subdued rates seen over the past decade.

Overall, our latest main scenario is for UK GDP growth to average around 1% in 2019-20, assuming a reasonably orderly Brexit, while consumer price inflation averages around 2% over this period. Our main scenario projections for growth and inflation are broadly similar to the latest consensus and OBR forecasts, and indeed the latest Bank of England forecasts, but all are subject to significant downside risks in the event of a disorderly Brexit and/or a sharper downturn in the global economy.

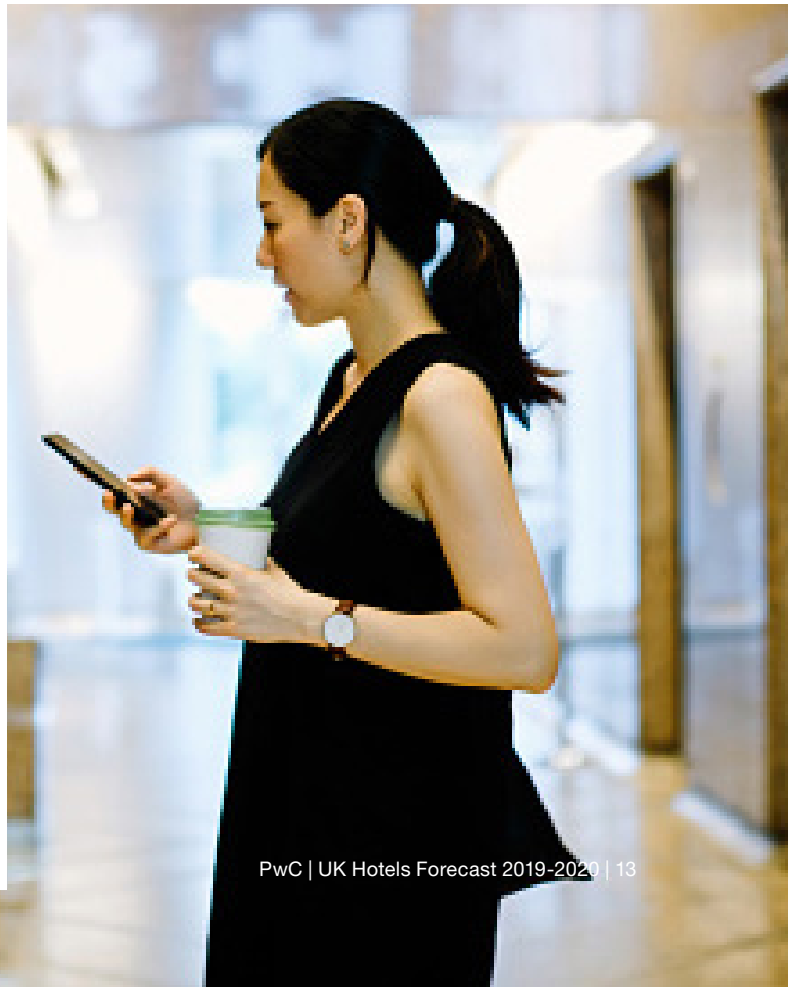
These macroeconomic risks also point to an uncertain outlook for the UK hotels sector. Brexit-related uncertainty is likely to be felt particularly strongly within the regions, as a weakened pound may provide a short-term boost in travel to the capital. That said, depressed consumer confidence and decreased business investment will have an impact throughout the UK in the event of a disorderly Brexit and/or a sharper global downturn.

Regional prospects

In contrast to previous years, and indeed decades, where London has generally had the strongest growth rate of any UK region, our latest projections suggest London will grow no more quickly than the UK average in 2019. This is partly due to the greater exposure of some London activities (e.g. the City) to adverse effects from Brexit-related uncertainty, as well as growing constraints on the capital in terms of housing affordability and transport capacity.

If, as we assume in our baseline forecasts, a 'No Deal' outcome is avoided, and greater clarity is provided on Brexit, we expect London could see growth accelerate to around 1.5% in 2020, although this rate would still be markedly slower than the pace seen in past periods.

However, it is important to note that as regional output data is published on a less-timely basis than national data, the margins of error around these regional output projections are even larger than for national growth projections.



Travel outlook: inbound leisure benefitting

The UK is an important international tourism destination. So far, the travel outlook has been largely supportive of hotel demand, unsurprisingly in travel to London, but also travel to other well-known tourist cities, such as York.

The exchange rate is helping inbound leisure trips, but not business tourism or domestic demand. The weakened pound may provide a short-term boost in international investment and travel to the capital, but reduced consumer confidence and business investment is having a negative effect. Domestically, meetings and conference bookings remain unpredictable, with fewer conferences per venue and fewer delegates attending.

On a positive note, the sector saw record numbers of inbound visitors from some areas of Europe and North America this year.

Looking ahead, UEFA Euro 2020 should help Glasgow and London hotels and a new Government Tourism Deal is intended to help tourism businesses attract more visitors, become more digitalised and ultimately, more profitable.

Positive global backdrop but growth pace slows

Globally, tourism is on the rise. In 2018, there were a record 1.4 billion international tourist arrivals. The UNWTO World Tourism Organisation reports that international tourism continues to grow, above the rate of global economic growth, though at a slower rate than in recent exceptionally strong years. Overall, UNWTO forecasts moderate growth of between 3% and 4% in international arrivals in 2019.

Uncertain UK outlook

While the travel backdrop for the UK has also been largely positive, early trends have not been as strong as expected. Nevertheless, supported by a weak pound, some markets such as North America (traditionally a high spend market) and parts of Europe remain very strong.

Business travel concerns

Inbound business visits reached a new record for March, although the IPS reports that they are still in decline over the longer term. UK business travel has suffered from the uncertainty around Brexit, with some operators reporting weaker corporate group business, especially longer-stay ‘project-based’ bookings.

Meetings and conference bookings

These are a key demand driver in hotels and remain weak, while conferences get smaller. The Meetings and Industry Association (MIA) reports that economic and political uncertainty around Brexit has not impacted rates, but may have been the catalyst for a ‘disappointing’ drop in the number of meetings per venue in Q1 2019. The average number of meetings per venue from January to March 2019 were ‘well down’ compared with the same period in 2018 and 2017, likely due to concern among clients as the UK approached the original 29 March Brexit deadline.

In the longer term, environmental and sustainability concerns are likely to impact corporate thinking and support the adoption of new technology and video innovation in this sector. A Sykes report[9] stressed that 20% of those surveyed wanted to book more sustainable holidays in 2019 and 33% said that being greener was one of their New Year’s resolutions which related to leisure, travel and business.

Holiday visits buoyed up

International holiday travel to the UK has been a strong driver of demand for accommodation. Inbound visits were down 1% year-on-year in March (at 1.1 million). However, January and February saw holiday visits in the first three months of the year up 7% compared to 2018, reaching just under 2.7 million visits. In the 12 months to March 2019, holiday visits were up 2% year-on-year, totalling 15.3 million.

[9] Sykes Cottages, Sykes Staycation Index 2019

Sterling underpins leisure markets

Current economic and investment uncertainties have seen sterling significantly weaken in the last three years. This trend is expected to continue while the UK political situation remains unclear.

Although tourism visits to the UK from the EU15 markets continued to decline over the longer term, visits from other EU markets reached a new record for March. Visits from European countries outside the EU saw the largest year-on-year growth at 31%. Results for North America were also positive, posting their highest number of visits for Q1 since 2006.

UEFA Euro 2020 comes to London and Glasgow

Football sells hotel rooms. Madrid's hotels saw record ADR and occupancy during the UEFA Champions League Final in June 2019. UEFA Euro 2020 sees London and Glasgow host several matches in June and July 2020. Wembley will host 3 group matches, a knock-out round match, the semi-finals and the final. Glasgow's Hampden Park will host 3 group matches and a knock-out round match. Hoteliers will be hoping for an influx of football fans desperately in need of accommodation.

Could staycations lift demand?

The falling value of sterling has seen many UK tourists assessing the benefits of a staycation, with hotels, holiday villages, rental cottages, shared homes, Airbnb properties and campsites all competing for a share of the market.

'Screen tourism' continues to boost visitor numbers around the country. Barclays 'The Great British Staycation' highlights how scenery from films and TV shows, such as **Skyfall** (Glen Etive, Scotland) and **Poldark** (the Cornish coast) and **Game of Thrones** (Causeway coast, Belfast), is driving visits and attracting fans.[10] Birmingham saw a record number of tourists last year as fans of **Peaky Blinders** journeyed from across the globe to visit the location of the popular BBC series.

