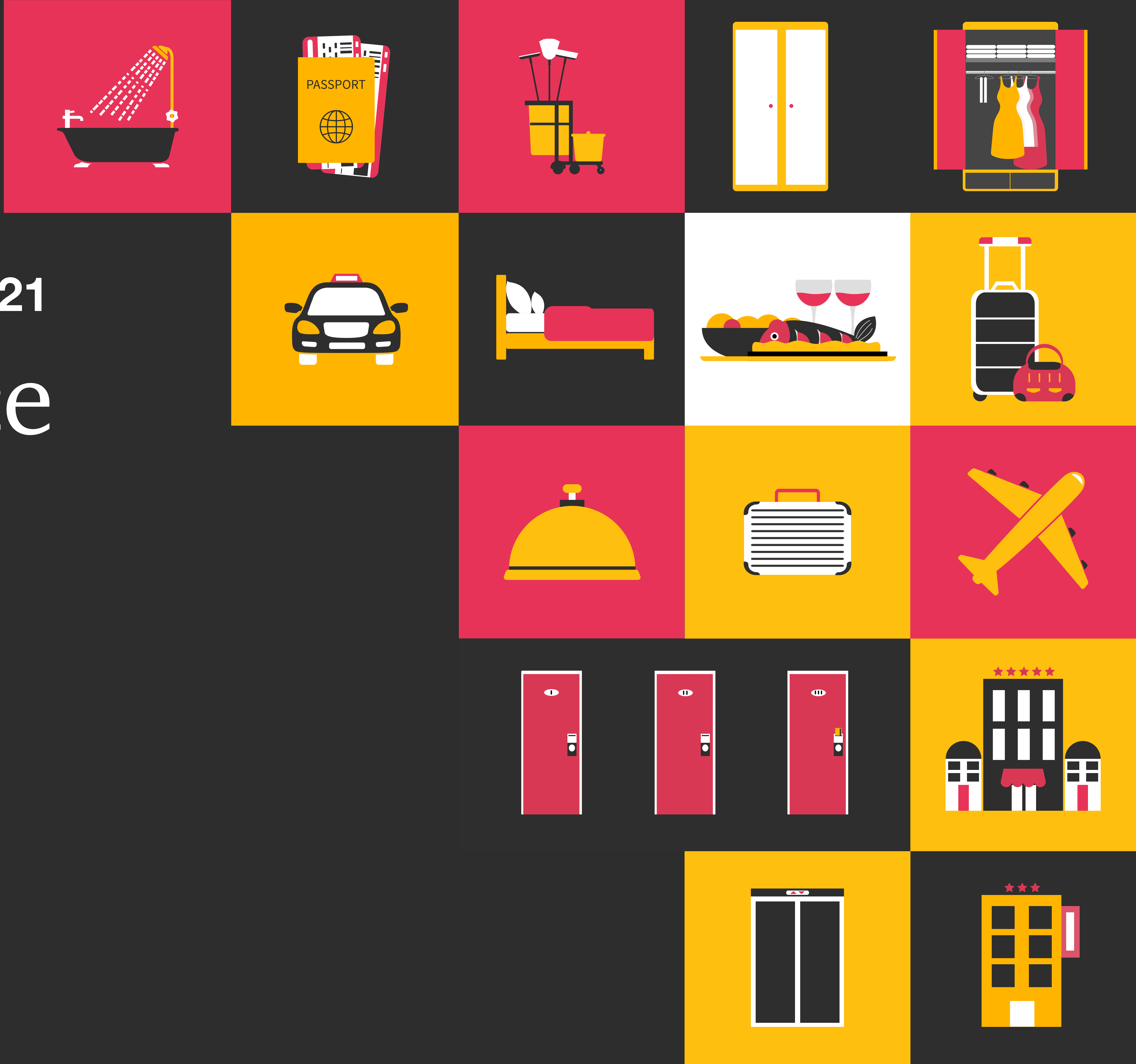
UK Hotels Forecast 2020 — 2021

From endurance to recovery

October 2020



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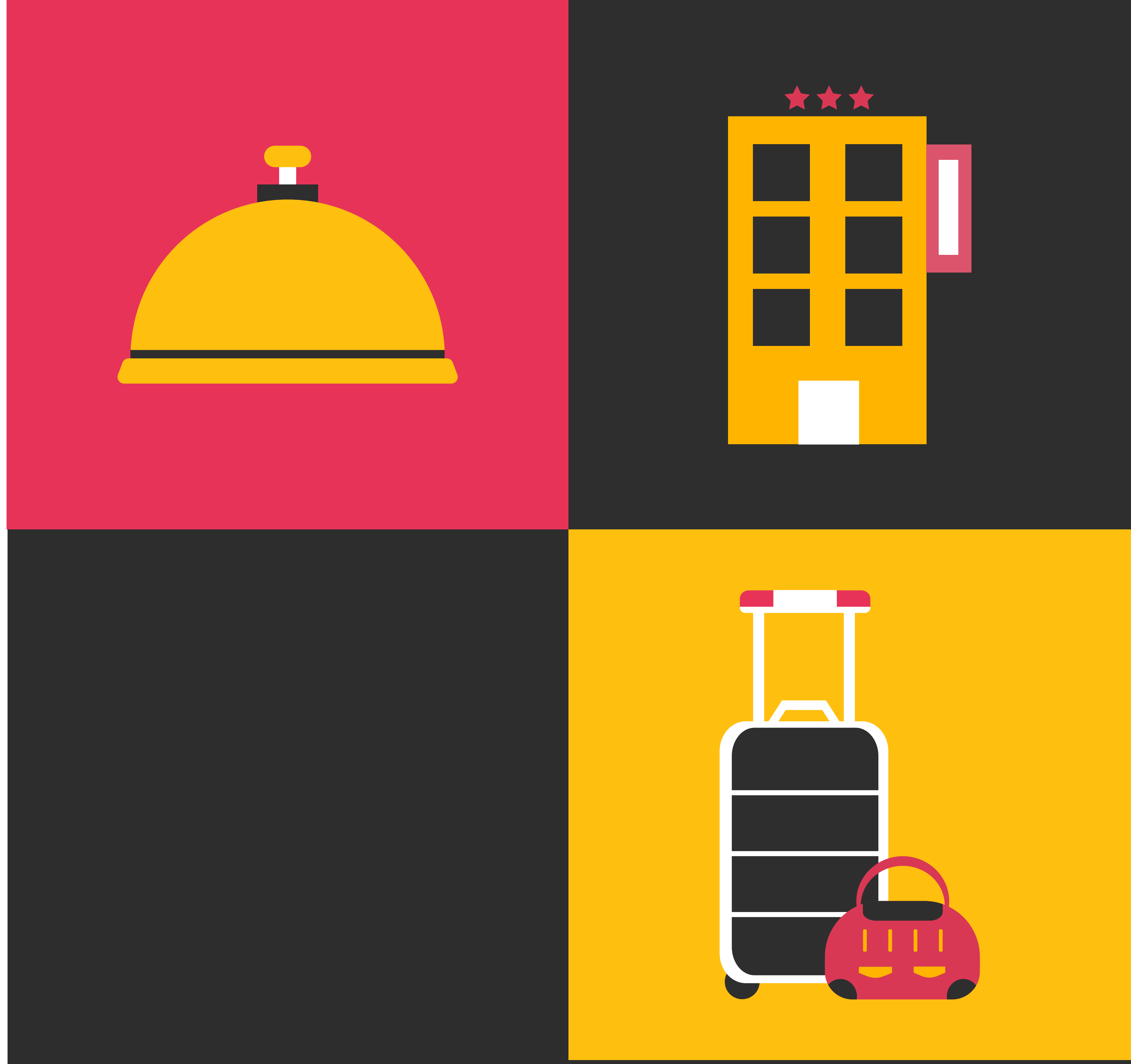
The forecast at a glance



A volatile outlook into 2021

In the bleakest outlook since benchmarking began, hotel occupancy rates in 2021 are forecast to be 55% across the UK, and could take four years to return to pre COVID-19 levels. This is a stark reality for a once optimistic industry, which had seen a decade of growth post the global financial crisis.

