

The Market: Issues of Profitability

by Graeme Aymer

Looking back at 2007, it would not be an overstatement to refer to it as being ‘tumultuous’. As expected, out went Tony Blair as prime minister, and in came Gordon Brown, his former chancellor. Despite many a serious and grave decision made by the former prime minister, it appeared that his premiership was permanently sporting a party hat, albeit one that was battered and ragged at the end, but certainly intact. It was a regime that reclassified cannabis, introduced “24-hour drinking”, the gambling act and almost “Las Vegas in Manchester” with the promise of a large, ‘supercasino’.

Gordon Brown appeared to poop the party, nixing the supercasino before a pencil hit blueprint paper, and announced reviews of the Licensing Act and cannabis reclassification. And his premiership arrived just as news arrived from the United States of unprecedented numbers of house repossessions as the word “subprime” and the “credit crunch” came to dominate financial discussions.

While Brown and new chancellor Alistair Darling are unable to shape the American housing market, they have certainly, between them, managed to rankle more than a few business people with proposed tax reforms. In his maiden pre-budget speech in October 2007, Darling announced an expected downturn in the economy, and that he would be undertaking a number of tax reforms of relevance to the UK’s hotel industry.

Chief among these was the end of taper relief from capital gains tax. Beloved of entrepreneurs and private equity groups, but derided by the press as a glamorous tax dodge, Darling announced that as of April 2008, the 10 per cent band would be raised to 18 per cent, all but doubling liability.

This was coupled with a move made earlier by Gordon Brown in his last budget as chancellor, which saw the phasing out over a four year period of Industrial Buildings Allowances. He also cut the percentage of capital gains tax relief available on integral fixtures from 25 per cent to 10 per cent and a cut from 25 per cent to 20 per cent on plant and machinery.

According to the industry, this was likely to add around 5 per cent to the operating costs of a hotel; of course the decision would mean that hotels would have to choose to either swallow the cost or, more likely, pass cost on to customers, and “drive hotel prices higher in these areas making British tourism even less competitive than before,” according to Travelodge finance director Jon Mortimore.

Marios Gregori, Tax Director at PKF, the business adviser and accountancy firm, commented: “Hotels that have been recently acquired will be hardest hit. Owners who planned on the basis of receiving tax relief over 25 years will now have to review their figures because they’ll only be able to claim in for the next four. In a sector where long-term financial planning is particularly important, these changes could be devastating. This has come as a bolt from the blue for the sector.”

According to Gregori, the industry was “up in arms” and felt “singled out” by the changes to the tax system. While it is acknowledged that the previous regime was at times opaque, and that the reduction in corporation tax would possibly help mitigate some of the reforms’ effects, the industry has vowed to lobby for a better deal. It also appears that the industry is likely to witness a fair bit of debate over which fixtures constitute being integral to the building.

While this legislature did little to help hoteliers’ fortunes, it felt relieved about changes to the minimum wage. While rising cost of staff always plagues the industry, for 2007 the rate for those 22 years or older rose from £5.35 to £5.52 over the course of 2007, a below inflation rise of 3.2 per cent. In October 2008, the rate is set will rise to £5.73, again, below retail price index (RPI) inflation (currently 4.1 per cent). Rises to operating costs are never welcomed per se, but considering that Unison general secretary Dave Prentiss believed a figure closer to £6.75, hoteliers have seen this as a manageable cost rise.

Credit crunch and the US economy

But to return to an earlier topic, it was the global ‘credit crunch’ that dominated both business and consumer economics in 2007, and will continue to do so through 2008. It severely curtailed the sort of massive deals seen over the past two years and even began hitting banks where they hurt. For example, in December, the Royal Bank of Scotland, which bought 46 Whitbread Hotels for \$1.7bn the previous year, said it would write off \$1.25bn (£630m) due to the turbulence within the American housing market.

Similarly Barclays Capital also saw a £1.3bn write-down. The proposed sale of 19 former Queens Moat House hotels and 18 Kew Green hotels to aAIM was postponed.

Beyond the financial markets, however, UK hoteliers found, and continue to find that the US economy is having an effect on in-bound UK tourism. Visitors from that crucial market fell 9 per cent in May, the weak dollar as well as a faltering economy playing a part in this drop off.

However, it’s not been all doom and gloom. In fact, silver linings abounded. Hotels in London and around major British cities have seen reasonable RevPAR and occupancy, despite a rainy summer. For instance, in June, London enjoyed a 12.8 per cent increase in room RevPAR to £103.12 according to research from TRI Consulting, the result of an 11.7 per cent rise in average room rates to £118.20.

There was also good news, in that some of the shortfall caused by dwindling numbers of American visitors was offset by a rise in visitors from elsewhere, including the Far East and Eastern Europe. And overall, visitor numbers were up; according to figures from the Office of National Statistics, the seasonally adjusted figure for tourists to the UK for the quarter ending December 2007 was up 3 per cent compared to the previous quarter, to 8.3 million, with spending up 3 per cent to £4.2bn.

Year-on-year, the annual figures nudged 1 per cent increase from 32.7m to 32.9m. Visits from Europe were up 2 per cent, while those from the US were down 6 per cent.

