

Hospitality industry forecasts for 2010

Gary Akehurst

Rotterdam School of Management, Erasmus University, Rotterdam. Previously of Deloitte & Touche Consulting Group, London.

2009 was a difficult but not impossible year for the hospitality industry. We believe that the industry is still well-placed to secure modest turnover and profitability increases in the face of continuing economic adversity and the onset of a sustained government squeeze, involving not just eye-watering tax increases but also deep cuts in government spending and public sector employment. The UK and global economic slowdown in 2009 will give way we predict to modestly improving hospitality industry growth in the first half of 2010 provided hospitality businesses provide good value for money and excellent quality services for discerning, value-conscious customers. But the second half of 2010 may well be a time of dampened demand as the real effects of government tax increases and spending cuts really begin to kick in.

Hospitality industry predictions for 2009

This article outlines what happened to the UK economy and the hospitality industry during 2009, examines medium-term trends for the British economy and hospitality industry, and makes hospitality forecasts for 2010.

We said this time last year that 2009 would be a year of probably negative economic growth, falling from 1% growth in 2008 to a 1% decrease in 2009 based on Deloitte forecasts. Even the Treasury estimated in November 2008 that economic growth would fall by between 0.75% and 1.25% in 2009. This meant:

- ◆ A decrease, on average and in real terms, in the demand for hospitality services throughout 2009 but this would again be variable according to sector and region; restaurants and pubs would have a particularly difficult time but hotel groups would continue to offer good value special packages and customers would continue to seek perceived value for money, good accommodation, good cuisine and excellent service but there was a danger that widespread discounting of hospitality prices would be counter-productive
- ◆ Acquisitions would again be few and far between as attitudes to risk hardened further, although some bargains might become available as some businesses unfortunately got into cash flow difficulties. Venture capital companies would be conspicuous by their absence in the acquisitions market. Hotel and restaurant groups would continue to adjust property portfolios at the margins to sustain better performing brands, by attempting to sell off under-performing properties, while modestly investing in high margin, good-performing units with even better future potential under new ownership
- ◆ Investment in refurbishment and capacity expansion would be held back partly by a continued reluctance of banks to lend to businesses in the first half of 2009 and partly by a natural but short-term reluctance of business managers to invest in times of difficult trading conditions
- ◆ Business and property values would fall by 5 to 12% outside London; this offered business opportunities for astute investors who took a medium-term view (that is, beyond 2010)
- ◆ Lenders would be very cautious and even more risk averse during 2009 and would continue to lend only on projects which could demonstrate clearly well-above average revenue and discounted profits streams; cash flows would be watched even more closely than usual
- ◆ Business planning and marketing, as always, would continue to need to be very focused, paying particular attention to underlying market trends and consumer reluctance to spend by keeping a level head and establishing a very clear market positioning based on value for money offerings

Generally our 2009 forecast was pretty accurate although demand picked up more strongly than anticipated in the fourth quarter of the year.

The economy last year

The economy appears to have picked up somewhat during the second half of 2009 although official figures recently released show that the UK was still in recession in the third quarter, much to the surprise of the economic commentators, who believed that Britain had come out of recession. There is however considerable uncertainty as to how recovery will materialise in the coming year. The Bank of England, through its "quantitative easing" programme, has pumped around £200 billion of money into the economy. It became obvious during 2009 that the government needs to substantially reduce its debt (that is public sector debt as a share of Gross Domestic Product or GDP). Government debt will not go below 40% of GDP until 2035, which is clearly not acceptable nor sustainable. Regrettably, Britain is set for a period of painful cost cutting and tax raising whichever party is elected to govern in 2010. Meanwhile unemployment, particularly among young people, continued to rise throughout 2009. Unemployment currently stands at 2.46 million (7.8% of employable people). The Organisation for Economic Co-operation recently forecast that UK unemployment will increase to 9.3% in 2010 and to 9.5% in 2011.

Banks are still reluctant to lend money especially to small businesses and they appear to be holding in reserves large chunks of cash while boosting their profits in a very low interest rates regime. The banks need to be brought into line with strong regulatory controls and they really cannot expect to return to their old and largely discredited ways of operating and levels of profitability. Government measures may have to be introduced to "persuade" them to lend more money to businesses.