Given the large number of uncertainties around COVID-19 restrictions, forecasting hotel demand is extremely challenging. The availability of a vaccine that can be quickly and widely administered is key to demand recovery coupled with consumer confidence to travel.

The challenge the industry has faced is which assumptions to model. For this reason our forecast is modelled on an average of two scenarios regarding COVID-19. The first assumes a vaccine in Q1 2021, the second assumes a vaccine in Q3, though neither are guaranteed. If no vaccine is developed this will dampen demand further.

In both scenarios, the forecast for 2020 shows the largest percentage decline in revenue per available room (RevPAR) since formal hotel performance benchmarking began, followed by the largest percentage increase in RevPAR for 2021.

The forecast for occupancy in 2021 is predicted to be 52.4% for London and 59.2% for the regions. This represents a decline of 31% and 16% respectively when compared to 2019. This shows the scale of the challenge for hotels planning for the year ahead: the only significant market now, and into 2021, will be UK domestic tourism.

Business travel will remain muted. Key gateway cities relying heavily on international leisure, or corporate and events driven demand, including London and Edinburgh, are forecast to experience lower occupancy rates in 2021 compared to coast and country locations.

Although forecasts for 2021 show some relief compared to the precipitous declines of 2020, this is far from ‘business as usual’, with room occupancy rates across the UK forecast to be at the lowest level since hotel benchmarking services began gathering data in the 1970s.

Hotels must act now to recover

The recovery in occupancy is likely to take longer than recovery from the 2008 Global Financial Crisis. It appears unlikely RevPAR in London will return to 2019 levels in real terms until 2024, with the UK regions possibly achieving the same result a little earlier in 2023 subject to a successful vaccine implementation in 2021.

The economic outlook for the UK is ‘unusually uncertain’, according to the Bank of England. After five years of above average supply growth in the UK, new hotel room supply growth is likely to be severely reduced and overall supply growth may well turn negative when permanent hotel closures are factored in.

While the route to recovery is unlikely to be smooth, there are actions hoteliers, and those who invest in the industry, can take to put themselves on the right path. They need to have control over the complex financial, operational and strategic challenges they may face to find success through a strong recovery. Through focusing upon operations, liquidity and cash, financial restructuring and stakeholder management and strategic mechanisms now, hotels can help mitigate the uncertainty of the market.

To find out more about how to maximise your options and restructure for recovery, click **here**.

Occupancy — 2021

London

52.4%
(+81.9% vs 2020)

Regions

59.2%
(+57.4% vs 2020)

ADR — Average daily rate — 2021

London

£112.72
(+13.7% vs 2020)

Regions

£64.22
(+4.6% vs 2020)

RevPAR — Revenue per available room — 2021

London

£64.81
(+125.7% vs 2020)

Regions

£39.89
(+72.6% vs 2020)

> No previous event has had such a deep and long-lasting negative impact on hotels and there is no quick fix. The positives are that the UK regions are likely to benefit from increased staycation demand in 2021 and hoteliers have demonstrated great resourcefulness and adaptability in previous downturns in demand.
>
> **Stephen Broome, Lead Hotel Consultant at PwC UK**

Source: Econometric forecasts: PwC September 2020, Benchmarking data: STR. Our forecast is modelled on an average of two scenarios regarding COVID-19. The first assumes a vaccine in Q1, 2021, the second assumes a vaccine in Q3, though neither are guaranteed.

The forecast in numbers 2020 — 2021

Hotel forecast for 2019 — 2021

Occupancy	London	Regions
2019	83.4%	75.4%
2020	28.8%	37.6%
2021	52.4%	59.2%

ADR — Average daily rate	London	Regions
2019	£153.54	£71.18
2020	£99.16	£61.40
2021	£112.72	£64.22

RevPAR — Revenue per available room	London	Regions
2019	£128.70	£53.98
2020	£28.72	£23.11
2021	£64.81	£39.89

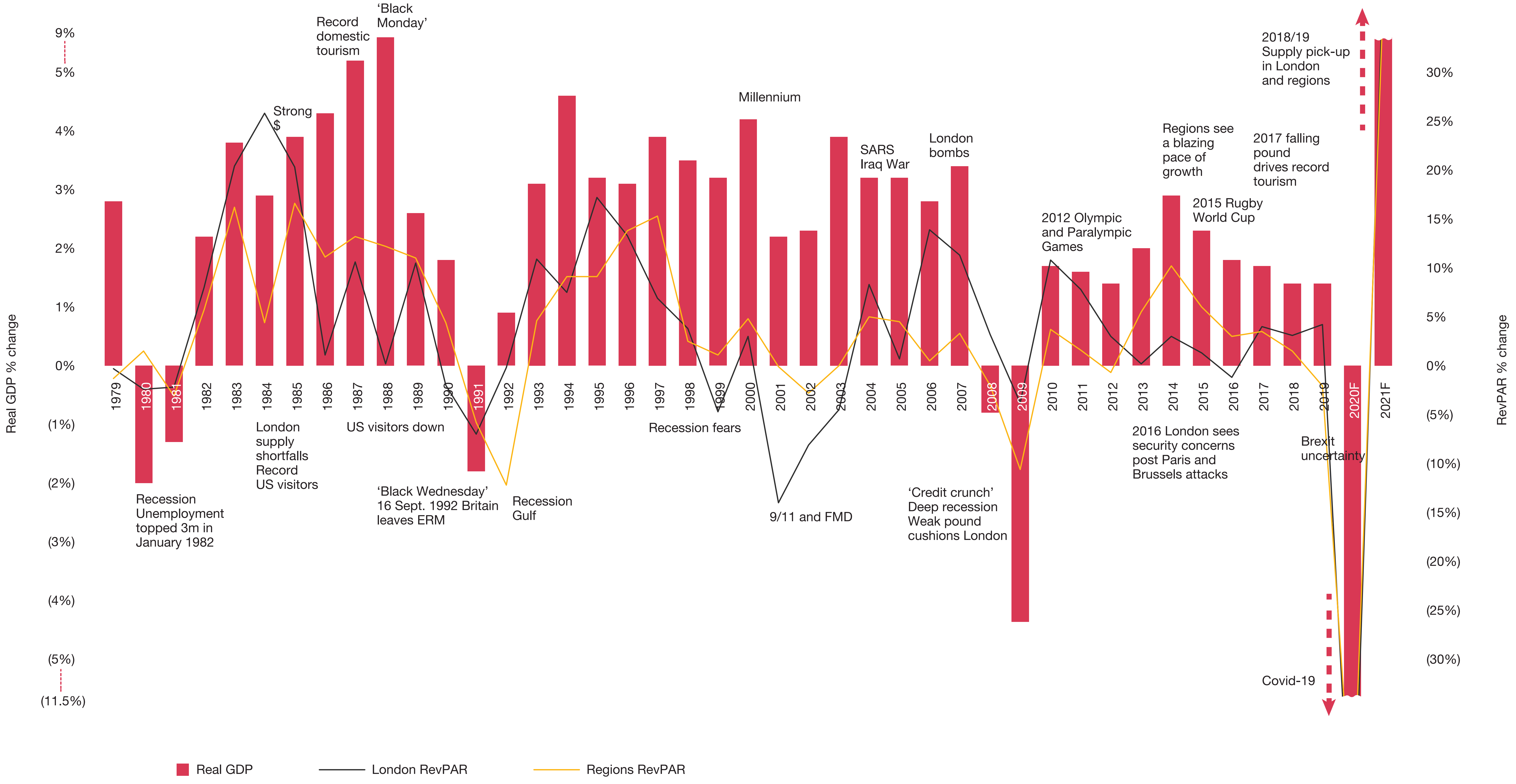
Assumptions

Figures are based on the average of two scenarios. The first scenario is a vaccine in Q1, the second is a vaccine in Q3. This would, in effect, anticipate a vaccine announcement in Q2 2021.

