Fáilte Ireland
National Tourism Development Authority

Recent Developments in the Hotel Sector & the Medium-Term Outlook

November 2010

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1. Executive Summary

Introduction

The aim of this paper is to contribute to the debate on recent supply and demand side developments in the hotel industry and to consider the medium term prospects based on an analysis of available capacity, trends in occupancy, and likely demand for hotel bednights.

The hotel sector is a key component of Irish tourism. A good stock of attractive high-quality hotels, operating to best international standards, is essential for the effective performance of the industry. Over the past decade, the quality of Irish hotels has improved greatly and Ireland is now considered a leader in this sector compared to many other countries.

Hotel Capacity – The Supply Side

Capacity in the hotel sector can be summarised as follows:

- There are 903 hotels with a combined total of 60,138 rooms. The average hotel now has 67 rooms
- Since 2005, 15,463 new rooms were added to the sector, which represents 26% of today's capacity or a 35% increase from 2005
- Most room capacity is in three and four star hotels
- Two-thirds of capacity is concentrated in Dublin and the other counties traditionally associated with tourism, i.e. Kerry, Galway, Cork, Donegal and Clare
- While room stock has increased across the board, the counties with the biggest capacity increases since 2005 are those not usually considered tourism centres (e.g. the Dublin commuter belt).

The 35% increase in room capacity since 2005 is best appreciated when it is considered that (a) the volume of international visits to Ireland this year is anticipated to be below the 2005 level and (b) the volume of domestic trips has increased by 16% over that time. These two trends combine to suggest a significant and growing dependence on the domestic market.

Hotel Occupancy – The Demand Side

Hotel room demand is measured in terms of occupancy rates. Past performance and international benchmarks suggest that a long-run viable occupancy level nationally is in the mid-60% range. At this level a form of price equilibrium is achievable and sustainable room rates can be maintained. Since 2008 the hotel sector has achieved occupancy rates in the mid-50% range only, well below the sustainable rates of earlier years. The problem is compounded by the fact that even these low levels of occupancy were only achieved following a period of heavy rate discounting.

The Spread of Hotels and Hotel Capacity Across Ireland

The spatial analysis presented in this paper suggests that a certain amount of hotel development in recent years took place outside traditional leisure tourism destinations. For example:

- It may reasonably be assumed that much of the expansion in hotel capacity in the Dublin commuter belt is targeted at non-leisure tourism users. Most probably it is best understood as domestic consumption.
- The level of room capacity in the Limerick-Ennis corridor is above what would be expected if the hotels were built purely to service tourism demand
- The shape of the Galway capacity hotspot, which runs east towards Athlone, would not appear consistent with tourism demand.

These developments may have been based on a business model and related considerations which were not rooted in the tourism sector, particularly leisure tourism. Consequently, the relevance of some of these properties to the tourism industry may be quite peripheral.

Financial Performance

Based on average room rates and revenue per available room, the 2007/2008 period can be seen to represent a turning point in the performance of the hotel sector. As occupancy rates fell below 60%, revenue fell almost 20%, and profits were down even more. In fact, profit before tax per room is now less than half of what it was in 2005. Room rates have fallen to exceptionally low levels resulting in growing insolvency levels.

The Outlook to 2015

Based on latest medium-term tourism targets for international visits[1], some 7.9mm tourist arrivals to Ireland are projected by 2015. Over the same period, domestic trips are projected to increase slightly to 8.4mn. This growth performance is, however, unlikely to be sufficient to fully absorb the hotel sector's excess capacity. At this level of performance it is estimated that there would still be an enduring excess capacity of 7,000 rooms, and this would need to be reduced to allow occupancy rates return to a long-run sustainable level in the mid-60% range.

In order to present a more rounded insight to the hotel market, the analysis in this paper highlights two interlinked variables which have driven developments in recent years. The first is the volume of visitors taking breaks in and to Ireland for tourism purposes. The second is the share of both domestic and overseas visits secured by the hotel sector (that is the share of the market won by hotels as opposed to other forms of accommodation). Other things being equal and given the current share of

[1] As outlined in *Trading and Investing in a Smart Economy: A Strategy and Action Plan for Irish Trade, Tourism and Investment to 2015.*

the market held by the hotel sector, growth in volume alone will have a relatively low impact on achieving sustainable occupancy levels. In fact increasing the hotel sector's share of international visitor bednights would have a much higher impact. Achieving improvements in both variables over time would hasten the return to commercial sustainability. However, this represents a formidable challenge for the hotel sector given its current very high dependence on the domestic market.

The central insight presented in this paper can be summarized as follows. The projected growth in international visitors assumed in the core projection (7.9mn by 2015), will generate a 23% increase in international bednights sold by 2015. This however would result in continuing excess capacity of 7,000 rooms, based on a sustainable occupancy target of some 65%. If the volume growth in the core projection is combined with an improvement in market share (with hotels increasing their share of accommodation won from 13% in 2010 to 17% in 2015), an increase of 61% in bednights sold would need to be achieved by 2015 in order to come close to eliminating excess capacity. This represents a significant challenge, and even this exceptional performance would not be enough to avoid some hotel closures.

It is important to note that the situation in the hotel sector is not static. It can be expected that the volume and composition of the hotel sector will change year-on-year as we move to 2015, reflecting both natural levels of attrition as well as particular factors arising from the excess capacity issue. Clearly, in order to facilitate a return to sustainable room rates and in particular to restore some much needed stability in the hotel market, it would be preferable for the sector, as a whole, if the necessary adjustments were front-loaded in the 2010-2015 period.

Market Forces Apply

The excess capacity challenge will be resolved by market based solutions, not administrative ones. Rational, commercially minded hotel owners will only exit the market if it makes good business sense either by shutting down or selling hotels. But even if a hotel is sold, it will remain in operation if the new owner can buy it at a price that makes sense. This could perpetuate room rates that are currently considered unsustainable by lowering a given hotel's cost base.

This implies that the anticipated capacity reductions will not be limited to the newly built hotel stock. Existing independent, long-established hotels have been through two years of deep rate discounting. Many, especially those without the advantage of scale and/or those in need of major reinvestment, may struggle to cope with a further two years of rate pressure.

Conclusions in Summary
1. Since 2005 hotel room capacity has grown by 35%. However, in the same period domestic trips only rose by 16% and international visits to Ireland declined to below 2005 levels.
2. Hotels nationally are failing to achieve commercially sustainable occupancy levels (i.e. in the mid-60% range).
3. A spatial analysis of hotel stock indicates that **many hotel developments**, especially those built outside traditional tourism destinations, were based on a business model and related considerations which **were not rooted in the tourism sector**, particularly leisure tourism.
4. **Looking to 2015**, it is expected that international tourist arrivals will number 7.9mn and domestic trips will reach 8.4mn. Based on current trends, even this level of demand is unlikely to fully absorb the hotel sector's excess capacity and **a persistent surplus of 7,000 is expected to remain at that time**.
5. Increasing tourism volume alone will not return the sector to commercially sustainable occupancy levels without substantial stock reductions and hotel closures. However, **the need for hotel closures would be greatly minimised if the hotel sector grows its share of international visitor bednights from 12% to 17%.**
6. Between 2011 and 2015 a number of hotels are expected to close. These closures will be market led and driven by two factors in particular (a) location and (b) the financial health of the business. **Hotel closures are unlikely to be avoided through administrative interventions.**

2. Hotel Capacity – The Supply Side Story

An Analysis of the Hotel Register 2005-2010

Table 2.1 presents an analysis of the hotel register as of May 2010 by county and highlights the major changes since 2005.

Table 2.1: Change in Registered Hotels by County Since 2005

County	No. of Hotels Reg'ed in May 2010	Total Room Stock	No. of Hotels Reg'ed Since Jan 2005	Room Capacity Since 2005	'New' Stock % of Total Rooms *
Carlow	9	525	3	268	51%
Cavan	17	844	3	198	23%
Clare	47	2,517	11	348	14%
Cork	82	4,694	16	1,326	28%
Donegal	61	3,091	12	441	14%
Dublin	159	19,194	36	5,009	26%
Galway	89	4,715	25	1,056	22%
Kerry	81	5,500	12	627	11%
Kildare	25	1,242	8	454	37%
Kilkenny	18	1,168	5	270	23%
Laois	9	510	4	285	56%
Leitrim	7	263	1	27	10%
Limerick	30	2,364	8	802	34%
Longford	4	111	2	24	22%
Louth	15	898	5	321	36%
Mayo	52	2,337	12	722	31%
Meath	22	1,272	12	865	68%
Monaghan	9	341	3	86	25%
Offaly	8	385	3	109	28%
Roscommon	4	170	1	84	49%
Sligo	17	1,070	6	447	42%
Tipperary	28	912	3	126	14%
Waterford	31	1,693	4	256	15%
Westmeath	19	1,244	10	489	39%
Wexford	34	1,675	9	552	33%
Wicklow	26	1,403	3	271	19%
Total	***903***	***60,138***	***217***	***15,463***	***26%***

* Above average increases in red.

Source: Fáilte Ireland

Note that while the table shows changes since 1 January 2005, not all of the increase in room stock is attributable to new hotels. Some of the capacity increase is due to existing hotels adding more rooms.

Some things to note from Table 2.1 include:

- There are 903 hotels with a combined total of 60,138 rooms. The average hotel now has 67 rooms

- Since the start of 2005, 15,463 hotels rooms were added, which is 26% of today's capacity or a 35% increase on 2005's level. The increased capacity is spread across new hotels and pre-existing ones that underwent expansion
- The net increase in hotels was 50, with some 217 new registrations and approximately 167 non-renewals
- Hotel room capacity, or stock, is generally concentrated in Dublin and the other counties traditionally associated with tourism, e.g. Kerry, Galway, Cork, Donegal and Clare. These six counties account for two-thirds of capacity
- While room stock has increased across the board, the counties with the biggest capacity increases were those that are not usually considered tourism centres
- Growth was particularly strong in the Dublin commuter belt. In fact, the counties with the three biggest changes in bed stock were Meath (68% of today's stock is new), Laois (56% new stock) and Carlow (51% new stock). Louth, Kildare and Westmeath all saw growth well above the national average.

