UK Commercial – 2019

SPOTLIGHT
Savills Research

European Hotel Trends Outlook

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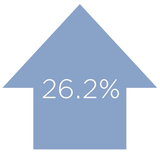
Changing consumer spend patterns are driving high demand across various emerging markets.



Total growth in consumer spend on accommodation services across European nations between 2013-2018.

Key European travel trends

Changing consumer spend habits and expanding international travel is helping to build the profile of numerous emerging European hotel markets.

Growth in international travel accelerated in 2018, with inbound tourist arrivals reaching 1.4 billion, according to UNWTO. Inbound arrivals to Europe accounted for more than half of this, totalling 713 million while increasing 6% compared to the year prior - cementing Europe's position as global leader in terms of inbound travel. Additionally, Europe continues to be the world's largest source market of outbound tourists.

This continued appetite to travel frequently across Europe along with an eagerness to explore new destinations is helping to boost a number of emerging tourism markets while opening extensive hotel investment opportunities along the way.

Changing consumer spend preferences continue to boost a number of emerging European hotel markets

Consumer spend preferences have started to lean more heavily in favour of experiences, such as holidays. This has resulted in total spend on accommodation services increasing 26.2% across European nations over the five years to 2018.

Key Eastern European cities have been notable recipients of such growth, driving up occupancy rates and resulting in 11.9% RevPAR growth in 2018 across the region - outstripping the strong Europe average of 5.2%, according to the STR press release.

Shrinking unemployment rate coupled with strong real wage growth outlook in Europe (due to increase 5.9% between 2018 and 2023, after inflation) provides a compelling outlook in terms of continued travel demand. Improving connectivity is therefore a key objective for many emerging markets in order to capitalise on potential future demand.

The chart below outlines the top 20 markets by means of airport passenger growth, benchmarked against interest levels derived from travel-related Google searches - allowing a number of potential growth markets to be identified.

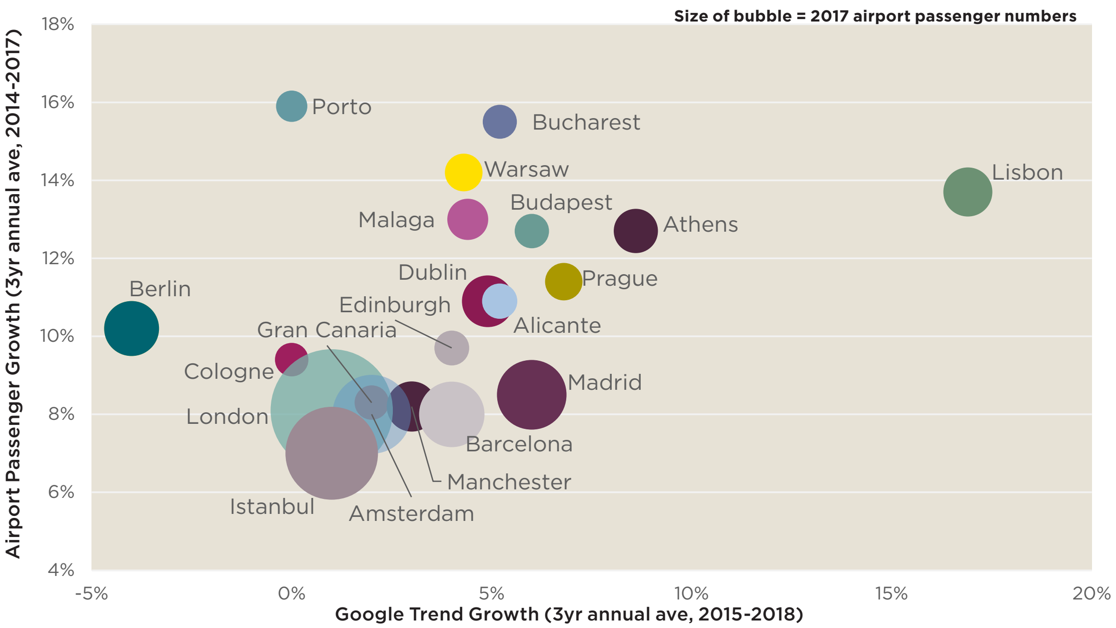
Major Portuguese hubs of Porto and Lisbon stand out, owed to recent airport expansion leading to passenger volumes increasing by 15.9% and 13.7% on average per annum respectively, between 2014 and 2017. Lisbon's interest levels continue to excel with a recent run of international events resulting in strong year-end RevPAR growth in 2018 (particularly convincing off the back of the 21.8% growth experienced in 2017).