2019 31% domestic holidaymakers plan to spend more time in this country that they did in previous years

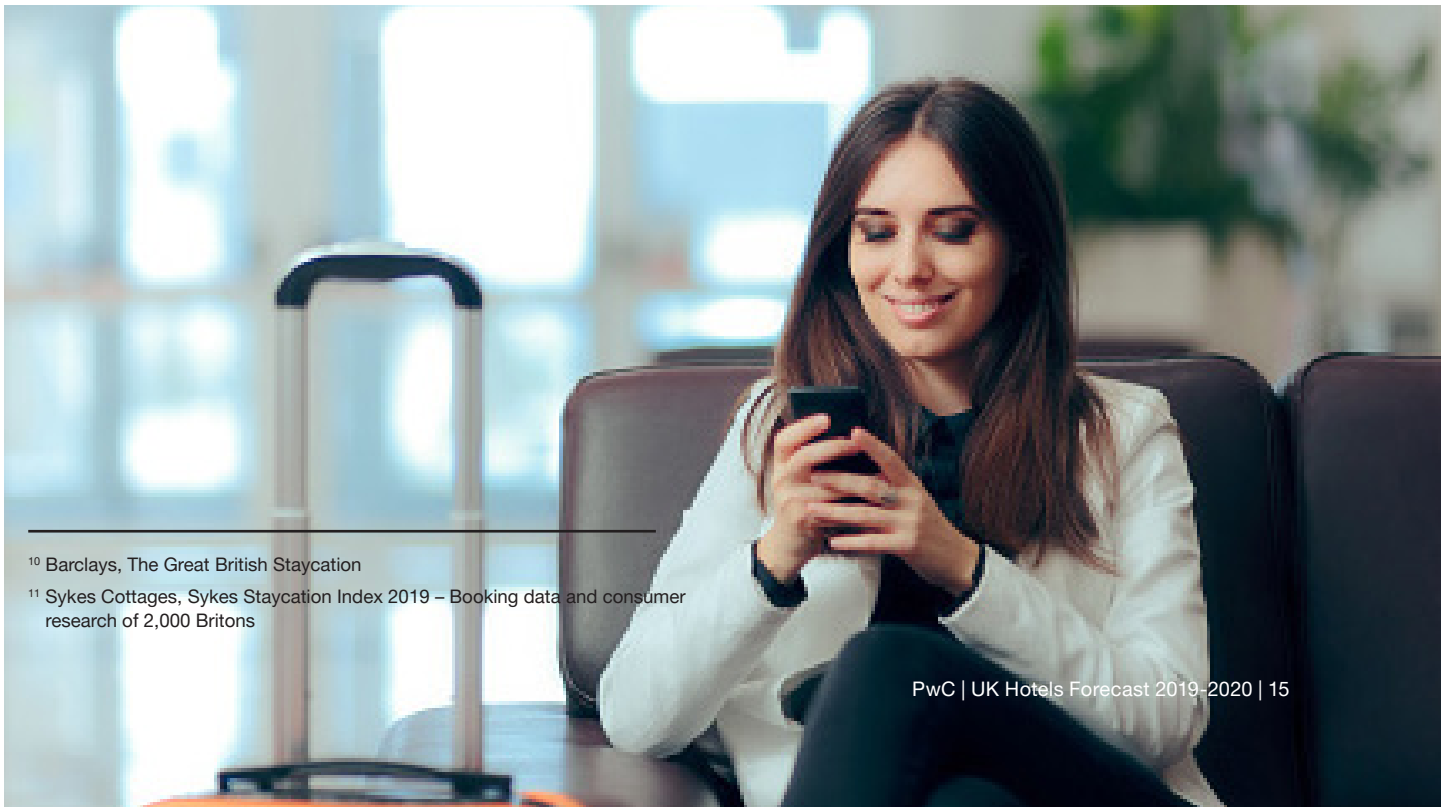
Reasons: convenience, replicating a previous holiday, greater affordability

Bookings for Sykes Staycation holidays soared by

36% year-on-year in 2018[11]

New recognition for UK tourism

The UK Government recently awarded the UK tourism industry a new Sector Deal as part of its Industrial Strategy. The agreement aims to give special focus to the sector to attract another 25 million visitors per year by 2025.



[10] Barclays, The Great British Staycation

[11] Sykes Cottages, Sykes Staycation Index 2019 – Booking data and consumer research of 2,000 Britons

Supply outlook: still some big numbers

No slowdown in pipelines (yet)

The economic and political uncertainty hasn't led to developer caution or a pipeline slowdown. Instead, London and the regions are seeing high levels of new supply continuing to open. Perhaps the slowdown story will be in 2021? Only around 74 hotels and around 12,500 rooms feature in the 2021 UK pipeline (with almost 4,000 of those rooms in London), although this may partly be due to the time scale and we expect more rooms will be added as 2021 approaches. There is often a lag between declines in demand and a slowdown in new supply due to the lengthy hotel planning and development process. Whitbread has said that it might slow its Premier Inn extension building programme in the short term.[12]

The Government Tourism Sector Deal intends to prepare Britain for an extra 9 million visitors per year by 2025, with a commitment to build 130,000 new hotel rooms – 75% outside London. However, currently it is unclear how this might work and how the business case for development would be made.

Some destinations around the world are displaying a more restrictive attitude towards 'over-tourism' and hotel development. For example, Amsterdam has seen a clamp down on hotel development, with hotel development now only permitted in designated areas. Could we see this come to some of our most popular destinations?

Already there has been growing talk of tourism taxes in the UK as a way for councils to alleviate central funding shortfalls, and generate new revenue. The Local Government Association recommended that councils should have the option to introduce a tourist tax in consultation with their own businesses and communities.

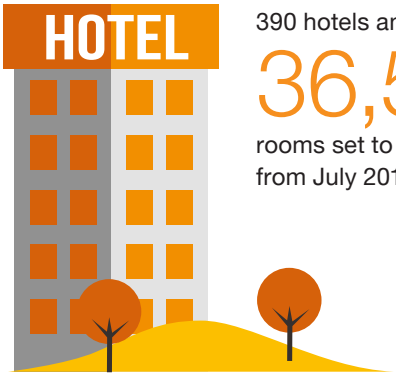
Figure 4: Additional rooms by year for London and Region

Source: AM PM Database and PwC Analysis 2019

[12] Alison Brittain, Whitbread CEO, replying to questions at an Analyst Briefing Call on Whitbread's presentation of its Q1 FY20 Trading Update

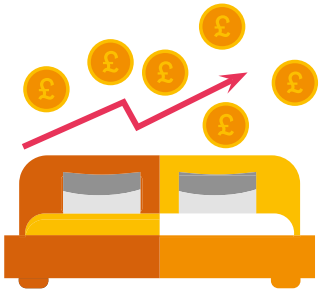
The big numbers

Branded budgets and four-star hotel rooms dominate the 2019 and 2020 pipeline across the country. Budget hotels account for close to 30% of the London pipeline and four-star rooms 27.5%.



390 hotels and

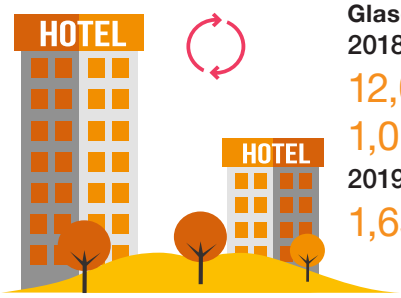
36,500 new hotel rooms set to open across the UK from July 2019 and throughout 2020



London accounts for nearly

13,000

of these rooms,
Scotland for just over 5,000 rooms,
Wales 870 rooms and
Northern Ireland 640 rooms



High levels of supply in some locations

Glasgow:

2018

12,000 rooms,

1,000 rooms opened

2019 and **2020**

1,655 rooms will open

> **Last year around 38 million people visited the UK, contributing £23 billion to the local economy. By 2025 experts predict that there will be an additional 9 million visitors to the UK. The new deal commits to building an additional 130,000 hotel rooms to respond to the increased demand for infrastructure.**
>
> UK Government Press Release, 27 June 2019

London supply to become even more competitive

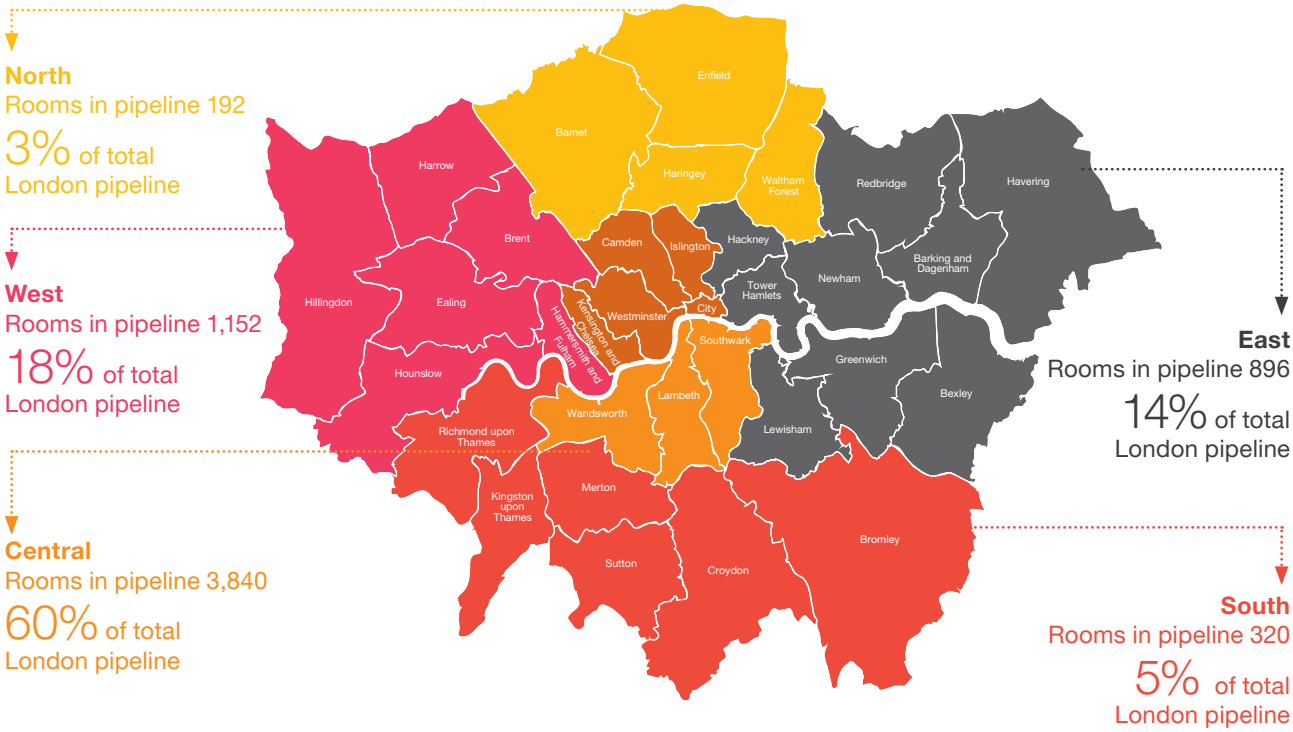
London currently has around 141,000 rooms. A large supply spike in an uncertain economic and volatile travel environment is likely to create an even more competitive environment, especially in certain locations. A weak pound may buoy up international inbound demand, but inbound and domestic business demand is currently challenging.