The regional spread of rooms and the annual change in room capacity is given in Table 2.2. See the appendix for a map of the Fáilte Ireland regions. Dublin has the highest concentration of hotel stock (32%), followed by South West (17%), with the remaining regions having a fairly even share of capacity.

Table 2.2: Registered Room Capacity in Peak Season

	2005	2006	2007	2008	2009
Dublin	14,000	15,200	16,600	18,600	19,100
East & Midlands	4,300	4,800	6,300	6,700	7,100
South East	4,300	4,500	5,400	5,600	5,600
South West	8,700	8,900	9,600	10,600	10,400
Shannon	4,500	4,400	4,700	5,500	5,400
West	5,700	5,800	6,500	6,800	7,100
North West	4,200	4,700	5,000	5,200	5,300
Total Rooms	**45,700**	**48,200**	**54,100**	**59,000**	**60,100**
Annual Change	*4%*	*5%*	*12%*	*9%*	*2%*

Source: Fáilte Ireland

Table 2.3 presents a similar analysis but looks at hotel stock by grade.

Table 2.3: Change in Registered Hotels by Grade Since 2005

Grade	2010		2005	
	Distribution of Hotels by Grade	Distribution of Rooms by Grade	Distribution of Hotels by Grade	Distribution of Rooms by Grade
Five Star	4%	6%	3%	7%
Four Star	29%	41%	17%	27%
Three Star	44%	46%	44%	51%
Two Star	18%	6%	25%	11%
One Star	4%	1%	7%	2%
Other	0.8%	0.2%	4%	2%
Total	**100%**	**100%**	**100%**	**100%**

Source: Fáilte Ireland

Most of our hotel capacity is in three and four star hotels. They account for 73% of hotels and 87% of rooms, up from 61% of hotels five years ago and 78% of rooms. Since 2005, one and two star hotels have declined in absolute and in relative terms. This means that all of the growth since then has been in higher grade hotels, especially four star hotels. The 'other' category has shrunk over that time due primarily to a change in the hotel registration and grading framework.

A few other noteworthy trends in the hotels sector between 2005 and 2010 include:

- Hotels with 100 or more rooms are now more widespread than before, with their share of total room capacity growing from 41% to 53%
- The share of total room capacity held by hotels with less than 50 room has fallen from 27% to 19% over five years
- The major urban centres, i.e. Dublin, Cork, Galway, Limerick and Waterford, now host 46% of room capacity, up from 26%. Interestingly, their share of hotels remained fairly constant at just under 30% over the period which means that urban hotels are getting larger.

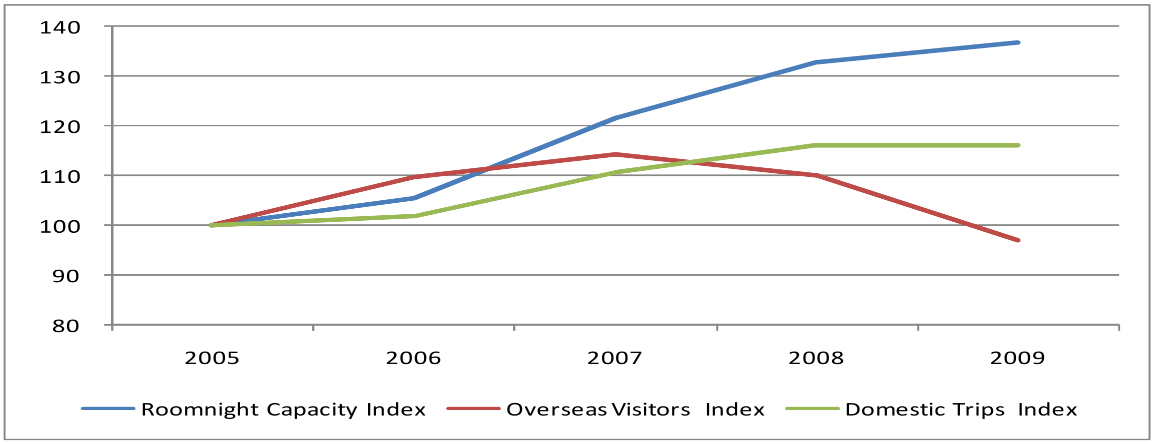
Contextualising the Change in Room Capacity

The significance of the 35% increase in room capacity since 2005 is better appreciated when we consider the following:

- The volume of international visits to Ireland actually fell slightly over the same period and is likely to fall further this year to below the 2005 level
- The incidences of domestic trips increased by 16% between 2005 and 2009, much less than the capacity growth

Figures 2.1 presents a set of indices with room capacity, overseas visits and domestic trips all set at 100 in 2005. It highlights the fact that since 2005 the growth in hotel capacity has outstripped the increase in domestic trips and international visits to Ireland. The situation has become very acute since 2008 following the global recession and the tightening of consumer purse strings, especially in the overseas market. Yet, since 2008 even more capacity has come on stream which reflects the long lead times involved in building hotels and the fact that those hotels were commissioned in very different economic circumstances.

Figure 2.1: Trend in Room Supply, Overseas Visits & Domestic Trips 2005-2009



Source: Fáilte Ireland and CSO

Unfortunately, and as a consequence of prevailing economic conditions, overseas visitors are now back at 2001/2002 levels in volume and value terms, and domestic revenue is now back at 2006 levels. It is important to keep in mind also the fact that travel, leisure, and tourism are areas of discretionary spending, and regrettably are among the first to be cut back by consumers who believe their jobs and incomes are under threat. Equally, however, they can be among the first to bounce back when economies recover.

3. Hotel Occupancy – The Demand Side Story

National & Regional Hotel Room Occupancy 2005-2010

Hotel room demand is typically measured in terms of occupancy. Between 2005 and 2007, occupancy rates nationally improved from 62% to 64%, driven by an increase in overseas visits and a buoyant domestic market. However, occupancy declined in 2008 and 2009 to below 60%. Indeed occupancy rates in 2009 were at very low levels nationally, although actual performance varied significantly by region, as shown in Table 3.1.

Table 3.1: Room Occupancy Percentage by Region 2005-2009

	2005	2006	2007	2008	2009
Dublin	71%	72%	72%	66%	62%
East & Midlands	53%	54%	54%	46%	37%
South East	55%	60%	57%	56%	57%
South West	63%	67%	66%	58%	58%
Shannon	60%	63%	61%	58%	50%
West	57%	59%	60%	59%	58%
North West	54%	56%	57%	51%	46%
National Average	***62%***	***64%***	***64%***	***58%***	***55%***

Source: Fáilte Ireland

It is important to note that even this low level of occupancy was only achieved following heavy rate discounting as operators attempted to generate turnover. We will return to this point at the end of this section.

In order to present a comparison of 2010's performance to date with the last few years, Table 3.2 modifies the previous table to present January to June occupancy.

Table 3.2: January-June Room Occupancy Percentage by Region 2005-2010

	2005	2006	2007	2008	2009	2010
			January to June			
Dublin	68%	70%	69%	63%	58%	63%
East & Midlands	51%	51%	52%	43%	36%	37%
South East	52%	54%	54%	55%	51%	54%
South West	61%	64%	65%	56%	54%	55%
Shannon	54%	62%	57%	54%	48%	51%
West	52%	54%	57%	53%	51%	51%
North West	49%	53%	55%	47%	42%	44%
National Average	***58%***	***61%***	***61%***	***55%***	***51%***	***54%***

Source: Fáilte Ireland

Tables 3.1 and 3.2 show that:

- The occupancy rates now being observed are amongst the lowest in some 20 years and well below the mid-60% norm witnessed over the last decade. The only positive is that the first six months of 2010 are ahead of the same period last year

- Dublin is the best performing region in 2010, followed the South West and the South East
- The East and Midlands is the worst performing region. This is due in no small part to the region's significant increase in hotel stock. As noted previously, most of the counties in this region experienced above average increases in room capacity.

County Level Hotel Room Occupancy

Table 3.3 presents occupancy data for the last two full years for 11 counties. These 11 counties are home to 694 hotels and 48,692 hotel rooms, respectively 77% of all hotels and 81% of all hotel rooms nationally. They also account for 11,265 (73%) of the room capacity added since 2005. Owing to data limitations it is not possible to generate robust occupancy data for the remaining counties and data is only available for 2008 and 2009.

Table 3.3: Room Capacity, Rooms Sold and Occupancy for Selected Counties 2008 & 2009

	Annual Room Capacity ^ / Supply of Rooms			Room Nights Sold / Demand for Rooms			*Occupancy Rates*	
	2008	2009	Change	2008	2009	Change	*2008*	*2009*
Clare	923,646	892,380	-3%	541,475	448,560	-17%	*59%*	*50%*
Cork	1,759,590	1,760,354	0%	1,003,512	1,005,571	0%	*57%*	*57%*
Donegal	1,000,434	1,010,403	1%	493,843	453,747	-8%	*49%*	*45%*
Dublin	6,704,351	7,058,196	5%	4,453,178	4,370,631	-2%	*66%*	*62%*
Galway	1,586,456	1,653,732	4%	936,062	928,696	-1%	*59%*	*56%*
Kerry	1,884,995	1,898,123	1%	1,105,510	1,099,811	-1%	*59%*	*58%*
Limerick	834,435	847,216	2%	484,572	420,193	-13%	*58%*	*50%*
Mayo	795,780	834,339	5%	463,107	460,491	-1%	*58%*	*55%*
Tipperary	342,501	341,531	0%	189,692	173,580	-8%	*55%*	*51%*
Waterford	625,855	585,878	-6%	333,876	287,429	-14%	*53%*	*49%*
Wexford	575,503	603,429	5%	326,582	360,629	10%	*57%*	*60%*
National Total */Avg*	21,018,669	21,667,635	3%	12,293,853	11,887,528	-3%	*58%*	*55%*

^ Annual room capacity is based on the number of rooms declared at the beginning of the year. In assessing occupancy rates, allowance is made for seasonality and varying capacity during the year.