The cluster of strong performing Central Eastern European markets features Budapest and Bucharest, each with rapidly advancing tourism markets matched with substantial RevPAR growth in 2018. Prague also ranks highly in terms of both airport passenger growth and interest levels. However, a particularly strong year in 2017 and extensive hotel stock has created marginal softening in 2018 RevPAR growth.

A number of well-established tourist markets also feature including Madrid, Barcelona and Amsterdam. The position of such cities could be boosted further if taking into account alternative transport methods. For example, London has drastically improved international rail services, adding new direct high-speed routes to Amsterdam, Brussels and soon Bordeaux. Likewise, Manchester has seen extensive growth through multiple transport hubs, resulting in overseas arrivals increasing on average by 9.9% per annum between 2014 and 2017.

Other established markets have begun to capitalise on current geopolitical tensions. For example, Amsterdam and Dublin have been the recipients of major corporate relocations in the run-up to Brexit, offering a potential boost in terms of future corporate demand.

Top 20 European tourism growth markets



Source Savills Research; Google Trends; AnnaAero

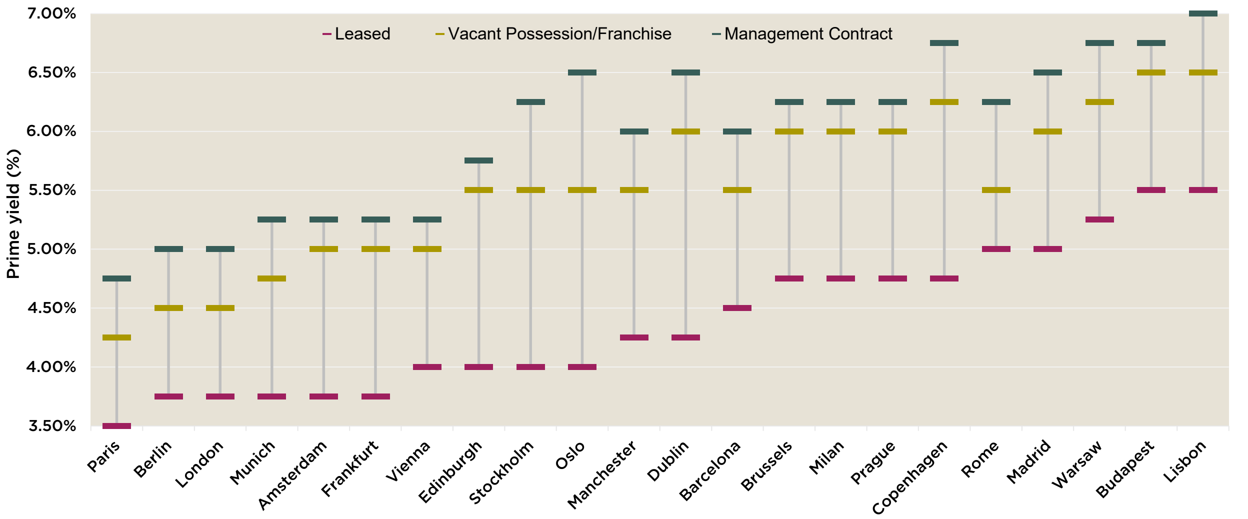
Bounce-back destinations

2018 marked a strong year of recovery for a number of markets that have experienced periods of softening following security challenges. Despite not featuring in the top 20 ranking (see chart) due to relatively weak average annual growth in airport passenger numbers, Paris did report double digit RevPAR growth in 2018 - a significant recovery following the terrorist attacks of 2016. Brussels too has experienced a pick up in RevPAR in 2018 (+12.4% year-on-year) following softening after the bombings seen in early 2016. This recovery, coupled with relatively subdued levels of stock expansion points to positive outlook in terms of operational performance.