Around 22,500 new rooms have been added to London's existing hotel room supply in the five years since 2015. 2019 is set to see approximately 6,500 rooms open. In 2020, a further 6,400 are set to open.

In addition, there are over 6,000 rooms in the serviced apartments pipeline. In total, around 2,000 serviced apartment rooms have opened since 2015.

Such a rapid increase in London's accommodation supply begs the question, how long will it take to absorb this new capacity? Previously, supply shortages helped contribute to London's profitability and high occupancies. A period of slower economic growth and weaker travel demand may trigger oversupply issues, particularly outside the higher demand areas of central London.

Figure 5: London's Central Zone dominates in terms of % share of the total London pipeline for 2020



Source: STR, AM PM and PwC Analysis 2019

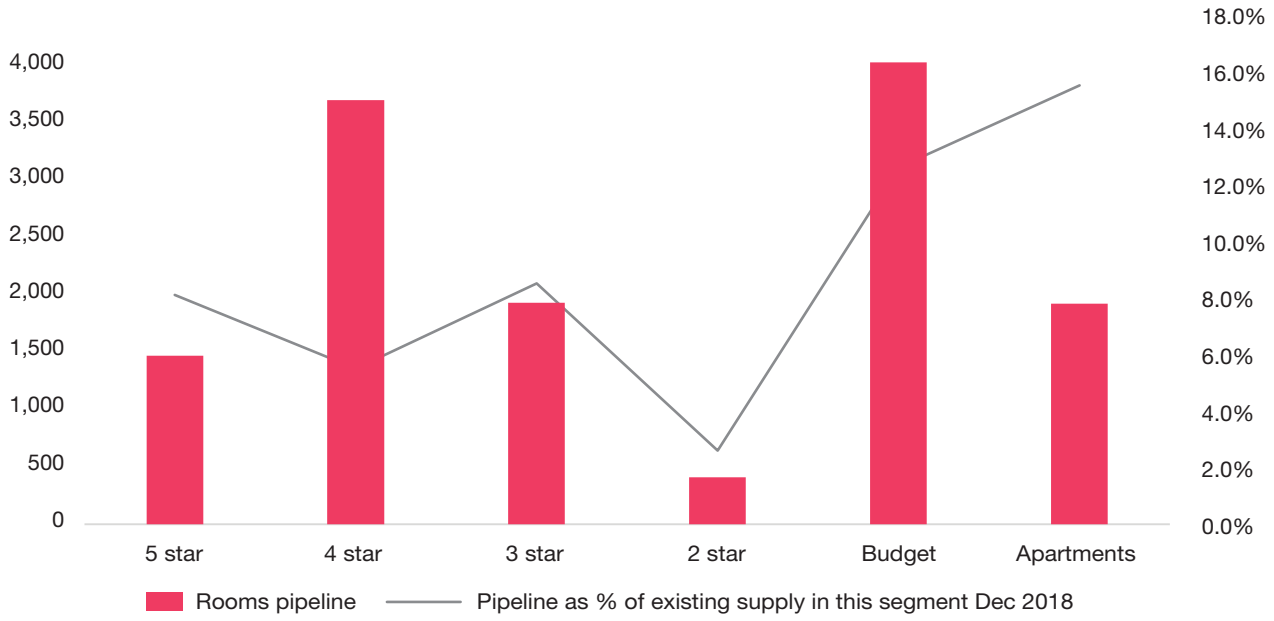
More branded budgets

Quality branded budget accommodation continues to open across London. Some 28 hotels with over 4,000 rooms will open between July 2019 and Dec 2020. This includes the enormous 758-room Zedwell Piccadilly Trocadero, scheduled to open in December 2019. Point A, easyHotel, Travelodge, Ibis, hub and Premier Inn, Travelodge and Z Hotels also all have new openings.

More attractive products, brands and buildings

New openings include: the 193-room Dixon, formerly the home of Old Tower Bridge Magistrates Court; the 92-room Vintry & Mercer; the 57-room Nadler Covent Garden, with views over the Strand; The Hard Rock London, a conversion of the Cumberland at Marble Arch; The Stratford: Manhattan Loft Gardens has been opened by the group behind the St Pancras Renaissance Hotel; the 266-room innovative Standard at Kings Cross, created in the former annexe to Camden Council Town Hall; the 290-room and the 190-room NHOW London City Road. Another former courthouse being repurposed includes the Sydell Group's 91-room NoMad Hotel next year in Covent Garden inside the historic, grade II-listed building famously known as The Bow Street Magistrates' Court and Police Station.

Figure 6: Budget and four star hotels now dominate London's room pipeline



Source: AM PM Database and PwC Analysis 2019

The regions at saturation point?

Hotel development remains surprisingly strong across the regions. The regions saw a 2% increase in supply over the past 12 months and the active pipeline accounts for 6% of current room supply.[13] This increase comes on top of high levels of new rooms over several years in some locations. In the face of weaker demand, this could spell trouble for some, particularly where more serviced apartments and home-share products will exacerbate things.

In 2020 these cities will see the following rooms open: Glasgow (1,340), Edinburgh (1,200), Manchester Centre (1,125), Liverpool (500), Birmingham (500), Oxford (390) Cambridge (380), Blackpool (240), Newcastle (190), Cardiff (175), Belfast (165), York (150), Leeds (120).

See Figure 2 on p9 for heat map.

Alternatives and the sharing economy still popular

Hotels are increasingly competing with other forms of tourist accommodation, such as home-sharing companies.

Despite efforts to regulate these companies (such as Airbnb) more stringently, research suggests growing numbers of affluent travellers are moving to home rentals and alternative accommodation. Airbnb continues to expand to new niches and have recently acquired Urbandoor, a global online marketplace where professionals can book furnished and serviced apartments tailored to their needs for extended business trips, relocations and longer-term stays. The aim is to strengthen Airbnb for Work's engagement with more than 500,000 companies who already use the service to help manage their business travel.

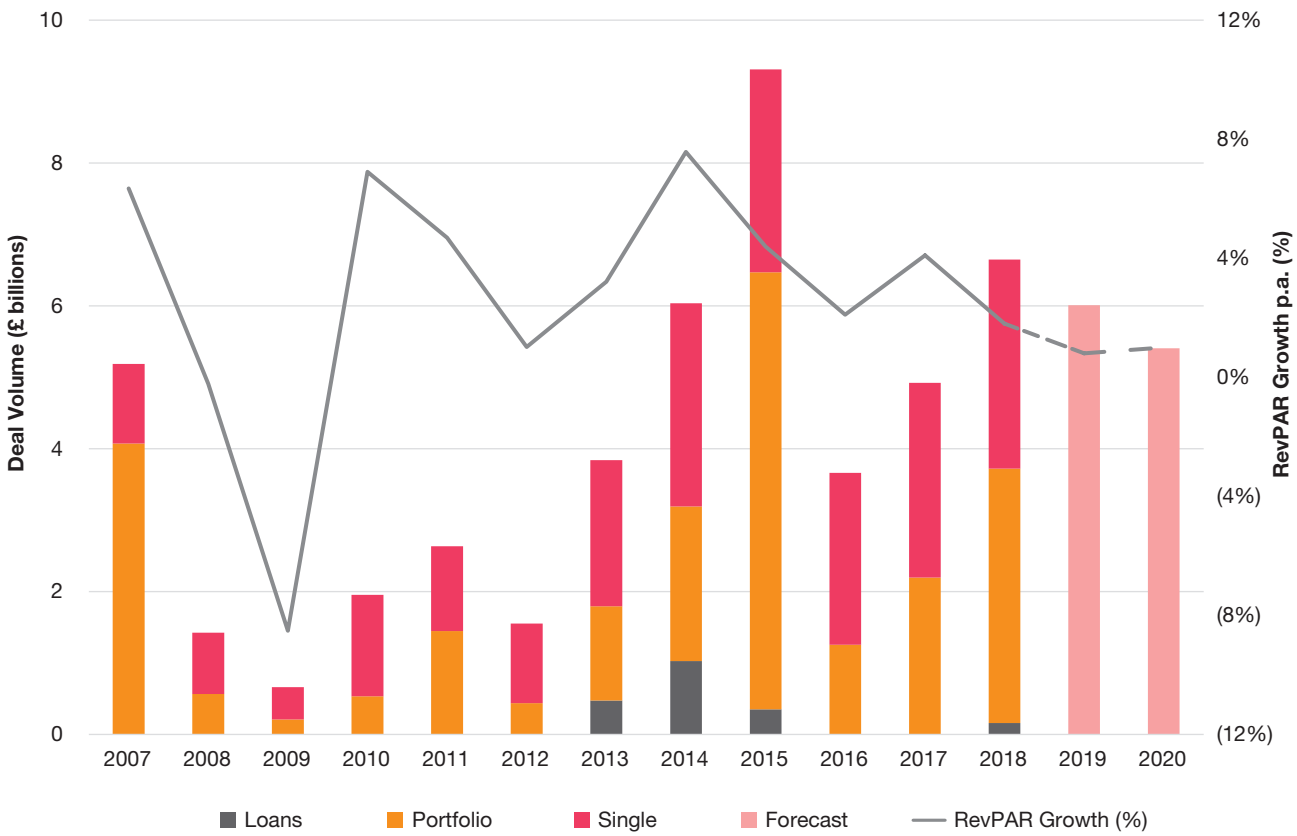
In the future, we expect to see more blurring of the lines between different accommodation products, with hotels adopting ideas from industry disruptors such as the experience sector, hostels, serviced apartments, home share and even co-working spaces.