Source: Fáilte Ireland

Some important points to note from Table 3.3 are as follows:

- For all counties listed, bar Wexford and Cork, occupancy was lower in 2009 than in the previous year
- Nationally, the drop in occupancy over the two years would have been less if supply had not increased by 3%, reinforcing the point that occupancy rates are being pushed down by (a) lower demand and (b) increased supply
- Dublin in the only county with occupancy rates in the mid-60% range but even this performance is low relative to the county's recent performance

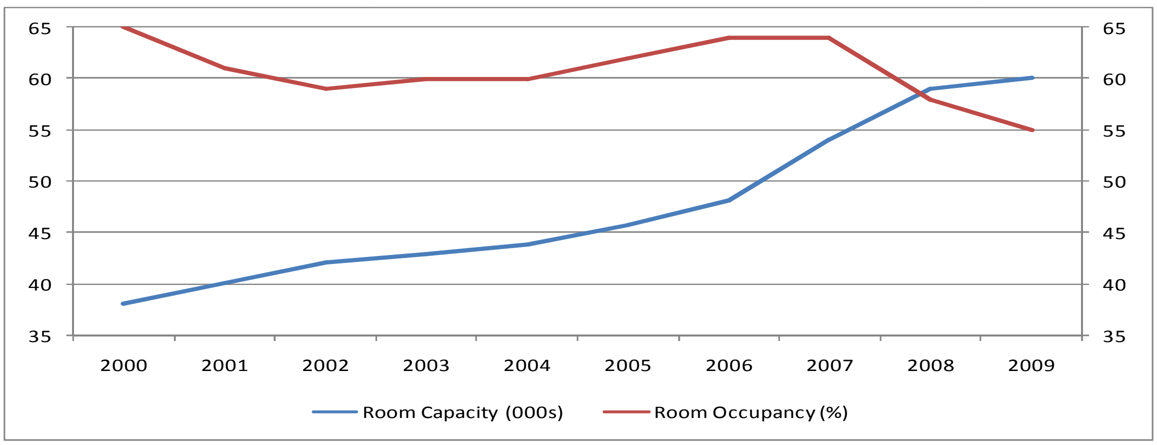
- Of the 11 counties considered, Donegal, Tipperary and Waterford failed to achieve national average occupancy rates in 2008 and 2009 but Dublin is skewing the national average
- In 2009 Donegal, Tipperary, Waterford, Clare and Limerick all failed to achieve national average occupancy rates but again Dublin is skewing the national average.

Contextualising Irish Occupancy Rates

Occupancy & Stock

Figure 3.1 plots room stock against occupancy. It points to 2007/2008 as the turning point; up to 2007 occupancy rates were in the 60% to 65% range even with growing hotel capacity. Since then occupancy has declined sharply as demand declined and further capacity was brought on-stream.

Figure 3.1: Room Capacity & Occupancy 2000-2009



Source: Fáilte Ireland

Occupancy Rates Internationally

Trends in Irish occupancy data would suggest that a sustainable room occupancy rate appears to be in the mid-60% range. At this level, room rates can be sustained and significant discounting avoided. International data, as presented in Table 3.4 for 2007, the last year in which Ireland's hotel sector reported sustainable occupancy, also suggest that a sustainable occupancy level is in the mid-60% range. Few countries experience sustained occupancy rates above 70%, and where this does occur it is often due to the importance of specific city-based tourism.

Table 3.4: International Room Occupancy Percentage 2007

	2007		2007
Wales	59%	Sweden	67%
Poland	60%	N. Ireland	67%
Ireland	64%	England	68%
Scotland	64%	France	69%
Austria	64%	Denmark	71%
Germany	64%	Belgium	71%
Italy	65%	Czech Republic	72%
Spain	66%	Netherlands	72%
Hungary	66%		

Source: Fáilte Ireland, TNS UK Ltd and MKG Consulting

Occupancy & Financial Performance

While occupancy rates are important, additional information on room rates allows us to build a more comprehensive picture. Financial advisors Horwath Bastow Charleton conduct an annual survey which tracks the financial performance of hotels. Their surveys reveal that the financial performance of Irish hotels worsened in 2008, when the occupancy rate fell below 60% revenue fell almost 20% and profits were down by slightly more. This outcome underlined the fact that because so much of the cost base is fixed, hotel margins are very sensitive to occupancy changes. The 2009 survey reported a further deterioration in the financial performance of the sector. Profit before tax per room is now less than half of what it was in 2005.

Table 3.4: Irish Hotel Financial Performance 2005-2009

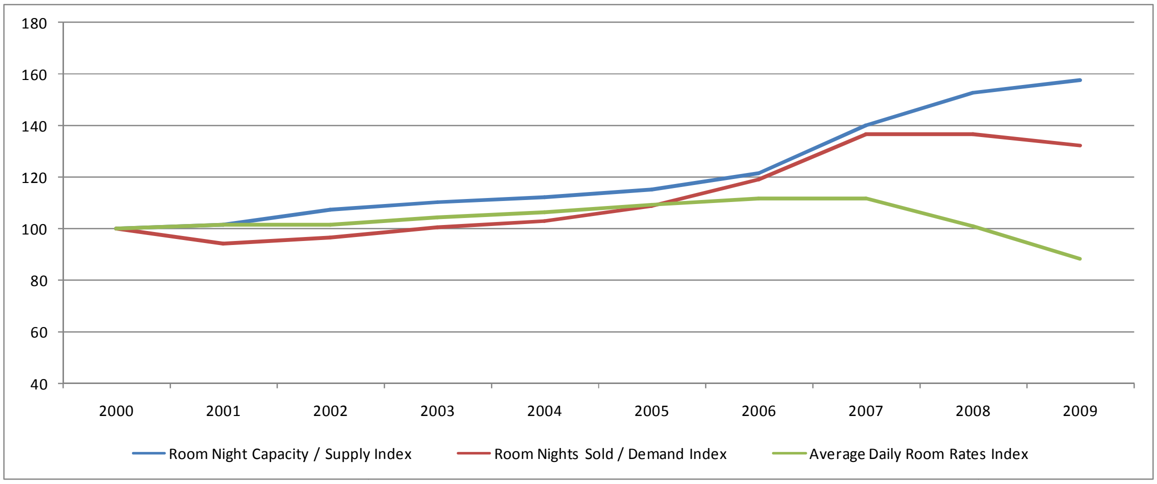
	2005	2006	2007	2008	2009
Achieved Average Room Rate	€95.22	€97.58	€97.69	€88.25	€77.81
Revenue per Available Room	€65.65	€68.12	€68.06	€56.04	€46.22
Profit before tax per room	€10,238	€9,786	€9,308	€7,056	€4,650
Profit before tax per room	17.8%	16.6%	15.5%	12.8%	10.4%

Source: Horwath Bastow Charleton

Looking at average room rates and revenue per available room, 2007/2008 is shown again to be the turning point. Hotel operators would appear to be attempting to generate occupancy, and revenue, by aggressive rate cuts. This has worked to some extent, but there is only so much occupancy that the sector can 'buy' through rate reductions. A bigger problem for the sector is that, in aggregate terms, room rates have fallen to exceptionally low levels as evidenced by growing insolvency rates. Moreover, information available to date in 2010 indicates that average room rates are continuing to fall and are a further 11% down on last year.

Figure 3.2 illustrates this point as it presents a series of indices with room night capacity (i.e. supply), rooms nights sold (i.e. demand) and average room rates all sets at 100 in 2000 and plots the changes since then.

Figure 3.2: Trend in Room Supply, Room Demand & Room Rates 2000-2009



Source: Fáilte Ireland and Horwath Bastow Charleton

Up to 2007, supply and demand moved in tandem which helped to keep occupancy rates relatively stable and allowed the sector achieved sustainable room rates. In fact, room rates were up by 12% with supply (room night capacity) and occupancy (room nights sold) both up some 40% from 2000 levels.