All forecast averages are based on trading for a 12-month period for 2020 and 2021

Real GDP growth

Revenue per available room (RevPAR) 1979-2021F



RevPAR % Change

2020	
London	(-77.7%)
Regions	(-57.2%)
2021	
London	(+125.7%)
Regions	(+72.6%)

Source: Econometric forecasts: PwC September 2020
NB: Dual axis GDP on left and RevPAR on right
Macroeconomic data: National Statistics
Benchmarking data: STR July 2020

London & regions forecast in detail

Staycations: A boon for the regions

As the UK hotel sector reflects on the worst RevPAR figures in half a century, those looking for signs of potential new revenue streams are converging on staycations in the UK regions.

Ongoing travel restrictions and local lockdowns, as well as the fear of quarantine on return from overseas holidays, will fuel domestic leisure tourism in 2021. At the same time, regional tourism boards and other players in travel and tourism are stepping up their game. However, this market is also not without risk, the new three tier system in England will see additional restrictions that may hamper holidaymakers ability to travel within the UK.

Sharp drop in occupancy, ADR and RevPAR

London hotels are forecast to achieve an occupancy rate of 28.8% in 2020, while the UK regions are forecast a higher occupancy of 37.6%. This is a significant decline of 54.6% and 37.8% respectively on 2019 and the lowest occupancy since benchmarking records began in the 1970s.

ADR also dropped substantially between 2019 and 2020, by £54.38 for London but only £9.78 for the UK regions. While RevPAR fell £99.98 for the capital in the same period, for the regions it fell £30.87. The forecasts for the remainder of this year predict occupancies will reduce in Q4 as staycation demand dwindles. This is coupled with minimal business demand in many locations.

Subdued demand in London

The forecast for London in 2021 assumes a slow recovery in domestic business trips though this is conditional on how government advice evolves on people working from home. The capital's prospects are worse than that of the UK regions next year. London hotels are more dependent on business trips, meetings and events, as well as international travel – all of which show weak demand. In addition, fewer UK domestic tourists are visiting the capital for a staycation as consumers favour coastal and country locations due to COVID-19.

The impact of weak demand coupled with a demand shift towards lower-priced leisure travel, as well as an above-average increase in new supply, all contribute to the forecast low levels of occupancy and ADR.

Regions offer most potential

The UK regions are expected to fare better than London in 2021, whether a vaccine is developed or not. The demand for this is overwhelmingly domestic. UK coast and country properties offer potential, and it is the onerous and unpredictable overseas travel restrictions driving this trend. Yet a stronger staycation market is not guaranteed in 2021: a third wave of COVID-19, rising unemployment, recessionary pressures and a loss of consumer confidence could all dampen demand.

With room occupancies in the UK regions in 2020 exceeding 75% in the last week of August, and many coastal locations recording over 90%, there is a realisation this market has potential. Cornwall and Devon lead the way with the Lake District also showing high occupancy, according to STR data. While this trend provided a much needed-boost for UK hotels, it was perhaps surprising that demand was so strong in the middle of a pandemic, yet also a promising sign for 2021.

Source: Econometric forecasts: PwC September 2020, Benchmarking data: STR

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Priorities for hotels in 2021

1 Create an agile business model

The hotels that will realise opportunities into 2021 are those that are leaner, simpler and nimble. Now is the time to **think differently**, shift focus to customers and tune in to their needs, reorganise their operations and innovate. Week-by-week strategy reviews will be vital. They will allow hotels to be proactive and improve delivery in an unpredictable market.

Data in silos can be an issue. An overarching view will help hotels maintain cash flow and liquidity and enable them to be strategic when it comes to prioritising variable costs or cutting where necessary. Updating hotel occupancy forecasts daily will provide valuable insight, while looking to restructure finances and defer capital expenditure where possible.

The fallout from COVID-19 is expected to affect hotels for an extended period. Hoteliers and investors will need to do their own forecasting, scenario planning and stress testing. Doing this at speed and fine-tuning strategies must be part of this process.

2 Rethink your investment strategy

The market is in stasis as lenders so far deprive private equity and other hotel **Real Assets** investors the opportunity to pick up bargains in the UK hotel space. But this will only be for a limited time as the current uncertainty is making it difficult to make any positive decisions, which is forcing lenders to revert to ‘amend and extend’ until next year when there may be more visibility.

With the recent tendency towards greater leasing across the sector, there has been an immediate need for hotel operators to proactively negotiate new models of sharing the risk or pain with landlords with more variable hybrid lease structures, which has been essential to ensure ongoing survival during this volatile trading period.

And for those more recent deals which tended to favour increasing leverage through more complex financial structures, we have already seen a need to look to recapitalise almost immediately during this current operational distress, in order to prevent value already breaking within the capital structure. It is unlikely that this will prove sufficient to see these structures through the longer term market turmoil.

Investors need a forensic-level understanding of how their properties and portfolios are operating. Hotels with weaker covenants and those that are not well capitalised will struggle. It will be the survival of the fittest hotels — those with a good product, location, brand and operator, and most able to adapt to a post covid market — while those falling short in any of these areas will be in greater trouble.

And for those hotels that have relied upon those business segments potentially most susceptible to a longer term structural shift (e.g. conferences and events) there may also be a potential need to repurpose their product to look to accommodate alternatives, for example the seemingly growing corporate need for more remote flexi-working.

It is proving a very challenging market to determine the new norm and likely liquidity requirements, together with a difficult refinancing market, except with more expensive alternative lenders. The longer it takes for hotel markets to recover, more businesses will struggle with long term cash flow shortfalls, banks will need to find alternative remedies for ongoing covenant breaches, and more situations where **restructuring/recapitalisation** will result.

In the medium term, investors must look at their investment strategy — and whether the hotels they have in their portfolio are focused and targeted on the most significant market for 2021, UK domestic tourism. Regional holiday markets in 2021 that may have been previously overlooked for investment could show promise, especially if staycation becomes more of a long-term trend. The potential for acquisitions of hotel assets that are priced below long-term values could offer a once in a lifetime opportunity, while considering how you might divest or repurpose any non-core existing assets, and how you might most effectively structure your streamlined portfolio will ultimately be key to emerging leaner, smarter and stronger.

PwC UK Real Assets Business Recovery Partner Mark Addley comments: “Investors, lenders and management teams need to work together and act decisively to protect value where cash issues arise. This will be different for each scenario, depending on the medium term prospects of that hotel”.