[13] Alix Partners, HVS, STR, UK Hotel Market Tracker: Q2 2019

Spotlights

Deals outlook: turning uncertainty into opportunity

Figure 7: UK hotels deal volume



Source: STR, RCA, Dealogic, PwC analysis

What happened in 2018?

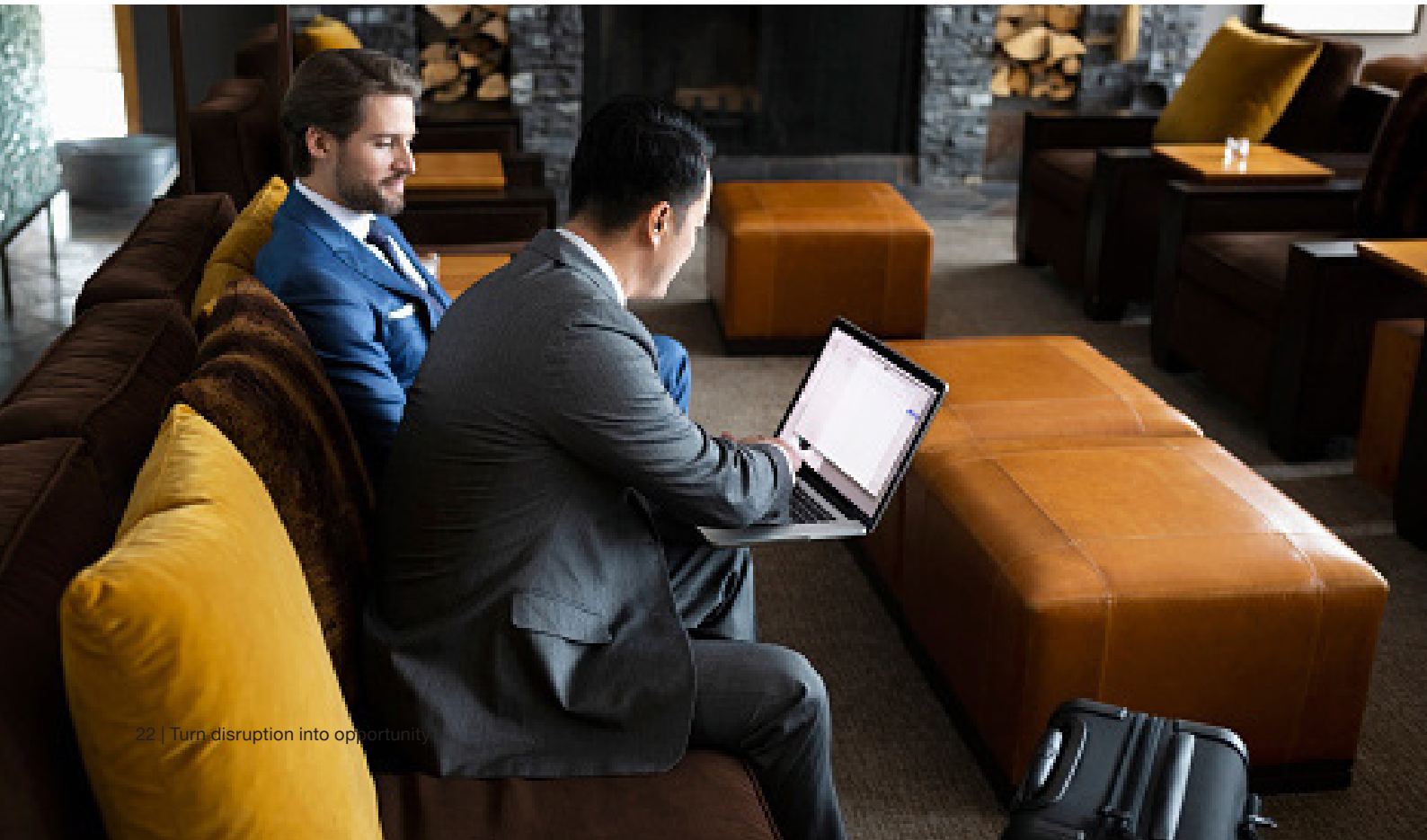
2018 deal transaction volumes reached c. £6.6 billion, up 36% on the prior year, and the second highest year ever (after 2015) which saw record levels of c. £9.3 billion. The year emerged as a tale of two halves: The higher than average H1 2018 transaction volumes consisted 80% significant portfolio transactions totalling over c. £3 billion; whereas the second half of the year saw much lower levels (c. £0.5 billion) of portfolio deals, with a significant increase in single asset transactions volumes (from c. £0.95 billion in H1 2018 to a total of c. £3.1 billion at year-end 2018) representing c. 80% of the total H2 2018 deal volume.

Major single asset transactions

Hotel	Location	Reported Price (c. £m)	Acquirer	Type	Origin
Grosvenor House	London	550	Katara Hospitality	State-owned hospitality company	Middle East
Hilton Kensington	London	260	Cola Holdings	Family Office	UK
The Beaumont	London	140	Ellerman Investment Ltd	Family Office	UK
The Midland	Manchester	115	Pandox	Listed hospitality company	Sweden

Major portfolio transactions

Portfolio	No. hotels	Reported Price (c. £m)	Acquirer	Type	Origin
Principal Hotels	13	860	Covivio	REIT	Europe
Ribbon hotel portfolio	22	750	Vivion Capital	Private Equity	Middle East
Amaris Mercure/ Hilton portfolio	23	600	LRC Europe	Private Equity	Europe
Saco Apartments	39	430	Brookfield Asset Management	Private Equity	North America



2019 to date

UK hotel investment volumes have seen a decline of 35% in H1 2019 to c. £2.6 billion, compared with the higher than average levels in H1 2018. This is as expected with the uncertainties of Brexit becoming more acute, ongoing volatility in economic growth and weakened business sentiment; all of which have contributed to increased nervousness by investors into the UK.

The drop in H1 2019 volumes were primarily as a result of a c. 38% decline in the number of significant portfolio transactions compared to those completed in the first half of 2018. To date in 2019, the main portfolio transactions include Queensgate Investments' acquisition of four Grange Hotels in central London for c. £1 billion, who subsequently sold a ground rent portfolio on three of the assets to Alpha Real Capital and the fourth asset to Aviva; in addition to this the other two transactions of note were an Israeli investment fund's acquisition of the Hallmark Hotel portfolio (c. £250 million), and Vivion Capital's acquisition of the regional Zinc portfolio of Hilton hotels (c. £246 million).

Single asset transactions have also seen a c. 28% decline in investment volumes in H1 2019 from the lower level already experienced in the first half of 2018 to c. £0.7 billion. The largest transactions included Dalata Hotel Groups' acquisition of the Clayton Hotel in Aldgate (c. £91 million) and the joint venture acquisition by KSH Holdings, Ho Lee Group and Heeton Holdings of the Crowne Plaza Kensington (c. £84 million).

Figure 8: Type of Investor (% share of value, by type)