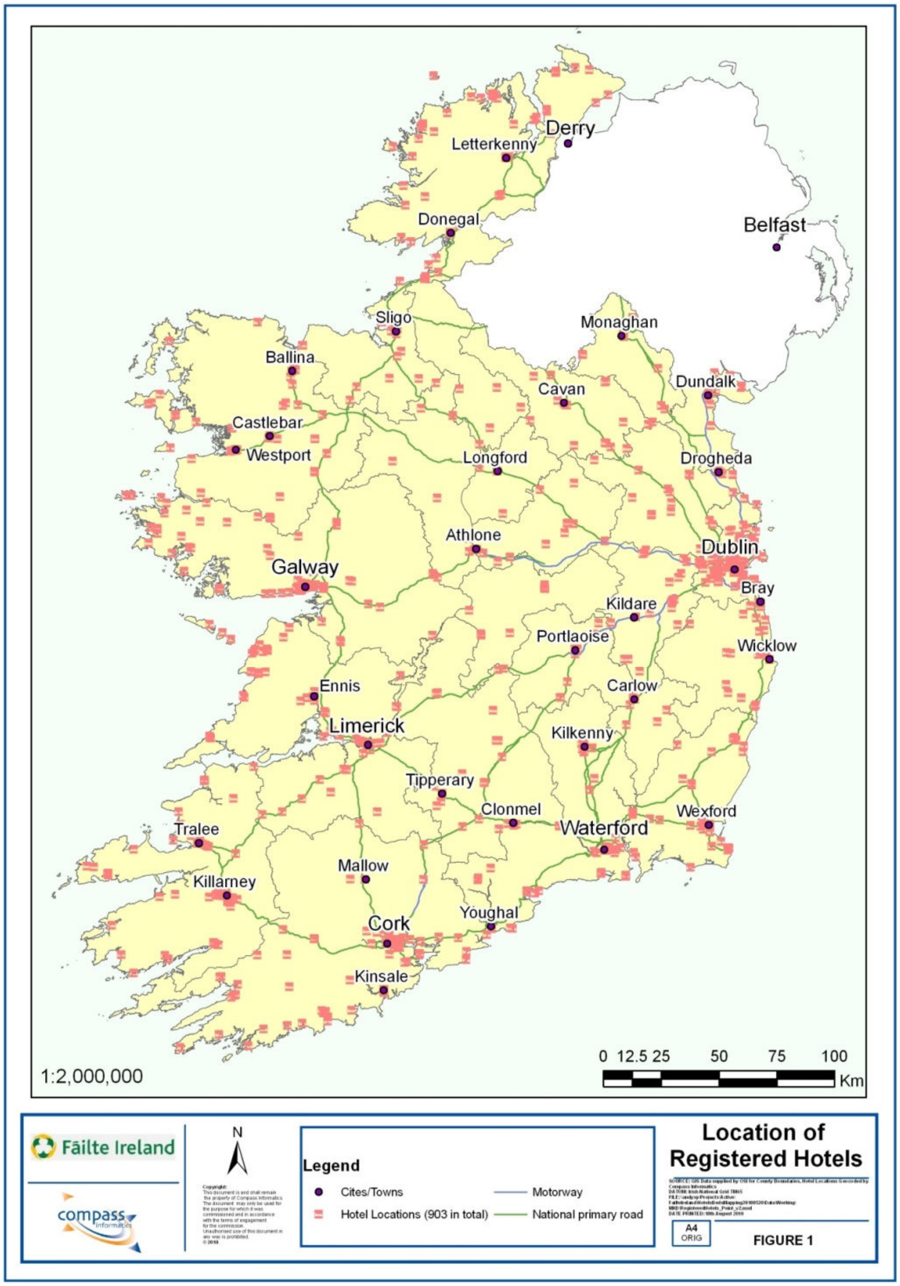
Post 2007 a widening gap opened up between supply and demand as supply continued to increase in the face of falling demand. The gap between supply and demand translated into falling room rates as hoteliers sought to maintain occupancy, and ancillary revenues, through aggressive rate cuts. By the end of 2009 average room rates, in nominal terms, were 12% below those achieved in 2000. In real terms the decline in average room rates was 30%.

4. A Spatial Analysis of Hotels Stock & Tourism

The Location of Hotels

Figure 4.1 maps the location of all registered hotels across Ireland with each hotel shown as a 'dot'. It highlights the spatial concentration of hotels either (a) within urban and adjacent areas or (b) along the coastline.

Figure 4.1: Location of Registered Hotels in 2010



Concentrating on the 11 counties that account for 77% of all hotels and 81% of all hotel rooms, the following observations emerge:

- Most of the hotels in Dublin are, unsurprisingly, in the urban area
- Galway's hotels are clustered within the city or towards the west of the county
- A lot like Galway, county Cork's hotels cluster within the city and along the coast
- Kerry exhibits a bi-polar clustering around Tralee and Killarney, with almost all of the remaining hotels situated near the coast.
- Donegal and Mayo both show a fairly even spread of hotels across each county, with clustering in some areas. The same is true of Wexford and Tipperary
- Looking at counties Clare and Limerick, the picture in Clare is similar to that in Galway except for an additional grouping of hotels around in and around Limerick city (which spills into county Clare). Most of county Limerick's hotels are in Limerick city with almost all of the remainder distributed along the N21 route to Kerry
- One third of the hotels in county Waterford are within the city.

The Location of Hotel Rooms

The next map, Figure 4.2, complements the previous analysis by showing the spatial concentration of hotel bedrooms. This is done via hotspot analysis which allows us to take account of the difference between the location of hotels and the location of hotel capacity as measured in bedrooms. The two maps, taken together, build a more comprehensive picture of where capacity is situated.

Owing to the sheer scale of Dublin, with 18% of hotels and 32% of rooms, its brightness or significance on the hotspot map makes the other areas of concentration appear less significant in comparison. However, this does not detract from the importance of these areas in absolute terms.

The map in Figure 4.3 is akin to Figure 4.2 only without county Dublin. This map presents a similar picture, but it is much easier to pick out the hotel capacity hotspots outside of Dublin.

Figure 4.2: Concentration of Registered Hotel Bedrooms in 2010 – A Hotspot Analysis

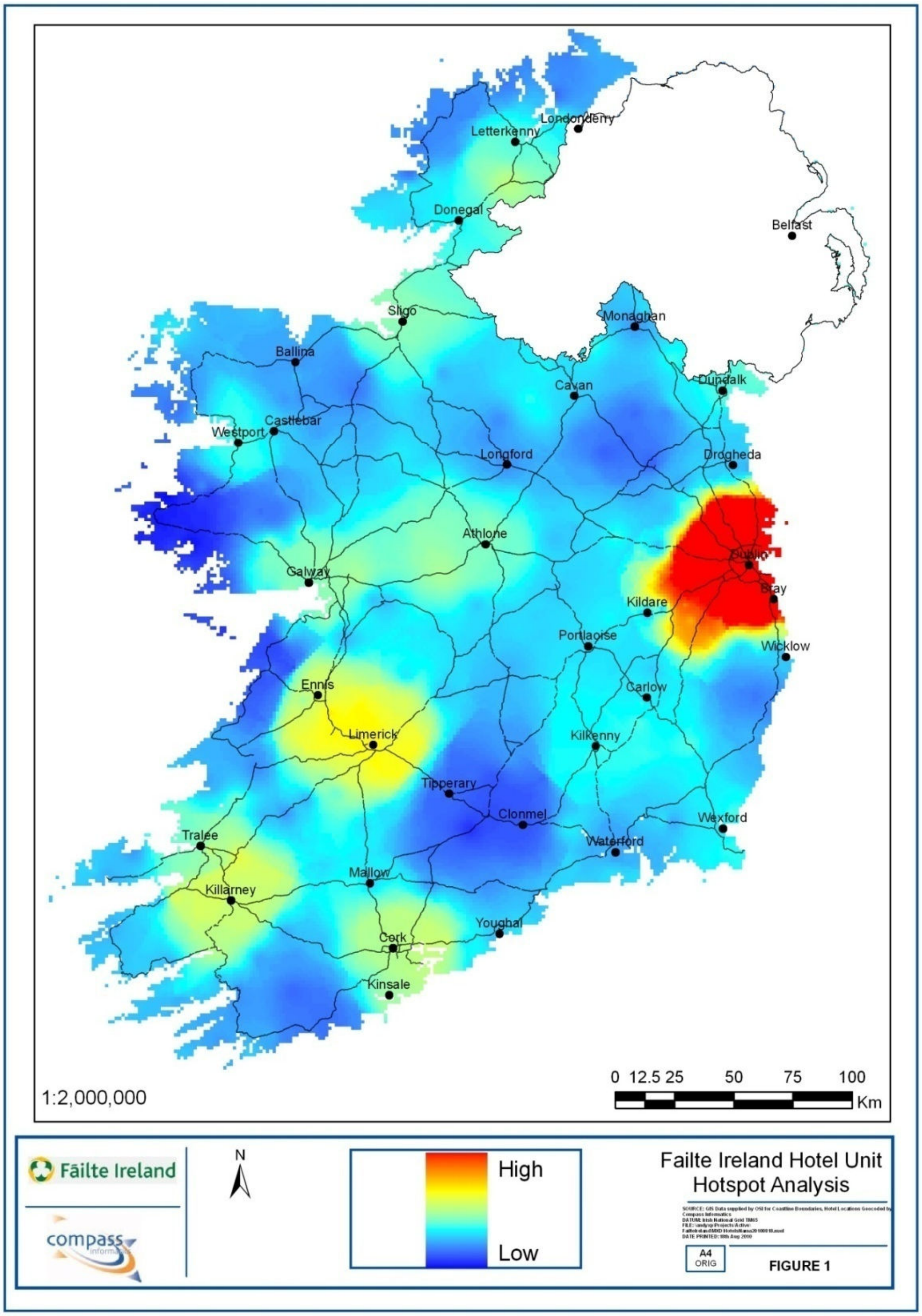
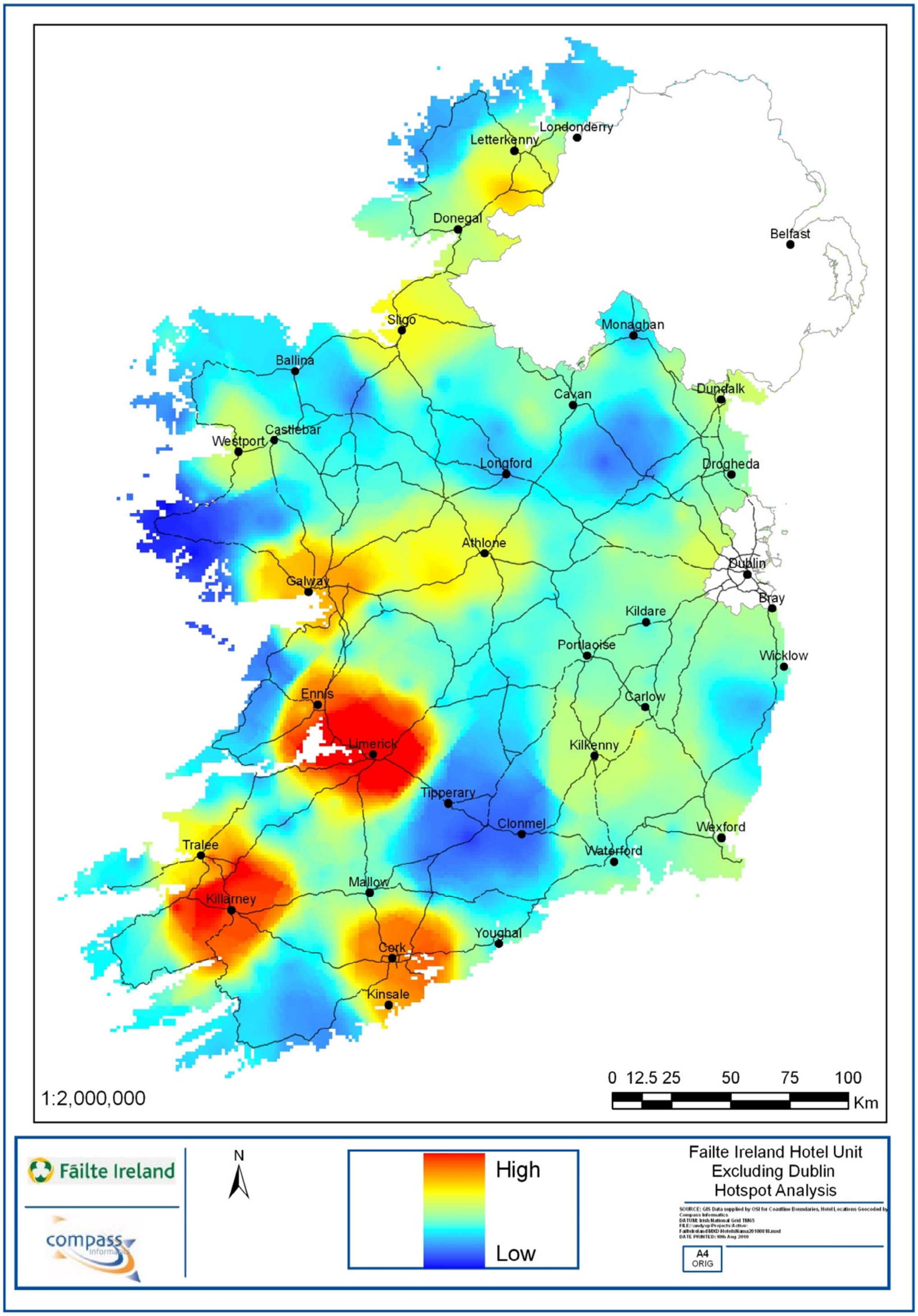