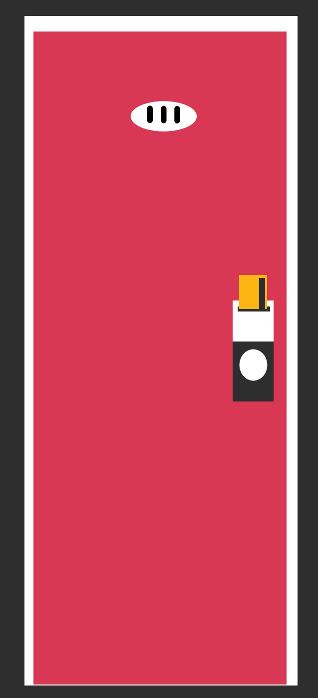
3 Know your customer and be prepared to change your strategy

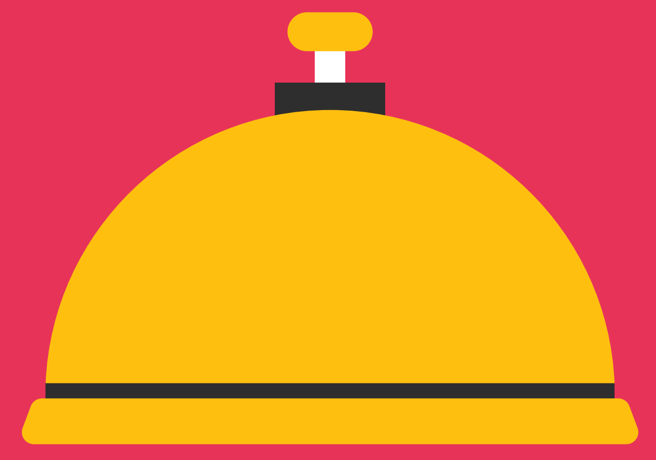
Understanding guest sentiment using customer relationship management (CRM) tools will be vital, especially as COVID-19 outbreaks linger. As revenue for some hotels shifts from business and international to domestic leisure guests, data will be crucial for delivering insight into their habits and a unified guest experience.

More joined-up and real time data, more accurate data analysis, and information from new sources — such as health, consumer sentiment indexes, retail data or mobile phone mapping – will help hotels stay competitive. Hotels will need to use their CRM system to gain insight in order to stay ahead of rivals and while it can sound advanced, it doesn't need to be expensive. Work quickly to determine what works, and what doesn't.

Hotels will need to be comfortable with a short-term marketing plan that is changeable based upon the evolving pandemic. This may be orientated towards UK domestic tourism and which can be constantly updated as the market shifts. For some hotels this may not have been their core market, and competition will be tough as more properties compete and focus on a smaller, less diverse cohort of travellers.

> As staycation demand for 2020 tails off and with nothing to fill the void, the end of this year and early next will be crunch time for many hotels in terms of the stresses they're experiencing. Now is the time for hoteliers to take action to help themselves through this difficult period.
>
> **Samantha Ward, Hotels Leader at PwC UK**





Beyond the forecast: future expectations

1. An uneven market and an uneven recovery

Key urban centres and gateway cities in the UK, dependent on overseas tourism and corporate travel, are likely to perform significantly worse than those in the regions focused on domestic leisure. Likewise, dependent on the shape of the pandemic, the recovery is likely to be felt unevenly.

A combination of lower spending domestic leisure demand and a drive to fill vacant rooms through discounting to offset fixed costs is likely to depress ADR and this in turn will negatively impact profit margins.

There will be a significant reliance on price-sensitive UK leisure demand going forward, with a large volume of supply chasing this market. This represents a particular opportunity for hotels in the regions in 2021, especially those offering unique stays in areas that are underserved by supply.

Competition among regions is likely to heat up in 2021, as popular areas from the West Country to the Lake District vie for guests. Strong domestic leisure will also offer new potential investment opportunities to expand UK portfolios.

2. Continued ambiguity following COVID-19

Uncertainty remains as to when overseas travellers will feel confident enough to return to the UK. It will also be dependent on infection rates in other nations and restrictions the UK government imposes.

Further ambiguity is found surrounding the return of events, conferences and large public gatherings. Q4 has traditionally been a significant time for this type of travel, yet 2020 will not see any benefit.

There's an increasing focus on hotel health and safety regimes, new protocols, and digital platforms to minimise interactions with guests, as well as paired down food and beverage offerings. Some changes may not be reversed and could represent a new way of working, with implications for operations and costs.

Some hotels have created branded health pledges, while others have joined accreditation schemes to strengthen their message. COVID-19 protocols including extensive use of visual PPE for staff and preparedness are a new differentiator for hotels.

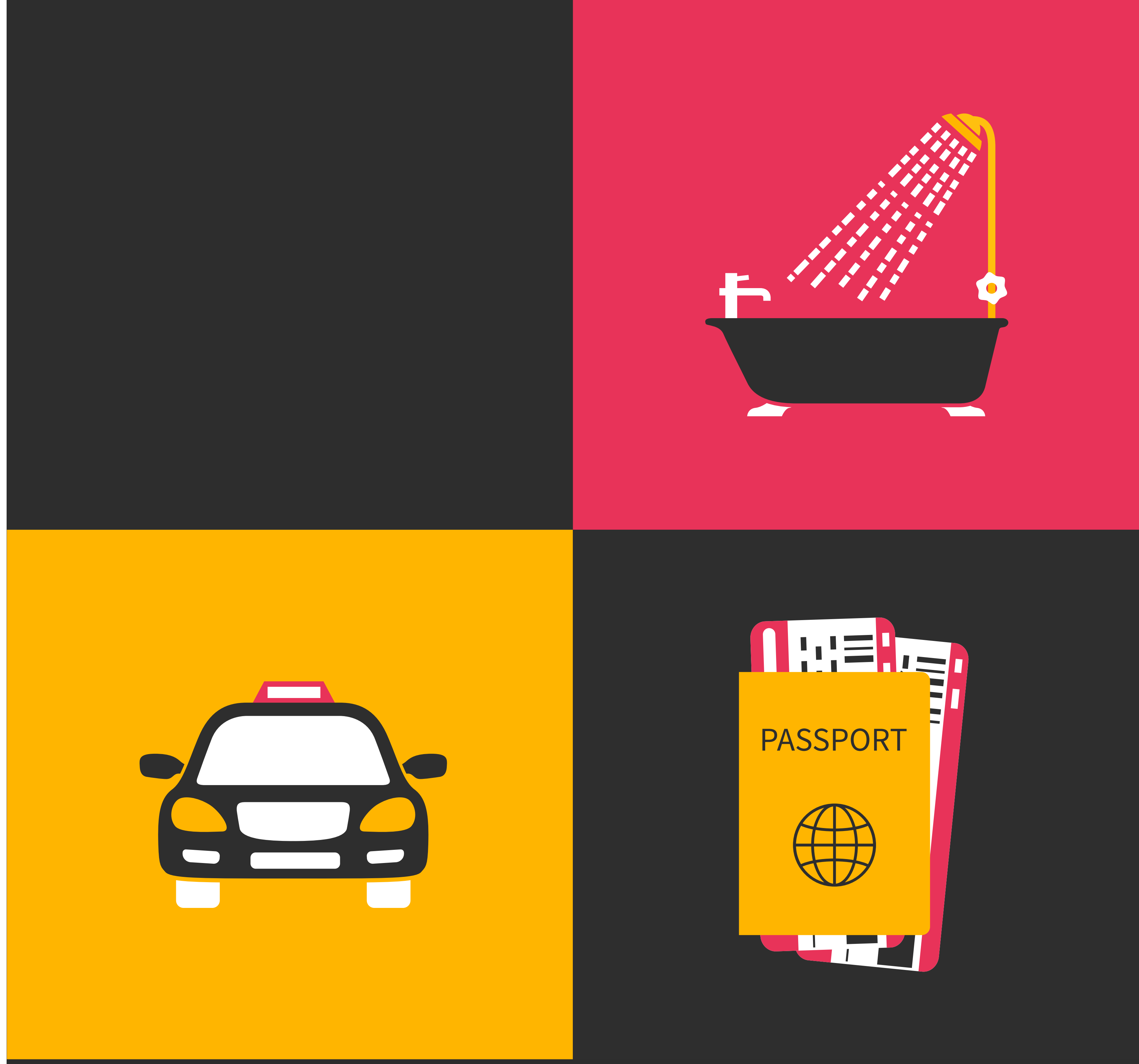
3. New working patterns will shift demand permanently

COVID-19 has accelerated the adoption of digital collaboration tools and reduced the need for face-to-face meetings. This is likely to have long-term business implications for travel demand.