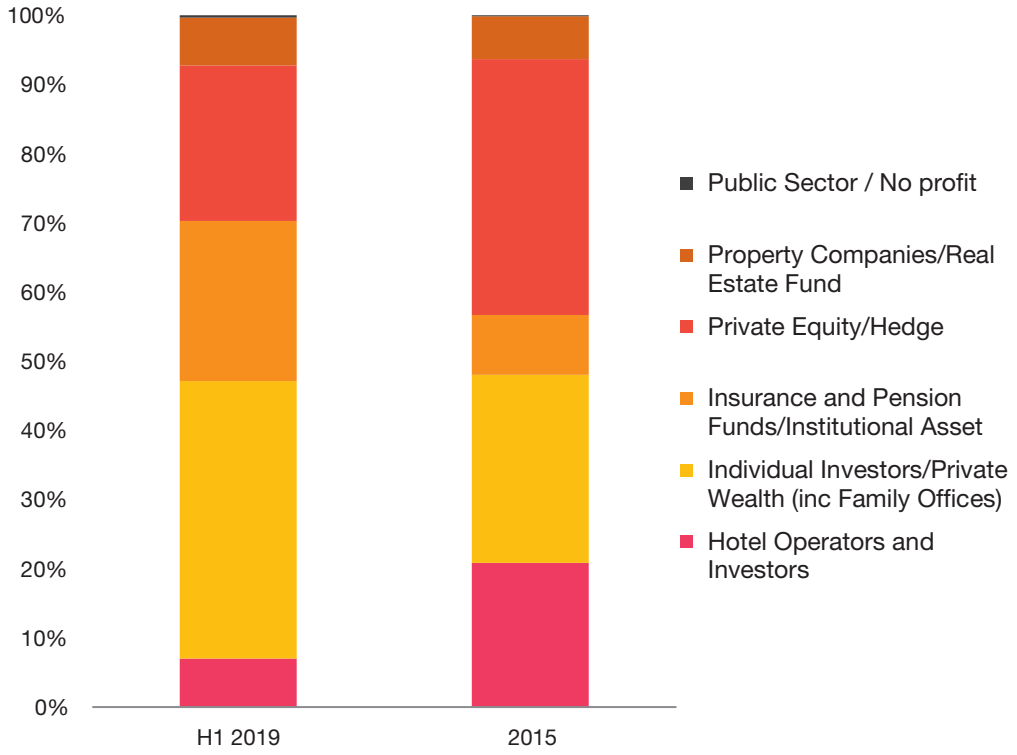
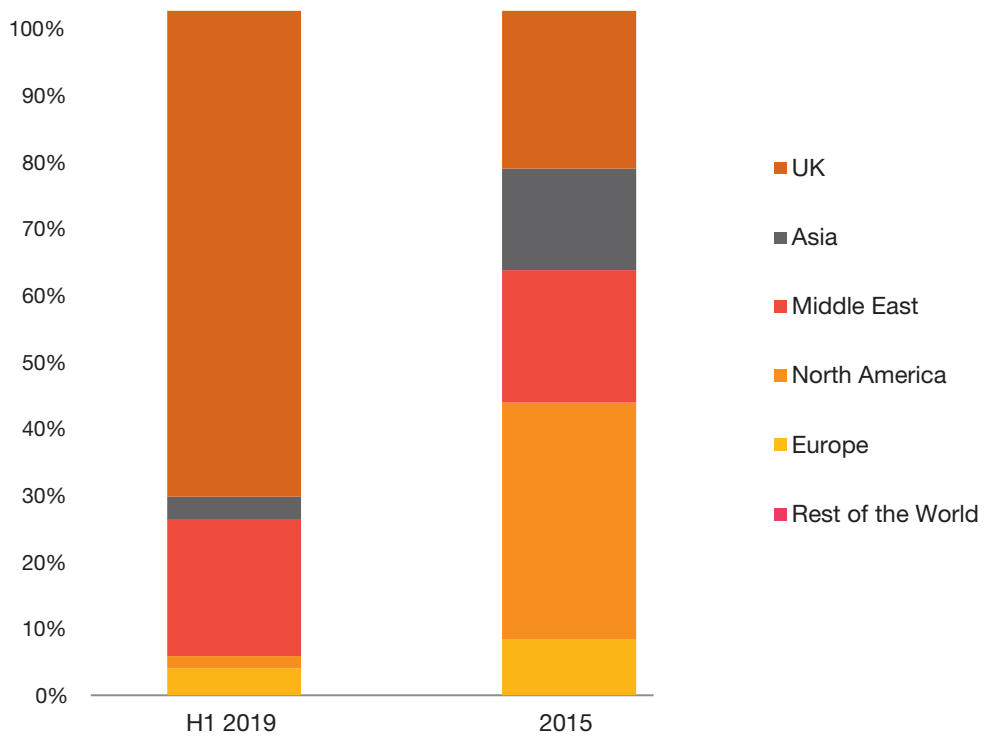


Figure 9: Origin of investor (% share of value, by region)



Source: RCA, Dealogic, AM PM, PwC Analysis 2019

The high value Grange Hotels deal, acquired by Queensgate Investments (a UK-based private wealth fund), dominates the H1 2019 investor origin and type analysis. Otherwise of note, there has been an increasing trend for Middle Eastern investors away from the GCC regions in 2015 to Israeli-based investors in 2019; while the investor type shows a decline in Private Equity investment and a rise in Insurance and Pension Funds representing the growing appetite in the sector from the long income funds recently. For example, M&G Investments c. £203 million acquisition of a long leasehold site in Paddington, London, to fund the development of a 620-bedroom hotel (due to complete by 2021), with 30-year leases agreed with Whitbread's Premier Inn (60% of the rooms) and short-stay apartments group Staycity (40% of the rooms)

What to expect going forward?

With continuing Brexit-related uncertainty, potential further volatility in economic growth, and declining business confidence, we anticipate investor appetite to remain cautious, until there is further clarity on the outcome of Brexit. There is still an expectation for continued inward investment from Europe and the Far East in 2019 looking for good opportunities and strong returns, especially given the relative low value of the pound, however, there is a limited supply of potential investment opportunities. There are some further portfolio deals reportedly in progress, including Macdonald Hotels and Marathon's combined QMH UK/Mint hotels portfolio; plus some significant single London hotels reportedly being marketed, including the Marriott Grosvenor Square, Cavendish, Sanderson and St Martins Lane hotels.

With these deals assumed to complete this year, and taking into account the other factors listed above, we anticipate that the total deal volume in 2019 will decrease by 23% from 2018 volumes to c. £5.1 billion.

Even if a Brexit deal is secured by the end of 2019, we forecast a further period of time before stability is regained and investor confidence returns to the UK, with 2020 hotel transaction volumes forecast to continue to marginally fall to c. £4.8 billion.

Creating value beyond the deal – Our corporate and PE surveys on M&A

We interviewed 600 global corporate executives to uncover the key attributes of deals that create the most value. Many acquisitions and divestments don't maximise value – even when some dealmakers think they do.

Our Creating value beyond the deal report explores how corporate organisations – both on the buyer and seller side – approach value creation throughout a deal. We found that the modern value creation approach must be built around three core areas:

1. Stay true to the strategic intent
2. Ensure the value creation plan is a blueprint and not a checklist
3. Put culture at the heart of the deal

We also surveyed 100 PE partners from a range of industries and geographies, to understand how their experience in creating value through M&A differs to that of corporates. All participants in this survey had made at least one significant acquisition and one significant divestment in the past 36 months. Our report outlines key findings, discusses their implications and shares insights on how to further advance and refine the way you approach value creation within your own organisation. So what key themes and considerations should PE investors be focusing on in 2020?

- **Driving value through revenue enhancement, not just cost-cutting**
  - Only 45% of PE dealmakers realise deal value through revenue enhancement
- **Embedding strategic clarity early on**
  - Almost a third (31%) of deals that used a formal methodology created significant value
- **Having an eye on talent retention and culture to drive deal value**
  - As many as 57% of PE deal-makers said cultural issues hampered value creation
- **Planning for exit and thinking about the business from a bidder's perspective**
  - 91% ran their exit processes according to a formalised methodology
  - 87% had an exit committee or specific individual responsible for running exit processes

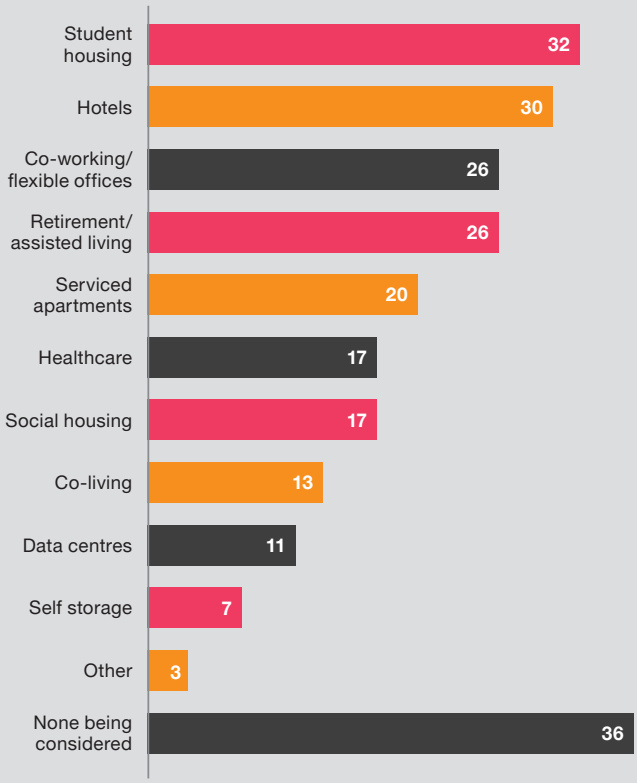
Emerging trends in real estate 2019

PwC's Emerging Trends in Real Estate Report Europe 2019 (produced jointly with ULI) found that alternative real estate and residential – in all its forms – dominate the sector preferences of survey respondents, marking a remarkable shift in industry sentiment over the past few years.

In 2015, just 28% of survey respondents said they would even consider investing in alternatives. This year, almost 60% of respondents are already investing in alternatives in some way, and 66% wish to increase their holdings. Hotels, student housing and flexible offices are the sectors where current exposure is highest while student housing also tops the wish-list going forward. More generally, alternatives are supported by strong demographics, and they are seen as part of the industry's structural change towards operational assets and property as a service.

There is also a sense that in this cycle, the shift to alternatives has taken the place of the move into secondary property that occurred during the last cycle – hopefully with more profitable results.

Figure 10: Niche sectors being considered in 2019



Source: Emerging Trends Europe survey 2019

Rise of leasing models

In such an uncertain UK market, investors are becoming increasingly cautious about their risk-adjusted returns: Lower end risk-return investors are seeking to protect potentially volatile income through leasing their hotels to operators; while the higher end risk-return investors are seeking to enhance their returns by taking advantage of the increasingly competitive pricing arbitrage offered on ground leases by long income funds.