Figure 4.3: Concentration of Registered Hotel Bedrooms in 2010 Without County Dublin – A Hotspot Analysis



Salient aspects of Figures 4.2 and 4.3 include:

- The high concentration of hotel room capacity in Dublin extends into the Greater Dublin Area. Picking up on a point made in section 2, capacity growth was particularly strong in the Dublin commuter belt. The counties with the three biggest changes in bed stock were Meath (68% of today's stock is new), Laois (56% new stock) and Carlow (51% new stock). Louth, Kildare and Westmeath all saw growth well above the national average. As these counties are not traditionally considered major overnight tourism destinations, this suggests that much of the commuter belt hotel capacity is targeted at non-leisure tourism users
- The next brightest/biggest room capacity hotspot is centred on Limerick city and Ennis. This level of room capacity is above what we would expect if the hotels were built purely to service leisure tourism demand. After Dublin city, county Kerry and Cork city and county are the next biggest tourism centres, yet the hotspot analysis shows that the Limerick-Ennis area has more hotel capacity. Like the Dublin commuter belt, the analysis suggests that much of this stock must be targeted at non-leisure tourism users of hotels
- The Kerry hotspot appears to be driven by the importance of Killarney and Tralee (and their hinterland) to tourism
- The hotspot in county Cork is caused by the volume of capacity in Cork city which reflect its commercial and tourism importance
- The shape of the Galway hotspot, which runs east towards Athlone, is not what we would have expected to see if the location of capacity was caused solely by leisure tourism demand. Leisure tourism demand in that part of Ireland is based around Galway city and the Atlantic seaboard
- The Donegal-Sligo hotspot is more inland, especially in county Donegal, than we might expect from because the hotels with the most capacity are inland rather than coastal
- The fact that Westport, Kilkenny and Wexford come out as smaller hotspots conforms to what we would expect based on the spatial spread of leisure tourism in Ireland.

Additional Comments

The spatial analysis presented in this section suggests that a certain amount of hotel development in recent years took place outside traditional tourism destinations. This in turn suggests that these developments were based on a business model and related considerations which were not rooted in the tourism sector. Consequently the relevance of some of these properties to the tourism industry may be quite peripheral.

5. Medium Term Outlook for Demand

The 2010-2015 Outlook

This section presents a five year tourism projection and draws out the implications for the hotel sector. This analysis is presented as the core projection for hotel demand. This 'core' projection is then subjected to sensitivity or stress testing in order to model the impact on hotel demand when two key variables which are central to the analysis – demand volume and hotel utilisation - are changed.

Core Projections

Volume and Earnings

The core projections for overseas visitors are based on targets contained in *Trading and Investing in a Smart Economy: A Strategy and Action Plan for Irish Trade, Tourism and Investment to 2015*. Forecasts for the volume of domestic tourism and revenue estimates are generated by Fáilte Ireland. The results are shown below.

Table 5.1: Core Projections – Tourism Volume & Revenue 2010-2015

	2010	2011	2012	2013	2014	2015
Out of State Visitors^ (000s)	*6,400*	*6,800*	*7,100*	*7,300*	*7,600*	*7,900*
Foreign Exchange Revenue (€mn)	3,500	3,800	4,000	4,200	4,500	4,700
Domestic Trips (000s)	*8,300*	*8,200*	*8,100*	*8,200*	*8,300*	*8,400*
Domestic Revenue (€mn)	1,300	1,300	1,300	1,400	1,500	1,500
Total Tourism Earnings (€mn)	**4,800**	**5,100**	**5,300**	**5,600**	**5,900**	**6,200**

^ Out-of-state visitors are overseas visitors and those from Northern Ireland.

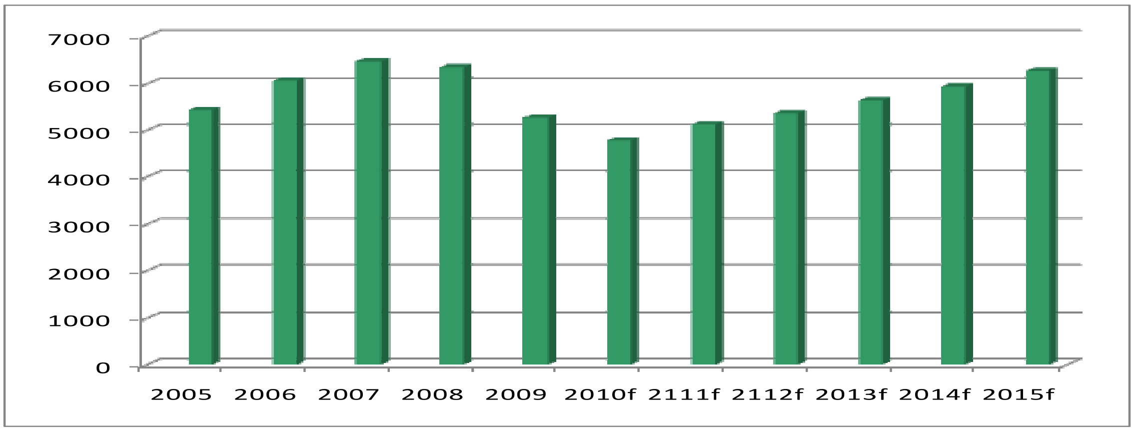
The principal assumptions are as follows:

- Out-of-state visitor volume falls by 13% in 2010 due in part to the impact of volcanic ash. There is a strong recovery in 2011 of 6.9% (as the sector catches-up on the estimated 180,000 visits lost due to volcanic ash related disruptions) and 3.6% growth thereafter
- Visits from Northern Ireland grow by 2% in 2010 and 3.6% thereafter
- Nominal foreign exchange earnings fall by 11% in 2010 and recover by 10% in 2011. From 2012 to 2015 foreign exchange earnings rise by slightly less than 6% each year (with inflation accounting for 2% of that growth)
- Domestic trip volume falls by 2% in 2011, and by 1% in 2012 before modest of 1% to 2% returns
- Expenditure on domestic trips, in nominal terms, declines by 5% in 2010, and by 2% 2011. Domestic trip expenditure is assumed to grow by 1% in 2012, and from 2013 onwards it rises by 3% to 4% annually.

Based on the foregoing assumptions, this core projection shows that by 2015 the tourism industry will generate total out-of-state visits of 7.9mn which is just short of 2006 levels. Most of the recovery comes in the latter part of the forecast period. In terms of the domestic market, volume holds up well and domestic trips reach 8.4mn by 2015.

Figure 5.1 presents the revenue forecasts in the context of past sectoral earnings. It shows that, based on the assumptions and targets above, by 2015 the sector could generate revenue in nominal terms of some €6.2bn which is very close to earnings in 2007.