There is also a question over when UK employees will be able to fully return to offices, especially in key gateway cities – this is now looking likely to be well into 2021. Gauging sentiment on this will be vital, even after the government's current 'work from home' edict relaxes.

Working from home and digital collaboration are also impacting hotel operations. Some chains are relocating staff to local properties closer to where they live so they can avoid public transport. There will also be a greater need for more digital infrastructure and up-to-date systems to cope with remote working, including up to date cyber security defences.

Some hotels may see an enduring shift in demand patterns post-COVID-19: Bernstein research indicates 20% of business trips may never come back. Combined with the shift to domestic leisure, it could create systemic issues for some and opportunities to innovate for others.



4. Uncertainty over new supply

The issue of new room supply at a time when occupancy is low is a crucial factor. Last year, PwC forecasted record supply growth of 1.6% for the UK regions in 2020 and 1.7% for London; for the regions this was likely to create a hangover across some UK cities.

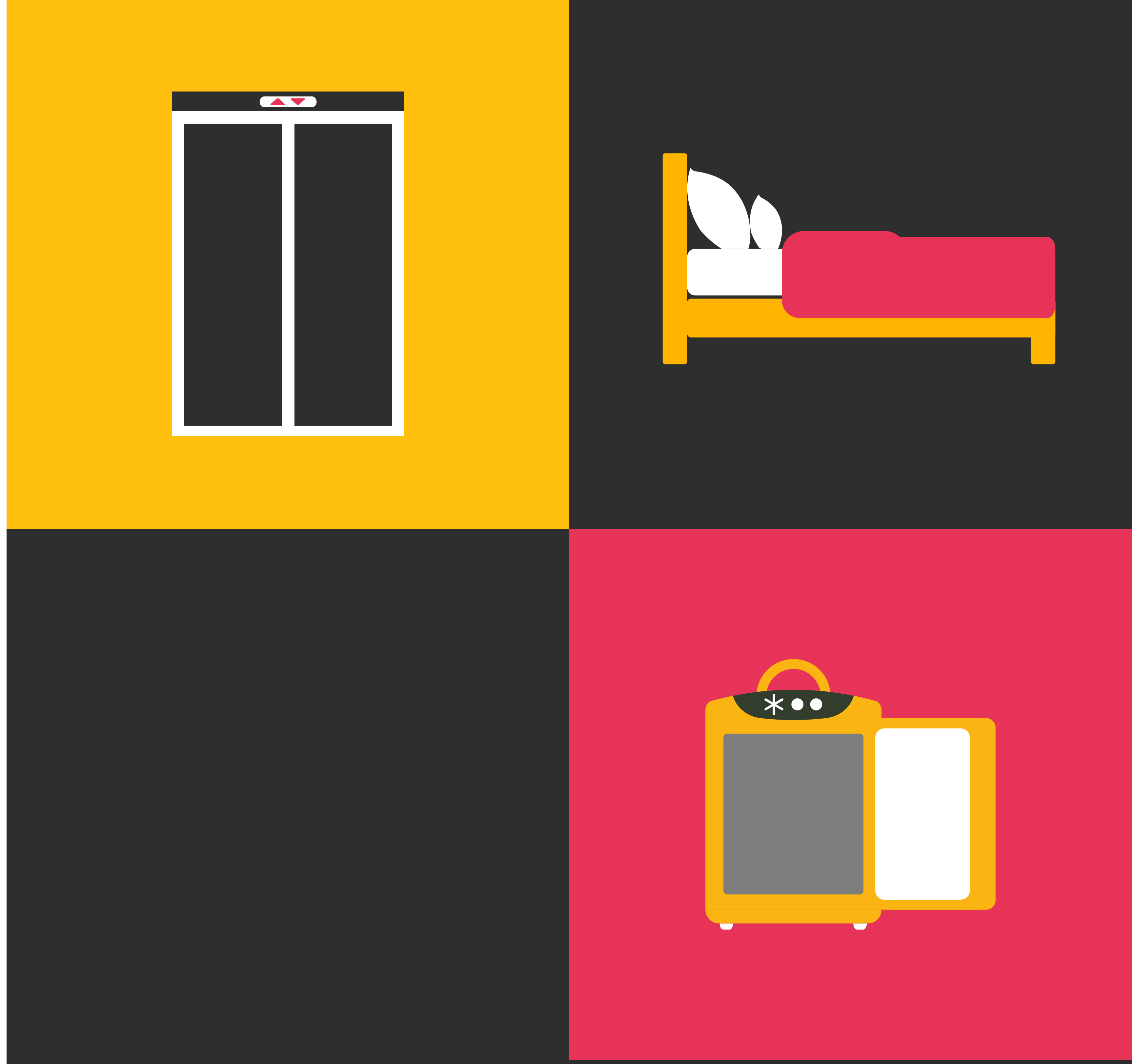
However, since the pandemic hit, some openings have been delayed and other developments put on hold. The number of hotel rooms in the pipeline is unpredictable and could impact performance, but new openings are still occurring. It is too early to predict the level of permanent hotel room closures but it is anticipated to be above average levels for 2020 and 2021.

5. Brexit unlikely to affect demand due to timing

When the transition period ends on 31 December, this is likely to have little effect on demand, since international and business travel arrivals will be subdued for the 2020-2021 period, although it may increase operating costs.

Brexit could create further uncertainty for both labour markets and the value of sterling. The UK government’s decision to scrap value added tax relief for overseas visitors from beyond the EU at the end of the transition period could also affect retail tourism.

> Travel will return, but the recovery is going to be longer this time. It took several years to climb out of the last recession. The post-COVID-19 recovery will be slow and gradual. As a result, the hotel sector will be forced to accelerate the pace of change in the use of IT, automation and lower cost business models in order to survive and prosper.
>
> **Stephen Broome, Lead Hotel Consultant at PwC UK**



Want to find out more about setting out on the road to recovery? Click here

Employment and furlough: time for the great rethink

What's the situation?

COVID-19 is forcing hoteliers to rethink how they deploy their human resources and manage staffing levels. Labour is a significant variable cost for hotels with many resizing, restructuring, reconfiguring and in some cases reducing their service offering.

The end of the Coronavirus Job Retention Scheme (CJRS) comes on 31 October. It is being replaced by the less favourable Job Support Scheme for those employees working at least 33% of their usual hours with a more generous version paying two-thirds of wages where businesses have had to close due to a local or national lock down. At the same time, hotels are likely to see demand slacken as we move into Q4.

City-centre and airport-based properties, those focused on international and business travellers, as well as those dependent on conferences and meetings are the ones looking at labour costs more closely.

A significant proportion of the hotel workforce are not UK nationals. This could impact labour retention, especially in the run up to the end of the Brexit transition period on 31 December.