Investor demand for hotels secured with fixed income leases remains strong and whilst this has typically focused on budget hotels, e.g. Premier Inn and Travelodge, we have started to see other leased operators enter the market, e.g. Leonardo for the Jurys Inn portfolio and 4 Grange Hotels recently acquired by Queensgate; and Dalata Hotels Group who have leases on assets in Birmingham and Newcastle, and have agreed leases on assets in Glasgow and Manchester.

With the continued strong investor demand for fixed income assets, we have seen prime yields compressing further to c.3-4%. However, there has also been an increase in investor appetite for secondary lease covenants or acquisitions subject to management contracts, for the yield arbitrage compared to the prime fixed income yields. Yields for weaker lease covenants typically see a yield differential of c.150 – 200 bps and assets subject to management contracts typically see a yield differential of c.150 – 300 bps for regional assets.

Commercial implications of IFRS16

From 1 January 2019 operating leases will be recognised on the balance sheet, creating both an asset and liability. This will result in lessees appearing to become more asset rich but also more heavily indebted. There will also be a more front-loaded pattern of expense in their income statements, from the combination of straight-line depreciation of the lease asset and a reducing interest expense from the decreasing lease liability.

As a result of this new accounting treatment, we have already seen a shift in priority for some tenants' commercial terms, and as the treatment get more widely adopted it may further reinforce the trend towards:

- Shorter leases and larger upfront incentives for longer leases, e.g. rent free periods
- Seeking a higher proportion of contingent rent, as this is not recognised on balance sheet
- Disincentivising tenants away from accepting fixed increases towards index/rate linked rentals
- Reducing the practice of including break/extension events which are not considered when determining the liability
- Discouraging sub-leases as the full liability will still remain on balance sheet

More Ground Lease Demand

In addition to this over the past 24 months, we have also seen an increase in demand by institutional investors for hotel freeholds with longer-dated fixed-income lease structures such as ground rents. Such leases provide freeholders with a source of capital that is cheaper than senior debt financing, ideally with enough headroom to avoid running into any difficulty causing default, and with some buy-back optionality.

Notable transactions include: Park Plaza Hotels' sale and leaseback of their London Waterloo hotel to CBRE GI for c. £162 million; Starwood Capitals' sale of ground leases on 6 De Vere Hotel assets for c. £162 million; and Queensgate Investments' sale of the ground rents for three of the four Grange Hotels to Alpha Real Capital, with the fourth to Aviva, for a total c. £250 million.

What is the attraction of Ground Leases?

For Freeholders/Occupiers – Ground leases can be seen as a financing mechanism; it is a way of obtaining cheap financing or releasing equity from the asset by selling off the freehold of the asset and taking on the long leasehold interest subject to an annual ground rent, which typically equates to c.15% of EBITDA.

The leases are typical for longer terms and have a tenant buy-back option at expiry, and generally the terms of the lease mean that the tenant can operate the asset uninterrupted.

For Investors – Ground leases provide long term low risk cash flows, generally with inflation linked growth to investors. Ground lease yields generally track 30 year GILTS and trade at a premium of c.1.5%, (which has declined from a c.2% premium as a result of the weight of capital), resulting in prime yields at c. 2-3% in 2018/2019 (down from c. 2.5-3.5% in 2017).

As a result of the low yields, ground leases can equate to c.30-45% of the assets freehold value, and the value of the real estate typically exceeds the value of the unpaid rentals providing an investor with comfort that a default would be adequately collateralized.

What are the challenges of Ground Leases?

Ground lease rents are typically set at c.15% of EBITDA, in a rising market, hotel businesses are suited to keeping pace with inflation through their revenues, however, in a falling market if the net operating income (NOI) declines, there could be a double negative impact on yield and the value of ground leases. Tenants are then unable to offset the rising indexed rent against the falling NOI, thereby devaluing the long leasehold interest and the freeholder is left with a depreciating asset.

UK Hotel Public Market Activity

2019 has also proved to be an active year for hotels in the UK public market:

Millennium & Copthorne plc

After 23 years on the London Stock Exchange (LSE), Millennium & Copthorne Hotels is to be taken private by its majority (65.2%) shareholder and Chairman, Kwek Leng Beng through his City Development Limited (CDL) vehicle. The group owns and manages more than 130 hotels across four brands, 20 of which are in the UK. According to the final offer announcement, CDL cited the reason for this deal was to leverage its significant infrastructure and resources to develop and execute a long-term strategy with significant but targeted capital investment to reposition assets in a highly competitive landscape.

The final offer of 685p per share represents a premium of c.37% over the share price prior to the start of the offer period, and values the equity at c. £2.3 billion, equating to an enterprise value (EV) of c. £3.4 billion. This revised offer was accepted by a majority of shareholders in June 2019, 18 months after the original offer at 620p per share, which had been rejected by the 3 leading investors, MSD Capital, International Value Advisers and Classic Fund Management.

easyHotel plc

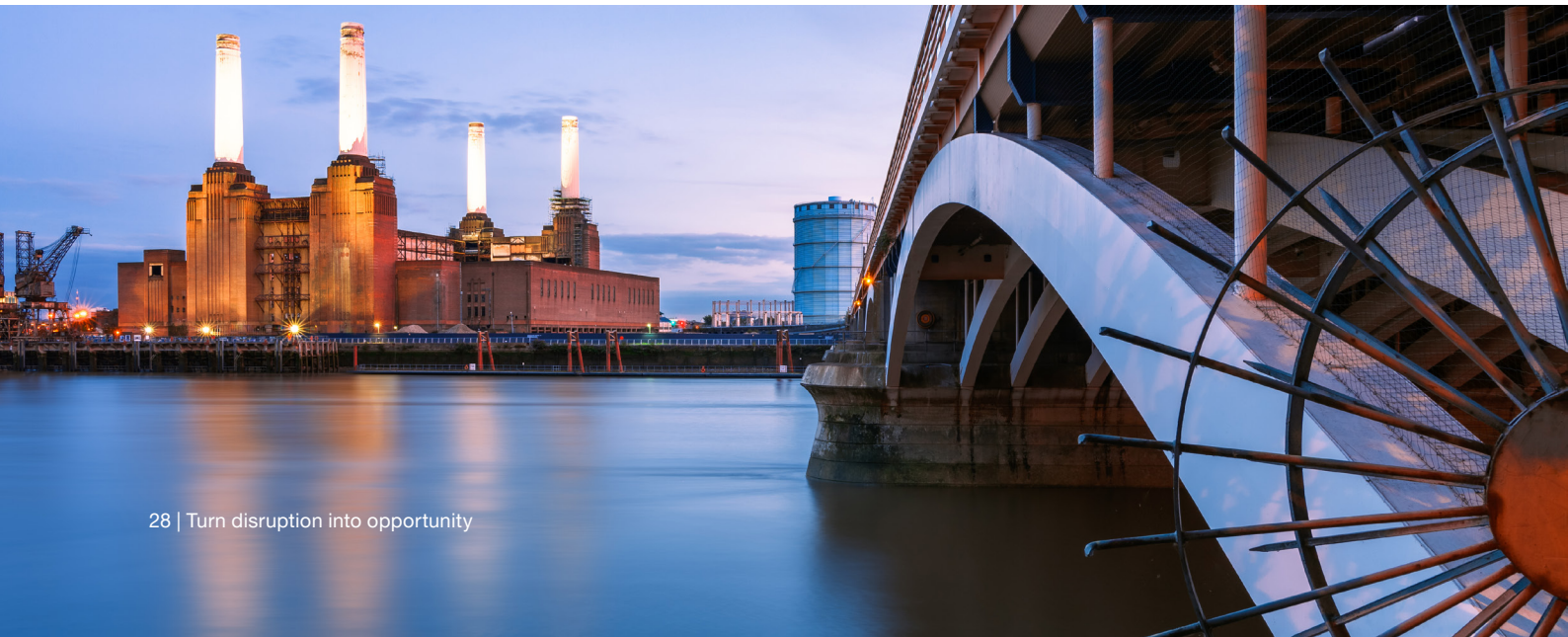
Just over 5 years after its admission to the LSE Alternative Investment Market (AIM) in June 2014, easyHotel is to be taken over by a consortium between real estate investor Ivanhoé Cambridge and property fund manager ICAMAP, despite objections from its billionaire founder Stelios Haji-Iannou. Sir Stelios founded the easyHotel chain in 2004, opening its first property in South Kensington in 2005. The company operates 38 budget hotels under owned or franchised models, and pays 0.75% of revenue to Sir Stelios' privately-owned EasyGroup, for 50 years worldwide rights for use of the 'easy' brand.

Ivanhoé Cambridge and ICAMAP cited in the final offer announcement that the current ownership structure was ill-suited to attracting the new capital required to fund its long-term investment and expansion programme, and are committed to developing easyHotel into a leading European budget hotel company. The final offer of 95p per share represents a 34.8% premium over the share price ahead of the offer period, and values the group's shares at c. £139 million, representing an EV of c. £126 million.

Shiva Hotels

Recent reports suggest that Shiva Hotels is intending to release a prospectus shortly for a c. £150 million LSE initial public offering (IPO) of its subsidiary Hotel Income Real Estate Investment Trust (REIT). Shiva hotels is a privately owned family business which was founded by Rishi Sachdev in 2001 with a track record in acquisition, development and hotel management with currently over 2,000 bedrooms in London either operational or under development.