Figure 5.1: Core Projections – Total Tourism Revenue (€mn) 2005-2015 in Nominal Values



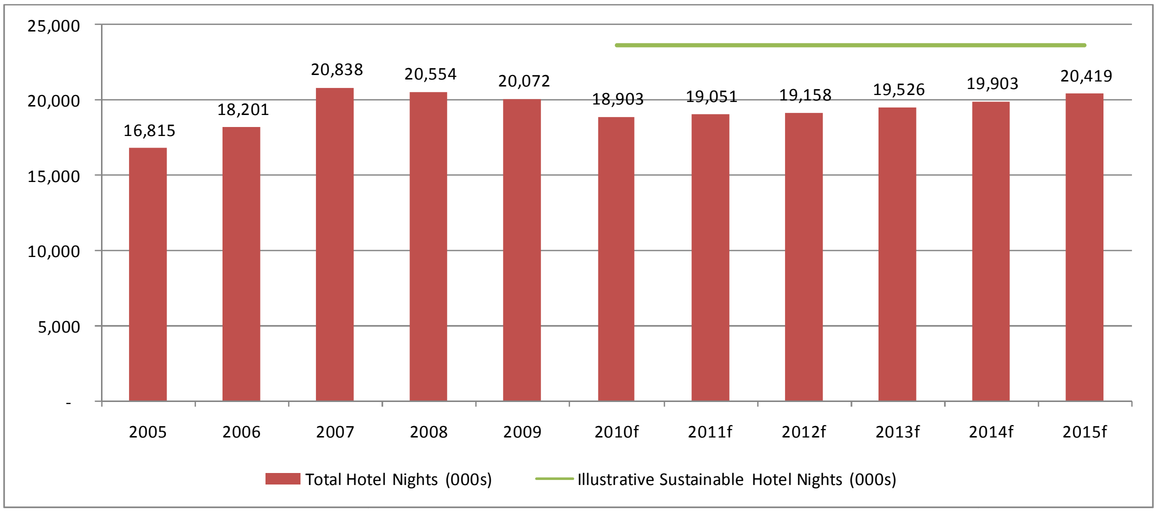
Core Projections' Hotel Demand

Figure 5.2 illustrates the outlook for hotel nights based on:

a) The volume of international visits and domestic trips presented in Table 5.1 and
b) An assumption that recent patterns of hotel usage are maintained.

This shows that by 2015 total hotel nights demanded would recover towards 2008's level of 20.4mn, but still fall short of the peak demand achieved in 2007. The core projections mean that international bednights sold grow by 23% over the five years to 2015.

Figure 5.2: Core Projections - Total Hotel Nights Demand 2005-2015



In 2007 Ireland's hotel capacity was 54,100 rooms (as per Table 2.2) or about 6,000 fewer than now. At that point in time the national occupancy rate was 64%. This is a significant figure as international research suggests that this is indicative of the occupancy level that must be achieved if the hotel sector is to function on a commercially sustainable basis. Failure to maintain this level in the industry is likely to lead to a period of heavy rate discounting which is unsustainable in the long run.

In the absence of capacity reductions, returning in 2015 to 2008 demand levels would result in a projected room occupancy rate of below 60%[2]. This leads us to conclude that a reduction of circa 7,000 rooms would be needed to return occupancy to sustainable levels based on the forecasting assumptions and viable room rates.

The green line in Figure 5.2 above represents an illustrative sustainable level of demand based on today's capacity (60,000 rooms) and it indicates that based on the assumptions employed in the core scenario, projected demand falls short of a level needed to maintain the commercial sustainability of the hotel sector.

Sensitivity Testing the Core Projections

Test 1: Lower Growth

Under Test 1 the core projections' assumptions are revised downwards as follows:

- Weaker recovery in overseas volume in 2011 of 3.5% and 1.8% growth thereafter
- Visits from Northern Ireland grow by 1% in 2010 and 1.8% thereafter

[2] Our focus here is on the medium term which is unlike the more immediate focus of the Irish Hotel Federation's *Over-Capacity in the Irish Hotel Industry and Required Elements of a Recovery Programme Report* (or the IHF/Bacon Report).

- Real foreign exchange tourism revenues recover by 5% in 2011. From 2012 to 2015 earnings rise with volume
- Domestic trip volume falls by 5% in 2010 and another 2% in 2011 and stabilise therafter at 2011 levels
- Real expenditure on domestic trips moves with volume
- Inflation is again taken to be 2% pa from 2012.

In essence, the growth assumptions for the international market are halved and the outlook for the domestic market turns more negative. The results, based on these revised assumptions, are shown below.

Table 5.2: Test 1 Lower Growth Projections – Tourism Volume & Revenue 2010-2015

	2010	2011	2012	2013	2014	2015
Out of State Visitors^ (000s)	*6,400*	*6,600*	*6,700*	*6,800*	*7,000*	*7,100*
Foreign Exchange Revenue (€mn)	3,500	3,600	3,800	3,900	4,100	4,200
Domestic Trips (000s)	*8,300*	*7,900*	*7,800*	*7,800*	*7,800*	*7,800*
Domestic Revenue (€mn)	1,300	1,300	1,300	1,300	1,400	1,400
Total Tourism Earnings (€mn)	**4,800**	**4,900**	**5,100**	**5,200**	**5,500**	**5,600**

^ Out-of-state visitors are overseas visitors and those from Northern Ireland.

If the assumptions used to generate Test 1 hold true then by 2015 the tourism industry would generate total out-of-state visits of 7.1mn which is similar to performance levels in 2001. Domestic trips will be 7.8mn by 2015 which is similar to performance levels in 2007.

Figure 5.3 presents the outlook for hotel nights demanded on the basis of the assumptions set out in Test 1. It is important to note however that this presentation assumes that recent patterns of hotel usage are maintained. In other words, the hotel sector secures no gains in capturing a larger slice of overseas accommodation demand.

Figure 5.3: Test 1 Projections - Total Hotel Nights Demand 2005-2015

Figure 5.3 shows that when volume growth assumptions are halved internationally and downgraded domestically, the hotel market will experience a demand of approx. 18.7mn bednights by the middle of the decade (which positions the sector at 2006 demand levels). The outlook means that international bednights sold grow by 11% over the five years to 2015.

It also implies that a capacity reduction of c.12,000 rooms would be needed to restore the hotel market to sustainable levels as demand falls far short of the line representing stable demand at today's capacity.

It is important to underline the reasons why the changes in the assumptions made have such a significant effect on demand:

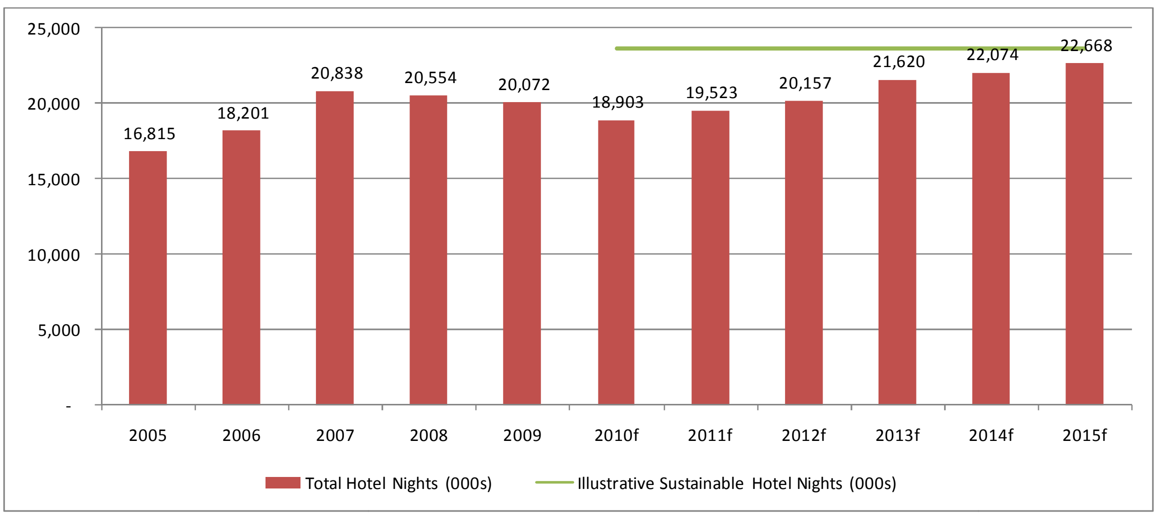
- Domestic tourists account for two-thirds of hotel nights and any downgrade in this component of demand has a very pronounced impact on total hotel demand
- On the basis of the assumptions made, international visits drop from 7.9mn by 2015 in the core model to 7.1mn in the low growth model. However international visitors only account for one-third of hotel nights
- Fáilte Ireland survey data indicates that 13% of international visitor nights are spent in hotels as against approximately 48% of domestic trip nights. To put it another way, (based on current rates of hotel utilization) to generate one extra international visitor hotel night, the tourism industry needs to attract eight more international visitors
- The implication of the foregoing points is that if the comparatively low conversion rate for hotel accommodation remains unchanged at 13%, then very significant increases in international tourist numbers will be required to reach a sustainable occupancy level in the sector. In the current economic climate this will present an enduring and formidable challenge.

In short, the future sustainability of the hotel sector rests on two inter-linked variables. The first is demand volume where changes impact only weakly on hotel occupancy. The second is the conversion rate (i.e. the slice of overseas accommodation demand captured by the hotel sector) where changes impact strongly on hotel occupancy. Therefore, improving overseas visitors' hotel utilisation rate would do more to address the sector's capacity challenges than just growing visitor volume alone. This point is brought out in the next two sensitivity tests.

Test 2: The Core Projections & Increased Hotel Utilisation by International Visitors

Under this test the enabling assumptions are as per the core projections, *plus* we assume that international visitors use hotels more than they have in the past. We take it that by 2013 one-in-six international visitors will stay in hotels as against today's one-in-eight, i.e. utilisation moves from 13% to 17%.

