SPOTLIGHT

Savills Research

European Hospitality

2024, THE TURNING POINT FOR TRANSACTIONAL ACTIVITY

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Key points

01.

Performance Normalising:
Performance across Europe has started to normalise, with growth in Average Daily Rates (ADR) and occupancy slowing, albeit remaining above pre-covid averages.

02.

Operator Margin Challenges:
Rising costs in 2023 impacted operator margins, but increased ADRs and operational efficiencies mitigated the effects. However, challenges to margins may persist in 2024 as ADR growth normalises.

03.

Standout Market Performance:
Markets with strong international leisure appeal, such as Rome and Paris, have seen robust ADR growth and occupancy recovery, driving impressive year-to-date RevPAR increases.

04.

Sustainable Demand:
Despite normalisation in performance, widespread correction in ADRs back to pre-pandemic levels is deemed highly unlikely due to sustained demand recovery, highlighted by ongoing growth in air passenger numbers and consumer prioritisation of travel spend.

05.

Luxury Hotel Expansion:
Demand for luxury accommodation remains strong post-pandemic, supporting ADR's. Luxury brands will continue to expand their footprint with substantial increases in room stock by 2028.

06.

Shift Towards Serviced Apartments:
Serviced apartments have gained popularity with investors post-pandemic due to higher occupancy rates and lower staffing requirements. Lack of purpose built investable stock, however, continues to create challenges.

07.

Investment Market Recovery:
European transaction volumes reached €13.33bn in 2023. This was 26% down on the previous year, but there are indicators suggesting that activity has bottomed out.

08.

Future Outlook:
European hospitality performance is expected to return to more steady growth rates. Transaction volumes this year are forecasted to surpass 2023 levels, supported by reduced borrowing costs. Yields may continue to fluctuate in certain markets, with mid-cap private equity buyers expected to return to the market.

Operational outlook

How sustainable are current ADR's?

The key trend across the majority of hotel markets in Europe in 2023 was the strength in growth of average daily rates (ADR's). For example, as of December 2023, year-to-date European ADR's were 25.9% above the same period in 2019.

This rate of growth is unsustainable and as Fig 1 demonstrates, more recently we have seen performance normalise. Year-on-year change in ADR's steadied to 4.6% in December, down from the 17.6% seen in the same month in 2022, alongside a normalisation in occupancy, bringing headline RevPAR (revenue per available room) annual change to 8.8% in December.

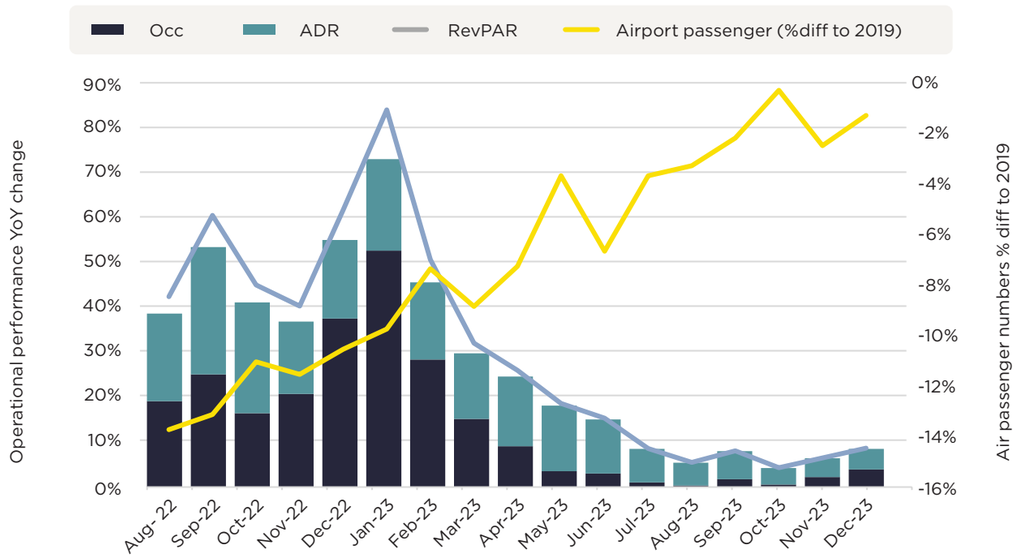
Markets that have seen the strongest growth in ADR's, alongside a faster recovery in occupancy, have largely been those with a stronger international leisure appeal.

The top five city markets in Europe based on year-to-December RevPAR performance included Rome and Paris where ADR's were 51.9% and 51.8% above equivalent 2019 levels respectively, with occupancy largely fully recovered.

While performance is now normalising it is highly unlikely that we will see a widespread correction in ADR's back to 2019 levels. There will be certain assets and segments that will see some softening, but with demand across several markets still in recovery mode, there remains significant support for further occupancy growth, which will underpin rates and help drive top-line performance.

This demand is highlighted by the fact that air passenger numbers across some of the largest airports* in Europe are still not fully recovered, with an average differential in December of -1.2% compared to the same month in 2019.

Fig 1: European performance vs Airport passenger numbers relative to 2019



Source: STR / Costar; Savills Research; *Eurostat (Note: Airport passenger data relates to the top 15 airports in Europe in terms of annual passengers)

Top 5 Major European* cities in terms of RevPAR YTD Dec23 vs Dec19

1st	Rome	+52%
2nd	Paris	+50%
3rd	Edinburgh	+45%
4th	Athens	+37%
5th	Budapest	+34%

Source: STR / Costar; Savills Research (Note*: excludes cities in Russia and Turkey)

Why a widespread correction in ADR's across Europe is highly unlikely

The pivotal factor in sustaining the newfound stability in ADRs across most European markets lies in the recovery and ongoing growth in demand, which directly influences hotel occupancy levels.