Why is this important now — what's changed?

The CJRS has helped hotels avoid an employment cliff-edge and has served as a vital lifeline. It has also allowed businesses to bring back staff when hotels reopened and claim money from the government when time hasn't been used.

Yet, the government scheme is delaying decisions, and potentially the inevitable. Many furloughed workers will turn into permanent layoffs.

At the same time there is confusion around CJRS 1 and 2. Hotels have had to be mindful of the claims they're making, because the calculations for HM Revenue and Customs (HMRC) are acutely complex. Some hotels have struggled to comply and things are only likely to get more complex under the Job Support Scheme (JSS) from 1 November.

Continued uncertainty over Brexit, along with concerns over COVID-19, has the potential to further impact hotel employees.

What should hoteliers be doing?

Businesses with less developed human resources and payroll schemes need to be fully aware of CJRS and JSS regulations and calculations, and should get advice if necessary. If hotels get claims wrong, it will not only attract the attention of HMRC but be damaging in terms of penalties and brand reputation.

A thorough review of human resources and core staffing needs is also vital. Many businesses must be more flexible when it comes to their labour model. At the same time, the expectations of employees have changed in the wake of the pandemic.

Staff are already taking on multiple roles; cleaners work front of house, and check-in staff manage concierge services. Smaller hotel groups should look to centralise reservations and bookings, as well as procurement previously duplicated in separate properties. Technology systems in the cloud and across multiple properties can help.

Hotels with a payroll of more than £3m have been contributing 0.5% to the government's apprenticeship levy for over three years now. They have accrued significant levy pots to fund and train apprentices, a lot of which hasn't been spent.

The accrued levy is dispersed after two years if it's not used, so now is a chance to invest this money in training, especially getting staff up to speed doing multiple roles in hotels.

Employers need a firm grasp on how many staff are overseas nationals, how many are from the EU, what their roles are, and how much of a risk this is to the business post-Brexit. Hotels have to consider how many will leave and when, as well as how they are going to recruit new staff.

Think twice about redundancies, there is a price to pay for losing staff and their know-how, as well as re-employing them. You are likely to need retained talent when occupancy picks up again. There is already a talent retention challenge in the hotel sector.

Hotels must also be aware of the increasing cost of payroll. The minimum wage, which many hotel employees earn, is £8.72 an hour — 60% of median UK earnings. This is projected to rise to 66% of median earnings by 2024, which under current forecasts means a rise to £10.50 an hour. This rising cost must be factored into budgets.

Businesses need to get the most out of their workforce and value their staff more. Employees will be an increasingly expensive asset over time, so it needs to be deployed as effectively as possible. Technology can help.

How can things be done differently?

COVID-19 is providing hotels with a fresh impetus for digital transformation. A number of hotels have been deploying more contactless technology, digital check-in, and digital room keys, as well as in-room voice devices and digital concierges. This allows fewer touchpoints with workers, but also automates systems and frees up staff time to improve guest experiences.

Hotels are lagging behind other industries, such as retail, when it comes to deploying technology. Some retail players have looked at pooling resources to cope with COVID-19, while others are looking at virtual onboarding to speed up hiring on the upturn.

> The people function needs a lot more attention right now. It is an increasing risk. Hotel businesses often neglect this. It needs continual investment. Now is the time to reassess.
>
> **John Harding, Head of Employment at PwC UK**

Key takeaways

- Furlough claims by hotels to HMRC are complex and the position is changing: seek advice
- The year-end Brexit cliff-edge is a risk: model its impact on your staff
- A thorough review of human resources is needed to create a flexible labour model
- The rising cost of employment is ongoing, deploy staff effectively
- COVID-19 is providing hotels with the impetus for digital transformation

Data: analytics can fine tune hotel strategies

What's the situation?

We're in an era of extreme uncertainty going into 2021. Past data is less valid than it was. Pre-COVID hotels data and data early in the outbreak does not tally with what is going on right now.

The booking window has also been shrinking, and for hotel revenue managers this is unnerving.

As of August, business on the books for UK hotels was 12% for the next three months: normally it would be three times that, according to STR. Hotels need intelligence right now on how to achieve revenue.

Yet hotels are often under resourced in terms of data analysts and analytics. Historically, this has not been an area of priority. With such low occupancy rates predicted into 2021 hotel businesses need a renewed focus on what data analytics can achieve. It can help hotels make informed, proactive decisions at pace and scale.

Why is this important now — what's changed?

COVID-19 has upturned the sector. UK government policy is having a significant impact on bookings. Gauging leisure and business travel sentiment on a day-by-day, week-by-week basis is crucial.

This is a volatile, fast-moving environment. Room rates are highly dynamic, and data can help inform a hotel's strategy.

The information that goes out in the press has a huge impact on UK consumer sentiment, the public's general behaviour and hotel bookings. This can be incongruous to the facts associated with the COVID-19 pandemic and science-based data. Gauging both at the same time is imperative.

Markets are also inefficient. Some hotels are overpriced in some spots or under-priced in others. This opens opportunities for hotels to capture desperately-needed market share.

What should hoteliers be doing?

With such uncertainty, it is crucial for hotels to have a 360-degree view of their customers through multiple sources of data, including profiling and demographics through segmentation, consumer sentiment regarding travel and mobility data. Cancellation information is also proving invaluable. Knowing why people cancel and factoring this into operations will be vital.

Many older people are still reticent to travel and may still be shielding, while the younger generation have fewer concerns. Therefore, modelling what drives booking and cancellation likelihood for prospective guests pre-COVID versus the present is imperative to understand which customers represent the best opportunity for hotels. Investors should also look at such analyses to consider alongside traditional due diligence methods as part of deciding which hotels will have bookings in the short or long-term.

Dynamic pricing has also come into its own during this volatile period. But it should be combined with highly targeted marketing so hotels achieve the right price from the right customer.

Providing discounts on non-core offerings such as food and beverage or wellness and spa can help hoteliers maintain pricing on their core room product, yet still attract the customers they want.

Customer booking patterns have also shifted to much shorter lead times. Hotels need to minimise any inventory restrictions they have and make the booking processes as flexible as possible.

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>
> One thing that's changed with COVID-19 is that hotels need to be more focused on the data that matters to them most. Localised data is also vital in this process. There's no doubt better data informs business agility.
>
> **Megan Higgins, Director, Customer Analytics at PwC UK**

How can things be done differently?

Because of COVID-19, new data sources are now vital to determine how markets operate. This involves health and consumer sentiment indexes, to mobility and behavioural data, most of which the hotel industry has never had to consider in-depth.

Bringing these new sources into the mix along with booking information, travel data, demographic profiling, as well as social media listening, online surveys, mobile phone data, government policies, including public and road transport information, hotels can make better predictions on traveller behaviour and future bookings; such an approach does not have to be costly. Instead, hotels should aim to 'fail fast' by trying new ideas quickly and adopting what works.

UK government policy in response to local COVID-19 outbreaks also impacts demand significantly. It influences all key indices right now including mobility, travel, discretionary spend, unemployment, disposable income, GDP and the cost of social distancing. This must be factored in. Pulling this together with how competing hotels react and how customers respond, will allow hotels to make more informed decisions.

Accor, for example, has adapted a hyper-localised business strategy after restructuring. Realising local opportunities to any property will be crucial going forward. Localised data sources can help with this process.

Traditional bricks and mortar retail, as well as print media have had to contend with major challenges in the past and reinvent themselves to compete against online disruptors. Successful incumbents have looked at rapid, short-term transformation projects powered by data analytics.