Sustainability and the environment

There was more on hotels' plates, however. Looming government regulation and customer preference have highlighted the issue of the environment and sustainability. Perhaps it helps that costs as mentioned before have skyrocketed, not to mention the cost of energy, with oil surpassing \$100 per barrel in late 2007 and lingering near that price point at the time of writing.

Travelodge for one revealed its plan to become a greener company. The strategy, to be overseen by its newly appointed director of environment and sustainability Nicola Stopps, will see the incorporation of sustainable energy sources in building construction, including underground heating as well as solar and wind power.

Marriott has been running a green masterplan for nearly a decade and has said its plans are still on schedule, namely to cut greenhouse gas emissions by around one-fifth over a ten year period ending 2010. It runs a number of schemes designed to encourage customers, employees and business partners to follow the three 'R's of the environmental movement: reduce, reuse and recycle. In addition, the group is to run a pilot scheme that will see the standardisation and expansion of its recycling programme companywide, as well as the planting of 3000 trees at hotels worldwide. It will also sponsor a Green Fair at its headquarters in April 2008.

Despite economic slowdown, the mood for 2008 appears cautiously optimistic. The pockets of high net worth individuals and sovereign funds are as deep as ever, and will likely be the leading drivers behind deals this year.

In terms of tourism, anecdotally, the green movement could be a useful ally for UK hotels, with a message of deterring jet set holidays for more domestic breaks, involving far lower emissions. VisitBritain also plans to promote the domestic market as a destination for holiday takers, too. While a VisitBritain poll in December pointed out that 32 per cent of British adults are planning an overseas trip abroad in 2008, 62 per cent said that they were planning a trip to England, 13 per cent to Scotland and 3 per cent to Wales. The tourism authority will plan a campaign promoting local destinations – both culture-based city break trips and peaceful rural destinations. The agency also believes that Liverpool's status as European city of culture 2008 and the opening of Terminal 5 at Heathrow – despite trouble with luggage – will boost inbound tourism. Similarly, the recent opening of St Pancras, VisitBritain believes, will be a boost to tourism from Belgium and France.

This will be particularly important, as analysts see no end in sight for the dipping value of the dollar, placing the UK and the Eurozone in general, beyond the reach of many Americans.

TRI Research foresees positive trends, according to its Hot Topic Trading Outlook. It has found:

- Two thirds (67 per cent) of responding UK hoteliers expect rooms RevPAR growth at their hotels in the first quarter of 2008 (compared to the first quarter of 2007).
- For the full year, more than four out of five (83 per cent) hoteliers surveyed expect their rooms RevPAR to increase in 2008 compared to 2007.

However:

- The majority of respondents consider UK-based consumer spending to be the most important influence on hotel performance in 2008.

Rooms RevPAR Growth (year on year)			
	2006 Actual Growth (%)	2007 Actual Growth (%)	2008 Forecast Growth (%)
London	15.1	9.6	4.8
Provinces	3.9	3.7	2.6
UK	8.4	6.6	3.6

Source: TRI Hospitality HotTopic Trading Outlook for UK Chain Hotels in 2008

PKF's Marios Gregori adds: "Although current economic conditions are not looking very positive, the future for the UK hotel industry includes many positive new developments over the next ten years. Hosting the Olympic and Commonwealth Games will lead to increased business opportunities as the demand in UK infrastructure as well as the events themselves will increase the number of corporate and leisure travellers. Low cost airlines will continue to bring European travellers to the UK and, although the weak US dollar continues to reduce the number of US tourists, new Asian markets such as China are replacing the American as their populations gain a taste for European travel."

Olympic gold

Beyond this is the Olympics. The year promises a boost for the 2012 London games on two fronts. First, the torch arrives in the UK in early April, which will draw attention to the games in Beijing. And then, of course, there is the Beijing games themselves. But what does 2012 mean for the UK hotel industry?

According to a study from Oxford Economics, key to the games success is in drawing visitors from emerging nations such as China, Russia and India who, says the report, will be encouraged to visit following positive exposure of the UK, particularly London, following Olympic coverage. According to the study, the games could generate between £1.6bn to £2.9bn worth of tourism for the UK as a whole, and £1.3bn to £2.2bn to London. It expects 15 per cent of the UK total to be generated in the pre-games period, 31 per cent during the games themselves and 54 per cent as a result of the games' legacy. (For London, the figures are 17 per cent, 35 per cent and 48 per cent respectively.)

Setting the scene: The Market: Issues of Profitability

The Games are also leading to plenty of construction work, according to TRI Hospitality MD Jonathan Langston. “The Olympic Games is acting as a catalyst for hotel development in London, particularly as an additional incentive to persuade planning authorities that more hotel bedrooms are necessary,” he says. “New hotels are springing up not just at the east London site, but in Southwark, Lambeth and the Heathrow area. The Games will provide fantastic PR and an exciting way of lodging London into the minds and onto the must-see lists of millions of prospective visitors across the world.”

As the adage goes, nothing is certain except uncertainty. With a range of variables that incorporates anything from summertime weather to how much more of a ripple the US subprime housing situation creates worldwide will all have a part to play. With all this to gamble, perhaps Gordon Brown was right: we really don't need that supercasino after all.