Figure 5.4: Test 2 Projections - Total Hotel Nights Demand 2005-2015

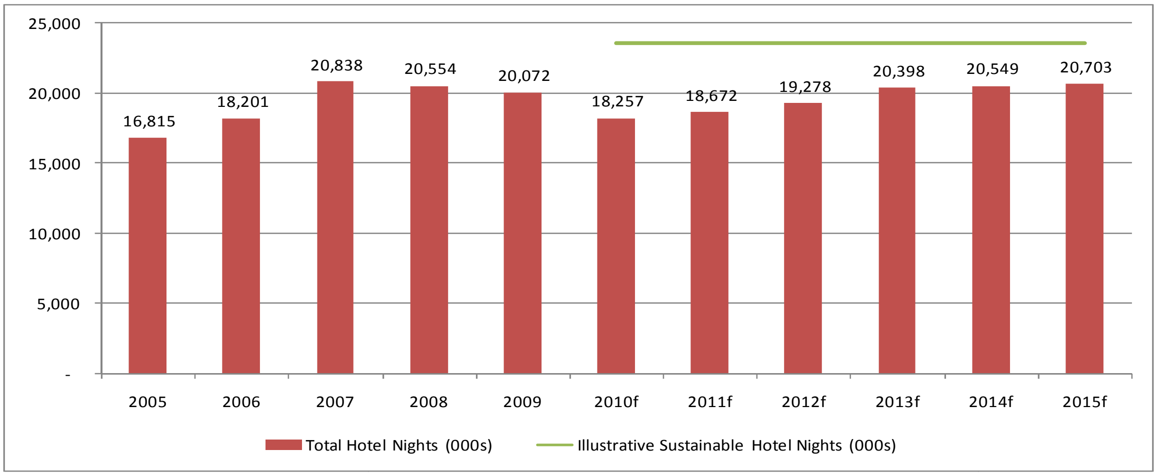


This situation shows that hotel demand would reach 22.7mn, a sufficient level of demand to suggest that stability could be restored to the hotel market with a 1,000 reduction in hotel room stock. Critically however, this scenario relies on vigorous demand recovery in the hotel sector. For example, international bednights sold would have to grow by 61% between 2010 and 2015.

Test 3: Lower Growth Projections & Increased Hotel Utilisation by International Visitors

In the final stress test we combine the lower growth projections of Test 1 with the improved hotel usage by international visitors introduced in Test 2.

Figure 5.5: Test 3 Projections - Total Hotel Nights Demand 2005-2015



This scenario shows that hotel demand would reach 20.7mn bednights by 2015, a figure that is very close to the 21.1mn bednights estimated in the core projections. This outlook also means that international bednights sold grows by 45% over the five years to 2015. At that level of demand it was noted that a reduction of 6,000 rooms would be required to restore stability to the hotel sector.

Additional Comments

- The foregoing analysis suggests that the demand-side challenge for the hotel sector is to grow its share of the overseas . The fact that the economic recovery in Ireland is expected to lag the recovery in our key international source markets is another reason for hotels to increase their focus on international visitors.
- It is important to distinguish between the two driving variables which underpin this analysis. Other things being equal, growth in volume demand will have a weak impact on achieving sustainable occupancy levels, whereas growing the international visitors' conversion rate (share of accommodation demand) will impact strongly. Clearly the interaction of positive movements in both variables represents the preferred state
- Consequently, improving international visitors' hotel utilisation rate will do more to address the sector's capacity challenges than just growing visitor volume alone.

In terms of how the hotel sector could generate more bednights from overseas visitors, the following are important considerations:

  - Hotel bednights in Dublin are split almost 50:50 between domestic and international guests (the capital attracts a higher share of business visits relative to other locations in Ireland)
  - For non-Dublin based hotels 72% of bednights are domestic, with international visitors making up 28%. This implies that they face a bigger challenge than hotels based in the capital

- The share of hotel bednights occupied by visitors from Britain and North America has halved since 2000
- The share of hotel bednights occupied by visitors from mainland Europe has held up over the last decade
- Short-stay visitors tend to use hotels more intensively than those who stay for longer.

The implication of the analysis presented in this paper is that the hotel sector needs to re-balance its business model in terms of the mix of international and domestic visitors. The capability of the sector to market itself effectively to the international consumer has become eroded over a decade of unusually buoyant domestic demand. This capability needs to be recovered. Indeed, based on the significance of the conversion rate variable presented above, the recovery of this capability is the single most important challenge facing the hotel sector today.

6. Conclusions

Capacity has increased faster than demand

Since the start of 2005, 15,463 new rooms were added to the sector, increasing sectoral capacity by 35%. To put this into context:

- International visits to Ireland this year are anticipated to be below the 2005 level
- Domestic trips increased by 16% since 2005.

The counties with the biggest capacity increases were those that are not usually considered centres for leisure tourism and growth was particularly strong in the Dublin commuter belt.

Occupancy rates and financial performance are suffering

The analysis suggests that a viable room occupancy level, in national terms, is in the mid-60% range once sustainable room rates are achieved. Since 2008 the hotel sector has only achieved occupancy rates in the mid-50% range. What makes this performance even more difficult for the sector is that even this low level of occupancy was only achieved following heavy rate discounting.

Looking at average room rates and revenue per available room, 2008 is the turning point. When the occupancy rate fell below 60%, revenue fell almost 20%, and profits were down even more. Profit before tax per room is now less than half of what it was in 2005.

Pockets of excess capacity based on current levels of demand

The area with the highest concentration of hotel room capacity is in and around Dublin with the capacity 'hotspot' spreading out into the commuter belt. As the counties surrounding Dublin are not traditionally considered major overnight tourism centres, this suggests that much of the commuter belt hotel capacity is targeted at non-leisure tourism users.

The next most significant room capacity hotspot is centred on Limerick city and Ennis. This level of room capacity is above what would be expected if the hotels were built purely to service leisure tourism demand, again indicating that much of this stock is targeted at non-leisure tourism users of hotels.

Demand is expected to recover in the medium-term, but challenges remain
Based on the core projections, by 2015 demand for hotel bednights recovers to 2008's level based on Ireland generating a targeted 7.9mn international visits and an estimated 8.4mn domestic trips. In the absence of capacity reductions, returning to 2008's demand in 2015 gives a projected room occupancy rate nationally of below 60% which is not commercially viable. With 7,000 fewer rooms, the projected occupancy rate would be at a more commercially sustainable level of circa 65%. The sooner these rooms are closed, the faster the sector's return to commercial sustainability.

The core projections are set against a number of alternative projections to assess the sensitivity of its outcomes and the results are summarised below.

Table 6.1: Hotel Bednight Demand & Excess Capacity Projections 2012 & 2015

	2012		2015	
	Projected Hotel Bednight Demand	Estimated Level of Excess Capacity	Projected Hotel Bednight Demand	Estimated Level of Excess Capacity
Core Projections	19.2mn	8,000 Rooms	20.4mn	7,000 Rooms
Lower Growth Projection	18.3mn	13,000 Rooms	18.7mn	12,000 Rooms
Core Projections & Increased Hotel Utilisation by International Visitors	20.2mn	7,000 Rooms	22.7mn	1,000 Rooms
Lower Growth Projection & Increased Hotel Utilisation by International Visitors	19.3mn	8,000 Rooms	20.7mn	6,000 Rooms

The exercise points to two driving variables (a) visitor/trip volume growth and (b) international visitors' hotel utilisation rate. Other things being equal, growth in volume alone will have a weaker impact on achieving sustainable occupancy levels than improving international visitors' hotel utilisation rates.

Positive movements in both variables above represents the preferred state, but this is a major challenge. To illustrate:

- Under the core projections international bednights sold would have to increase by 23% over five years, still leaving a persistent excess capacity of 7,000 rooms
- Matching the core projections' volume growth with improving international visitors' hotel utilisation rate from one-in-eight to one-in-six means that international bednights sold would have to grow by 61%. Even this exceptional performance would not be enough to avoid closures
- The alternative lower growth projections imply higher levels of excess capacity and point to more significant closures.

Market led closures

The excess capacity challenge will be resolved, in all probability, by market forces. There is no obvious way that a state intervention can administer away the excess capacity as hotels will continue to be owned/funded by 'rational economic actors'.

Rational, commercially minded hotel owners will only exit the market if it makes good business sense either by shutting down or selling hotels. But selling hotels only changes the ownership, not the nature of the assets which continues to trade as a hotel. Two examples may help to bring out this point.

Example 1
Consider the case of a heavily indebted hotel that would be commercially viable at a lower level of debt as there is a reasonable level of demand for its services. There are a number of options open to restructure the debt and continue operating the hotel as a going concern, these include: • Selling the hotel at a loss, with the next owner successfully operating the hotel at a lower debt level, thereby enabling it to operate into the longer term at rooms rates previously considered unviable • Taking the examinership route, if the courts allow, to write-down the debt to more sustainable levels and facilitate lower room rates • Going into receivership with a new owner buying the hotel at a price that makes commercial sense relative to the underlying demand and income projections. In such cases, the hotel continues to operate regardless of the option chosen.

Example 2
Example 2 concerns a hotel that is simply in the wrong place in that there is insufficient demand to generate enough revenue flows to meeting the operating cost, let alone cover debt repayments. This type of hotel cannot be made commercially viable through debt restructuring and, therefore, is unlikely to find a buyer. The most likely outcome is that the current owner limits their losses by shutting down the hotel.

Therefore, the anticipated capacity reductions will not be limited to the newly built hotel stock. Existing independent, long-established hotels have been through two years of deep rate discounting. In reality, many may struggle to cope with a further two years of rate pressure. Hotel closures could well be made up of a mix of: poorly located new hotels; independent, long-established hotels (especially those without the advantages of scale); and hotels need of major reinvestment. These hotels may struggle to cope with a further two years of rate pressure.