Hotels are facing a similar moment of upheaval right now. Those businesses that treat COVID-19 as a distinct agile transformation project could achieve quick gains over several months, compared to a traditional transformation project, which takes years.

This type of project can solve specific issues such as remedying data silos or demand-driven revenue management and forecasting. It helps if there are pilots to better segment guests, predict demand and gain a 360-degree view of the customer.

This involves rethinking a hotel's roadmap, with questions focused on change: How do I get demand back and make an impact on my business? Where do I need to invest quickly today to make a difference to hotel revenue tomorrow?

Bringing data silos together in an entirely new project will allow hotels to construct data models and pilots that could make a real difference to the bottom line.

Key takeaways

This highly dynamic, volatile, and uncertain market needs superior data analytics

Segmentation analyses and demand forecasting will help hotels target those travelling in 2021

New sources of data in the mix will allow hotels to stay ahead of the competition

Dynamic pricing should be combined with highly targeted customer marketing

Cost-based transformation: think differently about where you invest your cost

It is unlikely UK hotels will bounce back fully until the economy gathers momentum and COVID-19 is behind us. It's therefore not surprising some hotels are already restructuring.

The key issue right now is liquidity and cash flow, since there may be no clear route to better revenues. Layoffs and property closures have affected even the largest and best-performing properties. Many businesses that supply, or are landlords for UK hotels, also face challenges.

Why is this important now — what's changed?

Christopher Nassetta, CEO of Hilton, said recently: "Never in the company's 101-year history has our industry faced a global crisis that brings travel to a virtual standstill." He is not overstating the issue. There is now excessive risk in the hotel sector, and this is especially true around airport properties, those focused on conferences or international arrivals. At the same time sterling is weak, and the market is extremely competitive.

With two lean quarters ahead, hotels are focusing on rapid cost cutting. Yet many are failing to think about the bigger picture. A more holistic vision on costs could transform a business, and therein lies the opportunity.

The pandemic is also a catalyst for change. It's allowing companies to articulate projects in ways they never thought possible, specifically digital transformation and new deals with stakeholders.

What should hoteliers be doing?

Stockpiling liquidity right now is the number one goal. Cash is king. If you have cash, you have time, if you have time, you have options and if you have options you can create value.

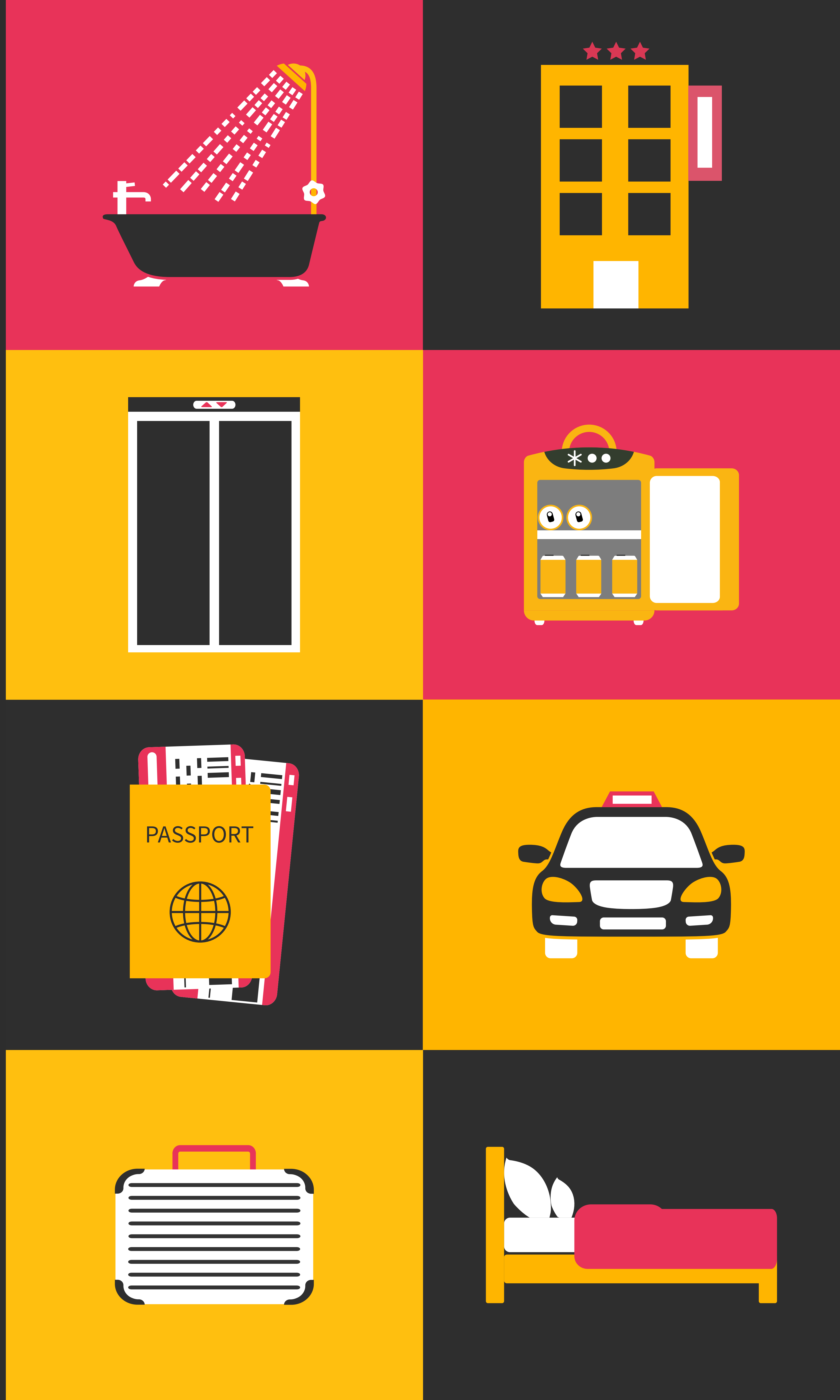
To have the best chance of coming through the crisis, hotels' focus should be on cost-based transformation. This involves removing costs from a business, with the capital released then reinvested in ways aligned to the strategic future of the hotel. In the process, this accelerates transformation.

Hotels need to look at the issues through three lenses. Firstly, a strategic lens, asking 'what do we want to achieve?'. Secondly, an operating lens, detailing how it can be achieved. And an efficiency lens, exploring how well it should be done.

In the current climate, hotels cannot cut their costs to success. It is easy for businesses to look at efficiency gains or reducing operating costs. Instead, management teams must create a strategic set of goals. This involves reframing the business towards the customers of the future.

It's also worth considering zero-based budgeting. This involves finance departments going back to zero, with every fixed and variable cost justified from the bottom up, rather than trimming last year's budget by a few per cent. This process forces hotels to rationalise every pound spent and could include for example revisiting established operational practices such as frequency and level of guest room servicing or revised food and beverage offerings and opening times and works well when each cost is linked to what it achieves, particularly revenues. It is important to think laterally about where reductions in operating costs can be made, whilst remaining focused on delivering what hotel guests actually want and value.

With the future of UK hotel demand so uncertain it's worth taking tough decisions now rather than risk losing control later. If you don't make hard decisions today, they are likely to get harder. If liquidity runs low, you cannot pursue your strategic aims. You are then beholden to other stakeholders and your management team risks losing control of the agenda.



How can things be done differently?

Cost-based transformation could be a way of using money saved on, for example, reduced food and beverage offerings, to achieve more with goals in sales and marketing, especially with the shift to staycations in 2021. Making investments in fresh revenue generators on the back of cost savings achieved through operational efficiencies is an innovative approach.