According to reports, the capital raised in the IPO is intended to be invested in Shiva's current portfolio of five Hilton-branded hotels in London and New York. Investors have reportedly shown a keen interest in Hotel Income REIT despite the uncertainties surrounding Brexit, as they consider this a rare opportunity to invest in income-producing, purpose-built assets and are hoping that the IPO will be oversubscribed.



Guest-centric transformation: turning digital disruption challenges into opportunity through a guest-led approach to transformation

Digital transformation continues to be an important focus for hotels.

Rapidly evolving guest expectations and the increasing digitisation of hotel services are two key themes increasing the risk of disruption, or outright failure, of digital transformations. Whilst these risks can be mitigated through adopting a guest led approach, the guest experience lens is certainly not the only important lens to apply to transformation strategy. Balancing business value, guest experience and technology perspectives is required to achieve the right transformation strategy. But how do you determine which perspective should take priority, or where to start?

At the heart of every business is a set of capabilities. A guest led approach to transformation will help identify the capabilities that will deliver the most value and impact to the guest experience.

Putting the guest first in the transformation journey

We've already described two important themes impacting transformation strategy:

1. Guest expectations around experience (across the entire customer journey) are rapidly evolving and not just informed by other often more advanced industries.
2. Increasing digitisation of guest services (everything from Artificial Intelligence (AI) to mobile and Internet of Things (IOT)), whether driven by OTAs, new disruptive entrants into the hospitality industry or other industries.

Effectively addressing these trends should be at the core of any transformation strategy.

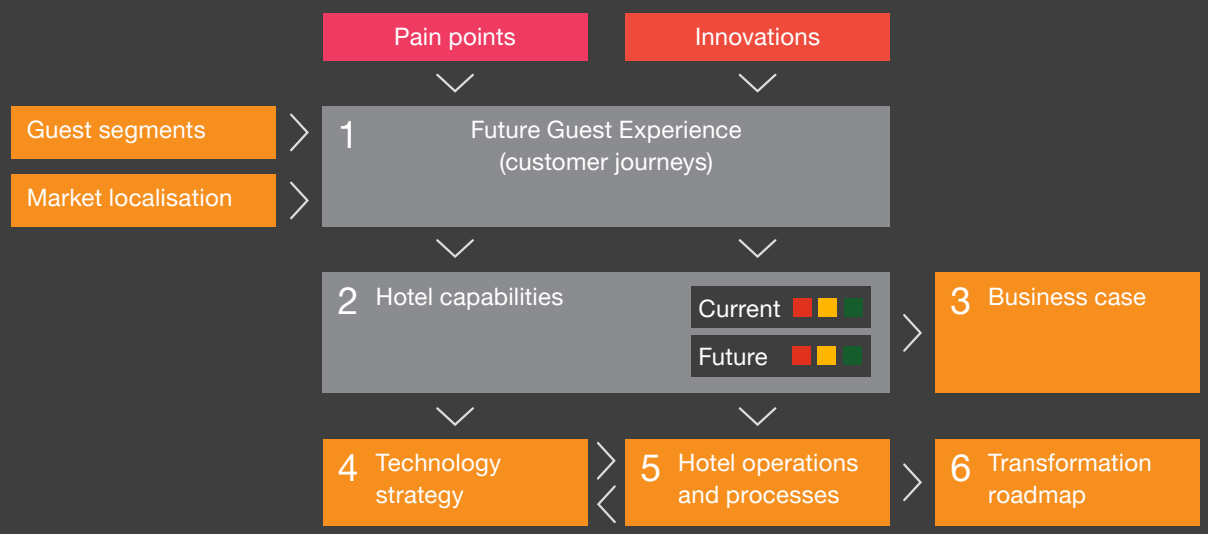
Understanding current and future guests wants and needs to find the right balance between technology and personal interactions

Guests do not always prefer personal interaction over automated digital/tools, particularly where staff are inefficient or don't have the right knowledge. Others value human interaction and experience at the front desk as a core part of their experience.

Equally, not all guest value digital apps or want to talk to AI/chatbot. Other guests rely on automation for a frictionless experience at key moments (such as self check-in/out or AI-curated recommendations for entertainment).

It's important to represent all these perspectives when defining the future guest experience.

A guest led transformation starts with experience lens, but the business and technology lens are equally important to ultimately achieving the correct roadmap



To design the future guest experience and journeys (1), we need to understand the gaps between the current experience and the vision, using guest data to understand the impact by segment or market/location.

- Start with customer journeys to identify the pain points and areas that matter
- Understand the guests, their needs and wants
- Set a vision for the future guest experience aligned to a realistic ambition
- Capture essential data based on customer experience
- Engage directly with guests, reservations and hotel staff to reveal new insights

Mapping the customer pain points to the capabilities required to address them is the next step – but it will also help categorise (at a high level) the capabilities required from the transformation:

- **Future guest experience/Innovation** – capabilities that fix a pain point or deliver a new or enhanced experience (such as self check-in or AI for chatbots or process automation)
- **Enablers** – capabilities that are essential for other capabilities to function (such as single guest view or improved analytics to drive revenue management or Business Intelligence)
- **Risk and renewal** – capabilities that don't usually impact the guest experience but may be required for the business to mitigate risks associated with them (such as cyber security to protect all the newly acquired and used data)

Transformation touches all elements of hotel operations using digital platforms

- Digital channels and apps impact reservations across both digital and offline points of sale (PoS)
- Guest relations, front desk and housekeeping impact on guest satisfaction
- Machine learning or AI in revenue management impact KPIs such as RevPAR
- HR capabilities to support a dynamic workforce
- The use of AI to increase finance operations efficiency

Moving from customer journeys to capabilities and beyond

Once the guest experience is defined, prioritising capabilities should be the next step (2):

1. Understand guest journeys, pain points and moments that matter, and link to the capabilities needed to address them
2. Assess capability gaps against the future guest experience and journeys
3. Create business/benefits cases only for the prioritised capabilities (where appropriate)
4. Link the technologies required to deliver the capabilities
5. Plan the operational and process changes required to absorb the new capabilities
6. Create the transformation roadmap

Linking the future capabilities (2) and transformation roadmap (6) will highlight where current technology (4) or operations (5) cannot support the new guest experience.

Using agile as a method to transform effectively at a pace that can be absorbed into business as usual is needed, but businesses do not necessarily know the best way to implement it. To be successful, digital transformation requires no fear and the ability to fail fast and iterate rapidly. An agile approach with short (2-3 week) capability build and delivery sprints is well suited to meet these challenges. A big advantage of this approach is that it doesn't require solutions to be fully designed before the requirements are correctly understood, which leads to better outcomes for the guests and the business.

However, not all aspects of transformation are as well suited to such a short sprint based approach.

Primarily, the business cannot stop every few weeks to absorb new capabilities. New capabilities can be delivered and embedded over longer 'business sprints' of approximately 3 months. This frequency links very well with traditional transformation timeframes for review and decision making governance and benefits measurement. This 'hybrid' approach delivers a number of benefits:

- Rapid iteration, ability to fail fast and refocus quickly – better solutions for the guests
- Regularly creates value for the business – which helps benefits and stakeholder engagement
- Structured testing, rigour and governance controls pace
- The pace new capabilities are embedded matches the pace at which the business can absorb the change without disruption.

Conclusion

By adopting a guest led transformation strategy, hotels can focus on building the capabilities to attract new guests and retain their most valuable guests, whilst key enabling capabilities like improved data will generate new insights into how hotel operations impact both the guest experience and also their profitability.

Cyber security: improve digital security and reduce cyber attacks

With increasing costs and operational pressures, hotels are embracing digital to improve efficiencies, personalise the customer experience and save costs. Though the move to digital brings benefits for hoteliers, it also brings a host of new security and data privacy issues.

A cyber attack or data breach can affect any business in any industry. In the hotel industry, though, businesses are increasingly dependent on technology systems that process payments and handle large amounts of sensitive and personal data. With this data being collected at various different 'touch points' throughout the business, there can be a number of weak spots in a hotel's cyber security:

- With high footfall in hotels, victims can include guests, staff and even visitors not staying in the hotel, putting personally identifiable information at risk.
- Hotels also risk being vulnerable if third-party services such as reservation or online payment services become compromised, which increases access points for attackers.
- Poor cyber security can be a threat to deals, too. Investors now need to consider whether an organisation has sufficiently strong cyber security before investing – they do not want to inherit an organisation's security vulnerabilities.

Breaches can have significant financial and regulatory implications, as well as trust, brand and reputation damage for hoteliers. Hoteliers must think about the many opportunities that their properties present for hackers.

Protect your property management system

Hotel property management systems (PMS) are the operations hub for many hotels – from small boutique to well-known brands. As a system that facilitates the management of a hotel, the PMS often connects with point of sale systems, WiFi networks, physical access control systems and even third-party components and services.

If an attacker gains access to the PMS they could access confidential business, customer and hotel information. In extreme situations, the physical security of your residents may be at risk, with hackers being able to access room locks or security controls.

Even if your internal measures are secure, a weakness in your third-party systems may provide direct access to your PMS, and with it customer, payment and reservation details

- Who can gain access to your PMS?
- How secure are your third-party partners?
- Do you use an internet-based reservation system, managed by you or a third party?
- Do you have any untested application interfaces connecting into your hotel's booking systems?