Similarly, Istanbul (which features in the top 20) has achieved very strong recovery off the back of multiple security threats and political unrest. Visitor arrivals and subsequently occupancy rates have therefore surged, confirming its status once again as a key global tourist destination. This has been helped somewhat by government subsidies paid to flight operators as well as the partial-opening of the new 90 million capacity Istanbul Airport in October 2018.

> For those willing to move up the risk curve, emerging tourist cities and non-leased operating structures offer attractive yields.

European city hotel prime yield comparison



Source Savills Research

The pursuit for higher yields

Where are the value opportunities beyond leased assets in Europe's core destination cities?

Cross-border buyers continue to drive the majority of hotel investment across Europe

European hotel transaction volumes remained high in 2018, exceeding that of 2017 according to RCA. Cross-border investors made up the lion's share of transactions, to account for a 65.4% share of total volumes in 2018, outstripping the 10 year average of 54.9%. Overseas investment into UK hotels form a bulk of this, owed to multiple large-scale portfolio transactions involving Canadian, Israeli and French buyers.

By city, London continues to lead in terms of investment volumes, exceeding the previous 2013 peak by 10.2%. Paris saw the second highest hotel volumes transacted in 2018, off the back of a relatively muted year in 2017. This included key deals such as the 428-room Westin Paris, acquired by Henderson Park for £489.4m in October 2018. Amsterdam and Frankfurt also feature within the top five investment markets of 2018. High volumes of transactions in these mature markets has maintained relatively keen yields.

Growth cities and alternative operating structures offers attractive higher yielding

The chart above outlines the spread in terms of prime indicative yields across the differing European cities and operating structures. For example, prime leased hotel yields in Paris are the keenest at 3.50%, with prime hotel yields on the same operating structure 25bps higher in Munich.

Investor appetite for leased hotels in mature markets such as Germany, Paris, Amsterdam and London has resulted in compression and very keen relative pricing. In some markets, such as London where the demand fundamentals remain robust, we have seen this investor appetite move up the yield curve with the spread between leased and VP (vacant possession) structures squeezed to 75bps. We are still to see the same squeeze in other mature markets particularly those that have the ability to drive RevPAR. For example, the leased to VP spread in Munich and Amsterdam stands at 100bps and 125bps respectively.

Emerging tourist markets are also looking increasingly attractive for those investors looking for higher relative yields. Leased hotel yields in Dublin are 75bps higher than those in Paris. Dublin's leased to VP spread is a further 175bps. This is against a backdrop where Dublin has been one of the strongest RevPAR growth cities across Europe over recent years, helped by a very constrained development pipeline. Unsurprisingly, it has seen strong transaction activity with volumes up 81.8% to €618 million in 2018.

Spain has seen significant investment activity over the last five years (partly due to Blackstone acquiring Hispania, becoming the country's largest hotel owner). While this has helped to compress yields in Madrid, Barcelona has witnessed some softening down to reduced investor sentiment off the back of political instability and security threats. However, the market fundamentals remain strong with overseas arrivals increasing 5.2% in 2018. Furthermore, the ban on future central hotel development minimises a potential pipeline risk, which should help to support pricing.

Hotel investment outlook in key Portuguese markets remains strong given recent RevPAR growth and rapidly expanding tourism industries. Additionally, the Portuguese government recently passed a law allowing REITs to operate in Portugal, potentially driving future investment demand.

An increasing international hotel brand presence will help to legitimise hotel investment in emerging cities

The growth in tourism to smaller emerging cities across Europe is helping to drive stock growth, enticing global brands into these previously under-served markets. A growing presence of global brands will help to improve the appeal of these cities to investors, while also increasing acquisition opportunities. While, this has and will create some operational headwinds in certain markets (Warsaw being a prime example), for those cities with more constrained development opportunities the impact on operational performance will be less pronounced.

€618m

Dublin 2018 hotel transaction volume (up 81.8% compared to 2017)

65.4%

2018 European hotel investment accounted for by cross-border investment

111 bps

Average spread (basis-points) between yields for leased and vacant possession structures across Europe

Savills Commercial Research
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