Companies are also using this crisis differently, with COVID-19 seen as a catalyst for reassessing the hotel delivery model. Many are accelerating the rate of technological change. Four-year digital transformation projects are now being squeezed into less than a year. This can involve moving back-office services to the cloud or digitising guest interactions.

The pandemic can be an opportunity to reimagine supply chains, tap into more affordable pools of remote talent globally, or a way of putting in place more flexible labour models. Job-sharing is increasingly popular in the US right now.

> Hotels need to realise the transformative power of cost. It's about using cost savings to release capital, and using this capital to reinvest in your product of the future. Cost-based transformation can help you reimagine your business.
>
> **Zubin Randeria, Cost Based Transformation Leader at PwC UK**

Key takeaways

- Cost-based transformation needs to be front of mind, alongside restructuring
- Create liquidity through operational cost savings to reinvest in revenue generators
- To stay in control, make the harder decisions sooner rather than later
- Use COVID-19 as a catalyst for change, it's time to reinvent your hotel business
- Where necessary, review contracts with stakeholders

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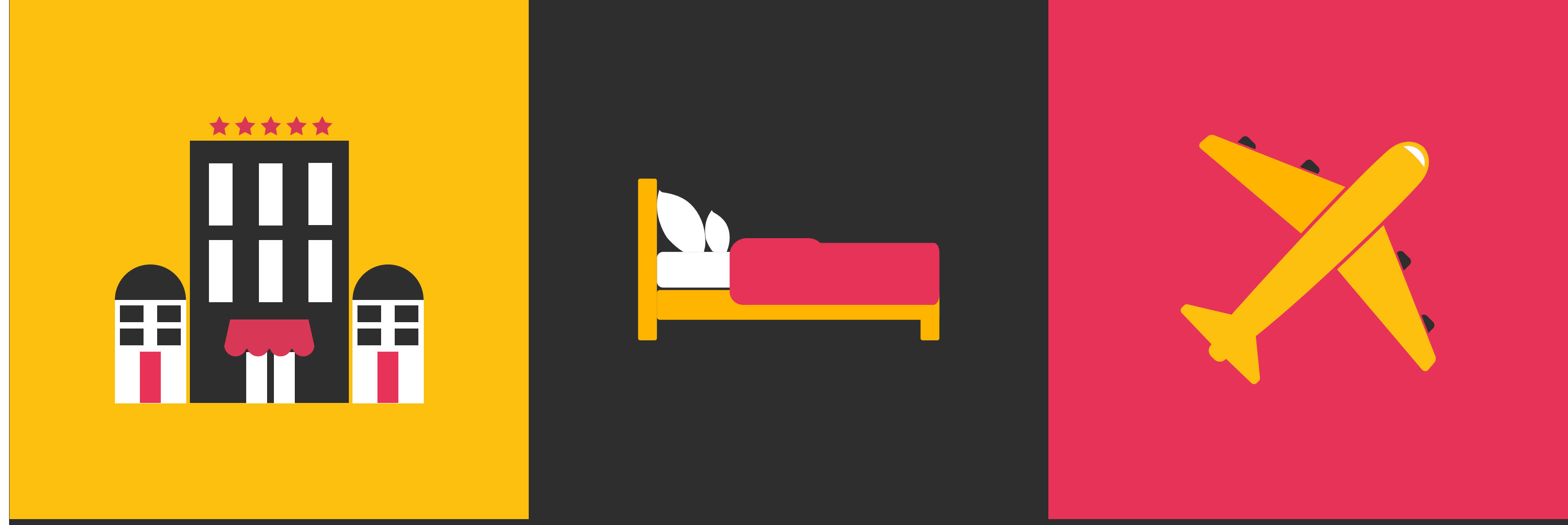

Methodology for the forecasts

Our econometric modelling approach: 2020 forecasts

For the 2020 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.

The econometric model was used to generate forecasts for Q3 and Q4 2020, and these were generated separately for London and the regions. 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. Between March and July of 2020, hotels were required to remain closed and our estimates account for this closure.

Moreover, this forecast was overlaid with our assumptions regarding the course of consumer and business behaviour as a result of the Covid-19 pandemic. Due to quarantine requirements and the uncertainty surrounding them, and changes in the willingness to travel due to personal circumstances, people are projected to take 'staycations' instead of holidays abroad. We used consumer sentiment survey analysis to estimate what proportion of UK residents will take 'staycations' instead of travelling abroad in 2020.

Following on from the adjustments to reflect 'staycations' and lower international travellers as a result of quarantine measures, our analysis predicts that the shock of Covid-19 will be felt differently in London and in regions. A large proportion of the hotel industry in London is supported by international travellers and business hospitality — early indicators in Q2 2020 show that both sources of demand were particularly hard-hit and historically business travel is much slower to recover than leisure travel. Therefore, while regions might see an upward trend due to the 'staycation' effect, London is expected to see a sharper fall in demand.

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2021 forecasts

To forecast Occupancy rates, ADR and RevPAR for 2021 we took a different approach to 2020. The approach is based on an analysis of historical growth rates, assumptions on vaccine development and corresponding consumer behaviour and, therefore, assumed phasing of recovery towards 2019 levels. The approach involved 3 steps:

- First, we use 2020 as our base case
- Second, we developed 3 scenarios: No vaccine scenario, Early vaccine scenario and Late vaccine scenario.
- Third, for each scenario we developed key assumptions for:
  - The percentage fall of ADR, RevPAR and occupations rate in the first months of 2021 compared to the same time in 2020
  - Target recovery levels towards 2019 levels (i.e. pre-covid levels)
  - Timing of a vaccine being developed

We developed a forecast for three scenarios in 2021. Our base case — the forecasts presented in the report — are the average across S1 and S2. This is based on our view that the vaccine will be developed between Q2 and Q3 2021.

S0: No vaccine in 2021

In this scenario we assume that no vaccine is developed and rolled out in 2021. We estimate the occupancy, ADR and RevPAR in this scenario using the following steps:

1. The 2020 projections are used as a base to develop this scenario with an exception of January and February. The lockdown in the UK began in March 2020, hence the hotel industry did not experience the full shock due to Covid-19 in January and February. For this reason, we expect that in a ‘no vaccine’ scenario, January and February 2021 will see a significant fall in performance metrics compared to 2020. The average year-over-year change from 2019 to 2020 is used to estimate the expected fall in January and February 2021.
2. A percentage of the average 2001-2019 year-over-year growth rate is then applied to the new estimates.

S1: Vaccine in Q1 2021

In scenario 1, we make an assumption that the vaccine will be available by the end of Q1 2021. We assume that occupancy rate, ADR and RevPAR will start to pick up in Q2 2021 and accelerate over the summer. By December 2021, we expect the London hotel industry to operate at c. 90%, 80% and 70% in terms of occupancy rates, ADR and RevPAR as compared to 2019 levels in the same month. We further assume that regions will recover faster and reach c. 93% across all variables in December 2021 as compared to the same month in 2019.

S2: Vaccine in Q3 2021

In scenario 2, we assume that the vaccine will be available in Q3 2021. The performance metrics therefore start to pick up in late summer and by December 2021 they reach 80%, 73% and 57% of 2019 levels in the same month (occupancy, ADR and RevPar) in London. For the regions, the effect of a vaccine becoming available later than under scenario 1 has a positive effect as a result of an increased period of staycations, by December 2021 we assume that occupancy has recovered nearly to 100% of the 2019 December levels with ADR and RevPar at around 93% and 91% respectively.

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