Over 2009 the pound fell against major currencies, especially the euro, and global demand was stagnating. Interest rates reached a record low of 0.5% and are likely to stay at this level for possibly another 18 months. In terms of economic growth, first quarter GDP contracted by 2.4% and further contracted by 0.3% by the third quarter. Overall, economists predict GDP will have fallen by 4.5% during the whole of 2009.

The hospitality industry last year

A 24% decline in business visits to the UK, in the year to September 2009, has contributed to the continuing fall in total visits to the UK, according to recent data released the Office for National Statistics. During the 12 months to September 2009, the number of visits by overseas residents to the UK, not seasonally adjusted, decreased by 9% (a drop of 3.0 million, from 32.9 million to 29.9 million) when compared with the 12 months to September 2008. Surprisingly in such difficult economic conditions holiday visits to the UK have increased by 1% due in large measure to the declining exchange value of the pound, particularly against the euro. Business trips by UK residents abroad were also down 16% in the 12 months to September 2009, compared with the 12 months to September 2008. Holiday visits by UK residents in the same period also fell 14%. In the 12-month period to September 2009, the number of visits abroad by British residents, not seasonally adjusted, decreased by 14% from 70.4 to 60.8 million (a drop of 9.6 million) when compared with the 12 months to September 2008.

The decline in visitors continues. In the three months to September 2009, compared with the previous three months, results from the International Passenger Survey show that overseas residents' visits to the UK, seasonally adjusted, decreased by 3% to 7.4 million, and overseas earnings decreased by 1% to £4.1 billion; while UK residents' visits abroad decreased by 1% to 14.7 million, and UK residents' expenditure abroad remained broadly the same at £7.6 billion.

During the first nine months of 2009 UK hotels inevitably saw reductions in occupancy, room rate, revenue per available room and total revenue per available room (Total Revpar) according to TRI Hospitality Consulting. This was due in part to business demand being replaced by discounted leisure demand but recently there are clear signs that hotels, particularly in London are improving profitability and Total Revpar as business travellers are now returning. Favourable exchange rates have been driving foreign leisure travel especially from Germany and France in the Eurozone. Also in the provinces occupancy levels have been steadily improving since the summer of 2009 but again heavy discounting has led to lower average room rates. These trends show that demand is growing again, and combined with good cost controls it appears that the declines in profitability have been halted. It is probable that average room rates will drop further until mid-2010.

UK Hotels Performance, 2008-2009 (nine months to September)

	2008	2009	% change 2008-2009
Occupancy (%)			
UK hotels	75.2	72.6	-2.6 points
London	81.6	79.8	-1.8points
Provinces	71.4	68.5	-2.9points
Room rate (£)			
UK hotels	91.90	84.80	-7.7
London	118.09	108.84	-7.8
Provinces	74.61	68.57	-8.1
Revenue per available room (£)			
UK hotels	69.09	61.57	-10.9
London	96.40	86.82	-9.9
Provinces	53.30	46.94	-11.9
Total revenue per available room (£)*			
UK hotels	114.73	102.42	-10.7
London	137.14	122.52	-10.7
Provinces	101.78	90.78	-10.8

Source: TRI Hospitality Consulting, HotStats, September 2009, based on a sample of up to 488 hotels, mostly 3 and 4-star hotels, averaging 185 bedrooms.

Forecasts

2010 will be a year of positive economic growth, albeit it very small growth of about 1% according to Deloitte. It is also an election year, which may bring a change of government or equally may bring a hung parliament if no political party secures an overall majority. Whichever party wins power we shall see an increase in taxation of one sort or another coupled with quite draconian cuts in government spending as attempts are made to bring government spending and income back into balance. This reduction in the government debt will be a long haul of several years and threatens to hang like a dark cloud over the entire term of office of the next government. These changing events and economic conditions would mean:

- ◆ A growing increase, on average and in real terms, in the demand for hospitality services throughout 2010 but this will as usual be variable according to sector and region; restaurants and pubs will find trade picks up especially in the first half of the year and hotel groups will continue to offer good value special packages; customers will continue to seek perceived value for money, good accommodation, good cuisine and excellent service
- ◆ Acquisitions will start to pick up again as bargains continue to be available as we pass through the trough of the business cycle. Some hotel and restaurant groups will seek new properties
- ◆ Investment in refurbishment and capacity expansion should pick up as the banks start to lend more to businesses by the middle of 2010, prompted in part by Bank of England and government actions

- ◆ The recent falls in business and property values over the past couple of years will be arrested during 2010 and property values will increase, albeit modestly; this still offers business opportunities for astute investors who take a medium-term view
- ◆ Lenders will continue to be cautious during 2010 but things will demonstrably ease; the banks will continue to lend only on projects which can demonstrate clearly well-above average revenue and discounted profits streams; cash flows will be watched closely
- ◆ Business planning and marketing, as always, will continue to demand very focused attention on underlying market trends and consumer sensitivities where value for money offerings are vitally important

The Deloitte Economic Review (Fourth Quarter 2009) has recently been published and this review has a good track record. Roger Bootle, Economic Adviser to Deloitte, writing in the review, believes the “great squeeze” has begun. Public finances are in a bad state, public borrowing is set to rise to around 15% of GDP (twice the levels when the UK sought IMF help in the 1970s) and public debt is moving towards 100% of GDP. Deloitte believes that real government spending may need to fall by an average of 2% per annum for five years. These cuts will have clear and prolonged effects on the economy, with annual real GDP growth reduced by up to 2%. While the positive effects of monetary policy and a more competitive exchange rate will offset some of the negative impact, economic growth is likely to remain sluggish until the squeeze ends. The impacts on employment and disposable incomes means that the hospitality industry will feel the effects more than many but a lower exchange rate should increase the numbers of people visiting the UK.

Taking the available, rather disjointed and contrary evidence, PriceWaterhouseCoopers forecast the following average room rates, occupancy levels and revenue per available room for the UK, London and Provinces in 2009 and 2010:

UK Hotel Forecasts 2008-2009

	2008	2009*	% change 2008- 2009	2010*	% change 2009- 2010
Average Room Rate (£)					
UK	84.53	77.69	-8.1	76.00	-2.2
London	122.75	110.75	-9.6	105.50	-4.7
Provinces	66.55	62.14	-6.6	62.11	0.0
Occupancy (%)					
UK	72.15	69.06	-4.3	68.89	-0.2
London	79.73	78.78	-1.2	79.54	+1.0
Provinces	68.58	64.48	-6.0	63.88	-0.9
Revenue per available room (£)					
UK	61.07	53.67	-12.1	52.38	-2.4
London	98.00	87.30	-10.9	83.96	-3.8
Provinces	45.69	40.07	-12.3	39.69	-1.0

* forecast

Source: PricewaterhouseCoopers Forecasting Model, Issue 18, September 2009.

Across the UK average room rate will continue to fall albeit at a decreasing rate but occupancy levels will stabilise. The mood among hospitality executives appears to be improving according to both PricewaterhouseCoopers and

TRI Hospitality. The recovery may be fragile and subject to setbacks (such as the economic problems in Dubai) but we believe PricewaterhouseCoopers will revise upwards their 2010 forecasts as the dangers of a stalled recovery or "double dip" recovery begin to recede. On current evidence, we believe average UK room rates will fall by just 1% in 2010 and increase by 1.5% in 2011 while UK occupancy levels will stabilise in 2010 or even increase by a modest 1%, with possibly a slightly higher rate of growth in London.

Conclusions

2009 was a difficult year to be sure but it was not quite as bad as some commentators had been predicting. Demand for hospitality services held up better than could have been expected, and while many businesses have seen demand drop, the levels of drop have not in most cases been catastrophic. A difficult market places a premium on good management and excellent service. Those hospitality businesses that can keep focused on good value, excellent service and rigorous cost containment will not only survive - they will actually prosper. We know this can be done, and have seen it countless times in the past but take nothing for granted. The great worry will be however, that a prolonged government squeeze will snuff out the rather fragile recovery, which has now begun. This remains a very real possibility and a very real threat to the prosperity of the hospitality industry.