Secure your IoT/connected devices

Internet of Things (IoT) devices are now standard in many hotel rooms, such as an iPad to control the lighting or shared mobile devices for use during a customer's stay. These devices tend to be linked directly into the corporate internet, providing a direct link into confidential and commercial data. Even seemingly innocent IoT devices can be a route into confidential areas of your network.

- Do you know all of your IoT devices?
- How can each device on your network be used?
- How is data protected as it travels between the device and the network?
- Do you have the correct policies and procedures in place?
- Do you have a public key infrastructure and use a digital certificate – based security system?

Defend your other assets

There are many other areas hoteliers should look to protect, but as a minimum, they need to secure:

- **Hotel wifi** – Poor wifi security gives attackers easy entry onto the corporate network through the use of interfaces that link into the corporate network.
- **Staff including contractors** – Staff have access to unrestricted areas of hotel buildings and offices. Make sure all of your staff are fully trained for all known cyber security risks.
- **Email** – Email allows attackers to directly send and execute malware, both to front of house staff and back office.
- **Point of Sales (PoS) Systems** – Unsecured PoS systems give access to full details of a customer's card and can also be used to access the PMS.

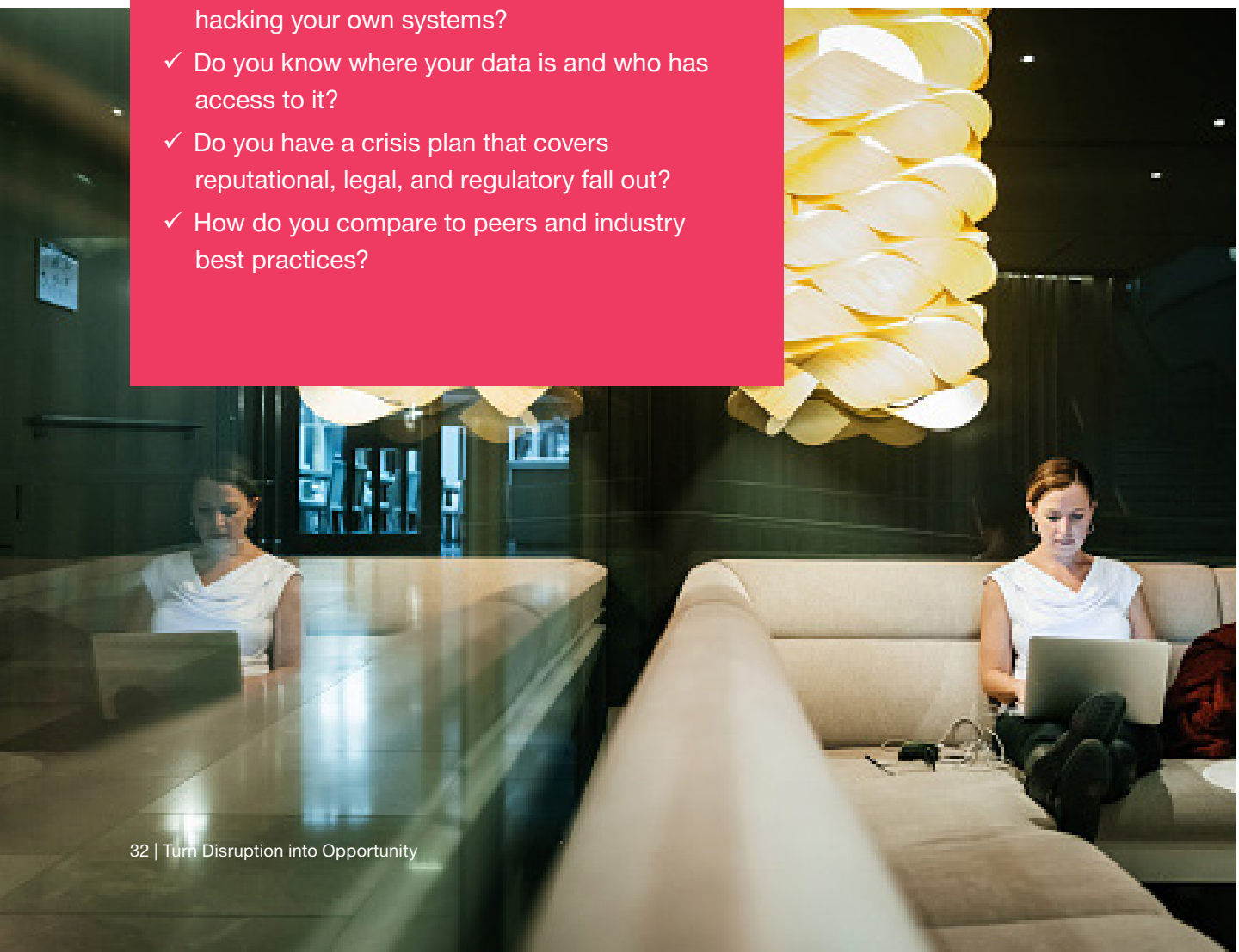
Audit your cyber security regularly

In a digital era, technology is everywhere. People can connect to your hotel, employees, customers, providers and competitors through innumerable connected devices. Cyber security is now of paramount importance, and hoteliers need to act quickly to avoid costly incidents.

Hotels need to undertake regular audits to detect any unusual activity. This may not be an easy task, but it is essential for hoteliers to do so in order to prevent attacks in the first place, and promote a safe digital environment.

Cyber security checklist

- ✓ Do you know your threats and potential threats?
- ✓ How good are your defences? Have you tried hacking your own systems?
- ✓ Do you know where your data is and who has access to it?
- ✓ Do you have a crisis plan that covers reputational, legal, and regulatory fall out?
- ✓ How do you compare to peers and industry best practices?



What does the future hold for EU nationals? What you need to know

EU nationals currently resident in the UK wishing to remain for the long term will be required to obtain confirmation of their status under the EU Settlement Scheme. Individuals who have been resident in the UK for 5 years or more will obtain a form of permanent residence known as 'Settled Status'. Those who have been resident for less time will initially be granted 'Pre-Settled Status' which they can later convert to Settled Status once they have accrued 5 years total residence.

Brexit will lead to significant changes to the future of the UK workforce, with new EU nationals wishing to travel to the UK for the purposes of employment being subject to immigration requirements and the need to obtain some form of work permission.

Under the Government of Teresa May, it was intended that regardless of whether there was a 'deal' or 'no deal', a new immigration system would not be implemented until 1 January 2021, with interim measures for EU nationals moving to the UK between Brexit and 31 December 2020. The Government has recently confirmed that these interim measures will involve submitting details which are yet to be announced on how this will operate in practice and could lead to potential difficulties in the future for individuals unaware of the requirements.

The proposals set out in the December 2018 White Paper, envisage an updated and expanded version of the current Tier 2 visa system for non-EU nationals, which would involve meeting certain skill and salary thresholds (potentially £30,000 per annum). On 4 September, the new government commissioned the Migration Advisory Committee (MAC) to investigate the possibility of introducing an 'Australian-style Points Based System', which may result in a stronger focus on higher skilled migrants than envisaged under the current proposals. The MAC is due to report its findings in January 2020, and this may result in substantial changes to the current White Paper.

EU National checklist

- ✓ Do you currently have an immigration compliance framework in place?
- ✓ Are you aware of the responsibilities that need to be met as a Tier 2 Sponsor?
- ✓ Have you identified which roles would be capable of Sponsorship under the proposals in the White Paper?
- ✓ Have you identified the potential costs associated with Sponsoring new employees and how this may impact different business units or locations?
- ✓ Have you engaged with the various immigration consultations issued to date, and will you engage with future consultations as they arise?

Appendices

Appendix 1

Table 2: Annual hotel statistics for London and the Regions 2017 – 2020

	Actuals		Forecast	
London				
	2017	**2018**	**2019**	**2020**
Occupancy	81.8%	83.5%	84.3%	84%
ADR (£)	147.7	148.5	151.5	153.4
RevPAR (£)	120.8	124.0	127.7	128.9
% change on previous year				
Occupancy	0.3%	2.0%	1.0%	(0.3%)
ADR	3.5%	1.0%	2.0%	1.3%
RevPAR	3.9%	3.1%	3.0%	1.0%
Regions				
Occupancy	75.8%	75.9%	75.9%	75.5%
ADR (£)	71.7	72.1	71.6	71.8
RevPAR (£)	54.3	54.7	54.4	54.2
% change on previous year				
Occupancy	0.4%	0.2%	0.0%	(0.6%)
ADR	3.1%	1.1%	(0.7%)	0.3%
RevPAR	3.5%	1.3%	(0.7%)	(0.3%)

Source: Econometric Forecasts: PwC July 2019. Benchmarking data: STR July 2019

Appendix 2

Methodology for the forecasts

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 two-stage least squares (2SLS) instrumental variables approach. The 2SLS approach has several advantages, namely, 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 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 have an effect on price, but have an influence on hotel demand. Our model specifications include 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% level. Equally, 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 regions provided by AM:PM to produce forecasts for occupancy rates. Adjustments were made to ensure the comparability of STR and AM:PM 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 2020, and these were generated separately for London and the regions, with forecasts for the UK as a whole constructed from a weighted average of the London and regions forecasts. These weights were generated using the share of London and regions hotel room demand as a percentage of total (London + regions) demand.

Table 3: Final specifications of the London and Regions models

	London	Regions
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 London hotel demand **Explanatory variables** • UK GDP growth • Growth in Regions 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 Regions ADR **Explanatory variables** • Growth in Regions hotel demand • Growth in Regions ADR in the previous year • Quarterly dummies

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.

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