Conclusions in Summary
1. Since 2005 hotel room capacity has grown by 35%. However, in the same period domestic trips only rose by 16% and international visits to Ireland declined to below 2005 levels.
2. Hotels nationally are failing to achieve commercially sustainable occupancy levels (i.e. in the mid-60% range).
3. A spatial analysis of hotel stock indicates that **many hotel developments**, especially those built outside traditional tourism destinations, were based on a business model and related considerations which **were not rooted in the tourism sector**, particularly leisure tourism.
4. **Looking to 2015**, it is expected that international tourist arrivals will number 7.9mn and domestic trips will reach 8.4mn. Based on current trends, even this level of demand is unlikely to fully absorb the hotel sector's excess capacity and **a persistent surplus of 7,000 is expected to remain at that time**.
5. Increasing tourism volume alone will not return the sector to commercially sustainable occupancy levels without substantial stock reductions and hotel closures. However, **the need for hotel closures would be greatly minimised if the hotel sector grows its share of international visitor bednights from 12% to 17%.**
6. Between 2011 and 2015 a number of hotels are expected to close. These closures will be market led and driven by two factors in particular (a) location and (b) the financial health of the business. **Hotel closures are unlikely to be avoided through administrative interventions.**

Appendix of Supporting Material

Figure A1: Map of Fáilte Ireland Regions

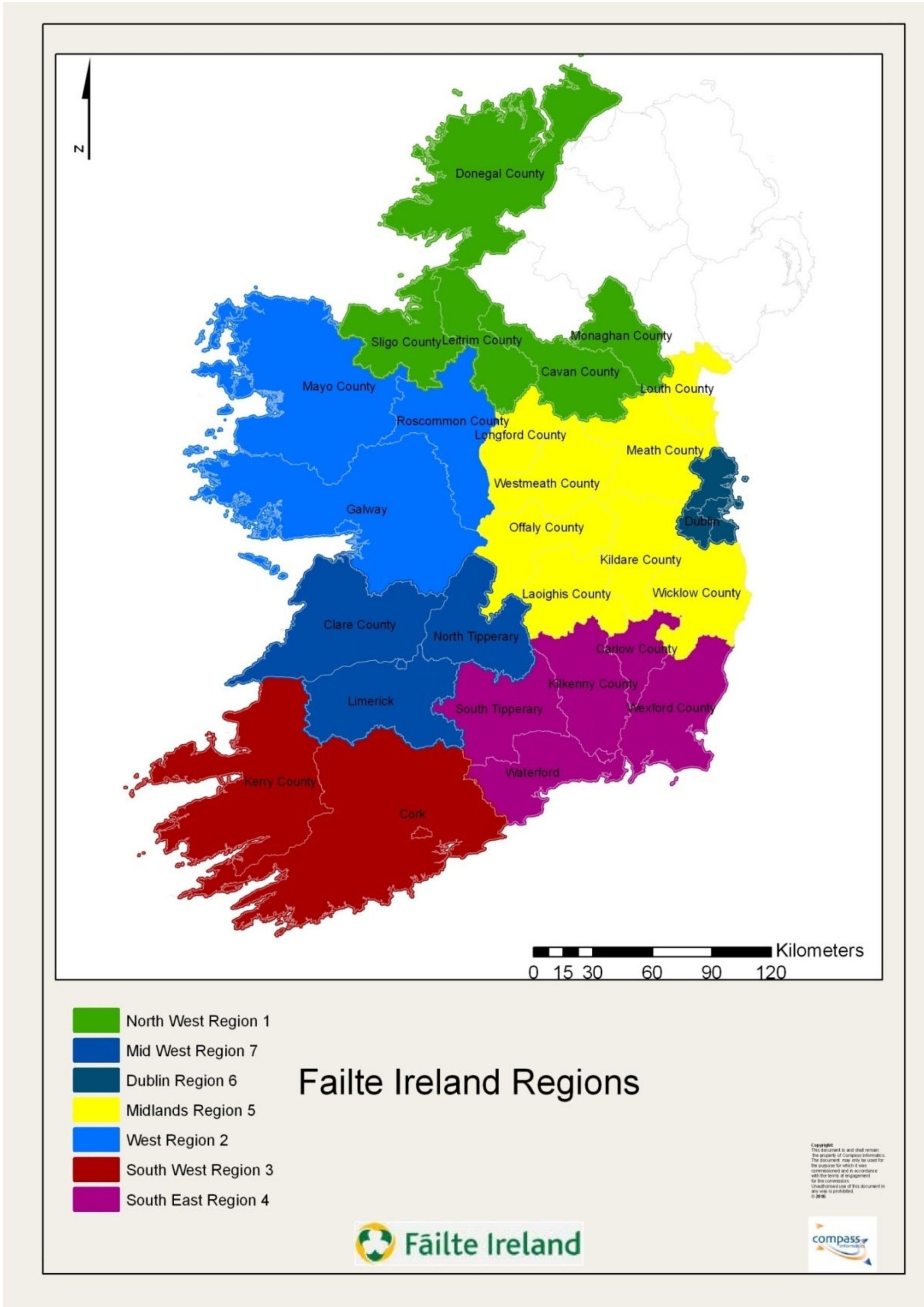

N
Donegal County
Sligo County
Leitrim County
Monaghan County
Cavan County
Louth County
Mayo County
Roscommon County
Longford County
Meath County
Westmeath County
Galway
Dublin
Offaly County
Kildare County
Laoighis County
Wicklow County
Clare County
North Tipperary
Carlow County
Kilkenny County
Limerick
South Tipperary
Wexford County
Waterford
Kerry County
Cork
Kilometers
0 15 30 60 90 120
North West Region 1
Mid West Region 7
Dublin Region 6
Midlands Region 5
West Region 2
South West Region 3
South East Region 4
Failte Ireland Regions
Fáilte Ireland
compass

Figure A.2: Regional Supply and Demand 2000-2009 Measured in Room Nights: Dublin, East & Midlands and South East

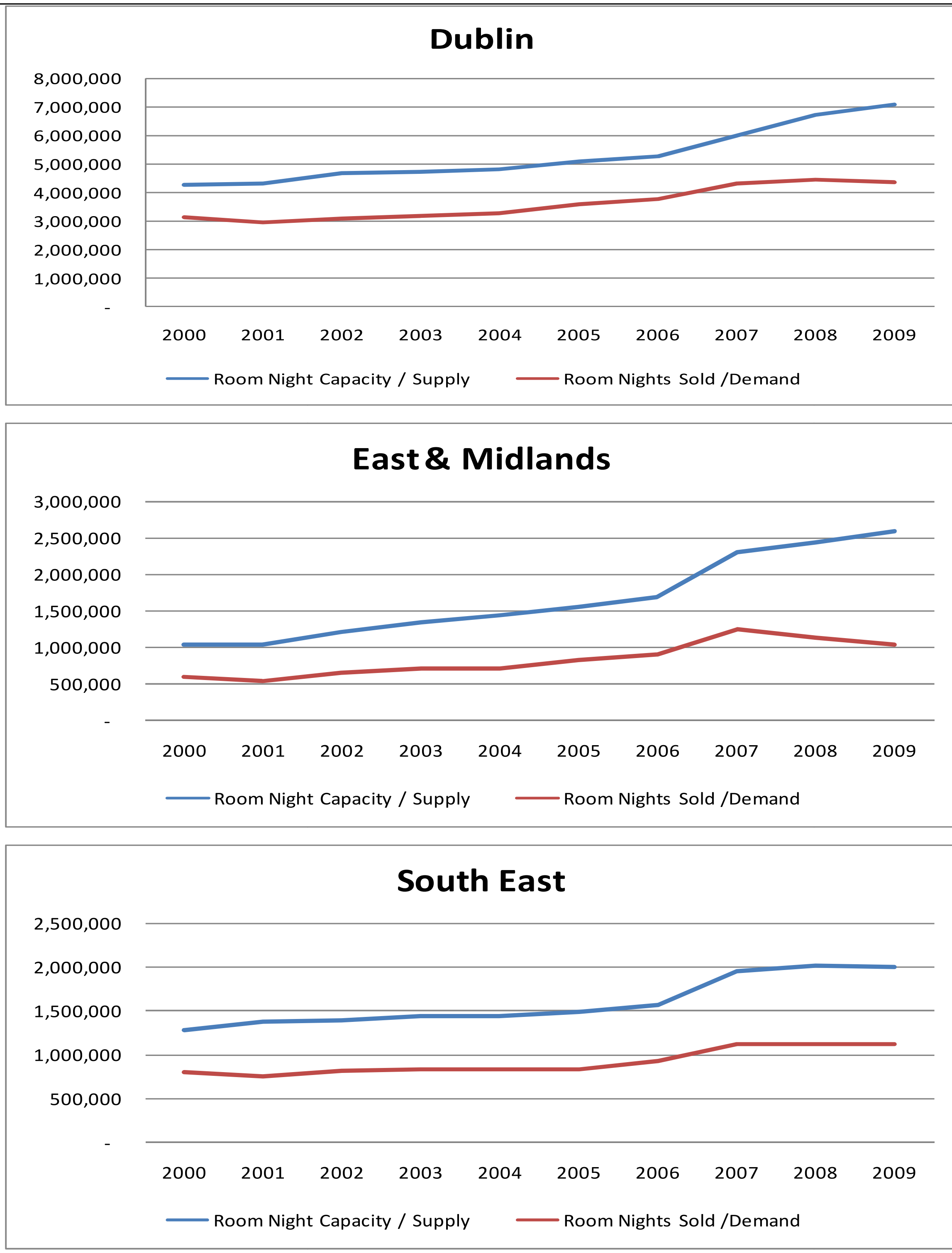


Figure A.3: Regional Supply and Demand 2000-2009 Measured in Room Nights: South West, Shannon, West and North West