Oxford Economics recently upgraded their forecast for international visitor arrivals into Europe, suggesting these will be fully recovered by 2024, with a resumption in their previous forecast trajectory. 2025 is expected to see an additional 10% increase in arrivals.

What will drive demand going forward?

A combination of factors will continue to drive demand. Over the short term, it's the continued and expanding appetite for travel both intra-regionally and from long-haul source markets, which will be key.

According to Tourism Economics, travel continues to be a priority for consumers across different economies, with leisure travel spend, both domestic and outbound, for European and North American consumers accounting for approximately 8% of consumption in 2023. This is in line with 2019 levels and ahead of the long-term average, with forecasts suggesting that this share could increase this year. This appetite is reflected in consumer sentiment, with the European Travel Commission's (ETC) latest consumer survey reporting that 68% of those surveyed were planning an international trip within the next six months.

Consumers' prioritisation of travel spend in the face of rising household costs in 2023 was supported, in part, by excess savings accumulated during the pandemic. Across the Eurozone, household overnight deposits as of December 2023 were 16.7% above the same period in 2019 (in nominal terms), with this saving excess skewed towards more affluent households. In the latter months of 2023, it was the rapid slowing in inflation seen across a number of major economies that further supported improving travel sentiment, and this is set to continue as we move through 2024.

For example, real disposable incomes for UK and German households, key source markets for the region, are forecast to increase by an average of 1.5% in 2024, with an average annual growth to the end of 2027 of 1.7% per annum.

There are, however, growing downside risks to consumer confidence, and in turn international arrivals into the region, over the short term. Slowing economic growth and geo-political uncertainty in the Middle East and wider China region could temper traveller sentiment this year. In the case of the latter, this could further delay the full recovery of Chinese arrivals into Europe.

While Chinese arrivals improved through the course of 2023, full-year numbers were estimated to be 67% below 2019 levels, a reflection of visa and airline capacity challenges but also a continued preference for domestic travel. Chinese arrivals are forecast to continue to improve but not fully recover until post-2025.

This slower recovery could pose more of an issue to those markets that have historically attracted significant numbers of Chinese visitors, such as Paris and Milan, particularly as visitor numbers from North America start to normalise. The scale of this potential impact, however, is likely to be offset by growth in other emerging source markets such as India, South America and elsewhere in the Asia Pacific region.

Have pressures on operator margins really started to abate?

It was not just consumers that faced an inflation squeeze last year, operators did too as rising costs generated headwinds for margins. However, most of this was offset by an increase in ADR's and improved efficiencies. Hotstats noted in August 2023 that year-to-date Gross Operating Profit margins for several key European markets, such as the UK, Germany and Spain were ahead of, or in line with, that reported in 2022. In the case of Spain, they were even ahead of 2019 levels, with the other European markets reporting GOP margins only slightly below pre-covid levels.

While it would appear that the wider European hotel market may have avoided the worst of the margin squeeze in 2023, the real challenges to margins may materialise in 2024, as ADR growth normalises to a slower rate than seen over the last 18 months. The good news is that some of those cost headwinds are already starting to wane – Eurozone headline CPI inflation slowed to 2.9% in Q4 2023. While inflation is forecast to lower further, the pace of this will be far slower, with Q4 2024 Eurozone inflation expected to reach 2.6%.

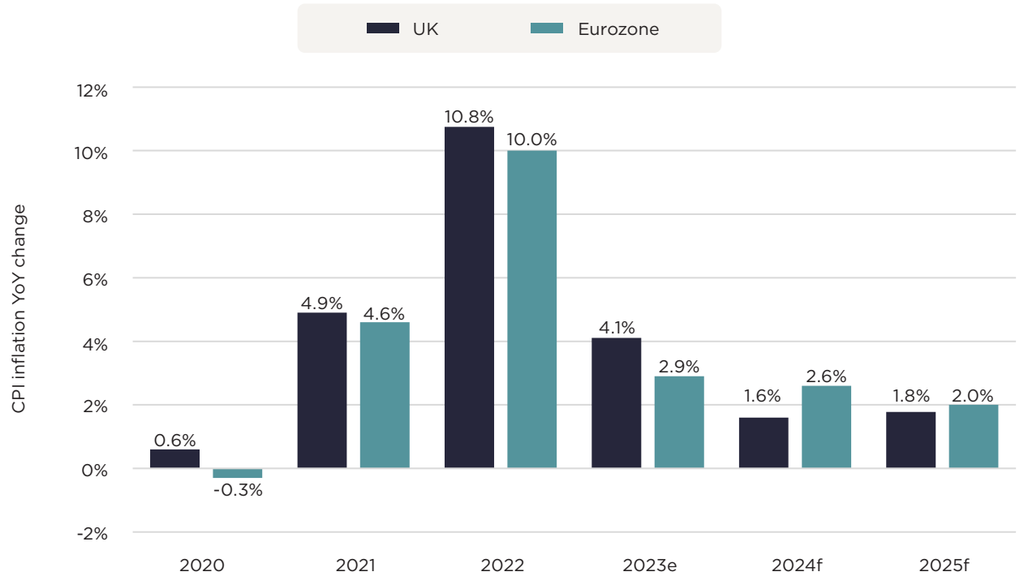
Slowing inflation has been driven in part by falling energy costs. STR Costar suggested that utility costs per available room across Europe stood at €7.70 in July/August 2023, down 29% on the €10.88 seen in Q1 2023. This is forecast to continue through 2024, with some economists lowering their energy price outlook for this year in response to robust European gas stockpiling and subdued consumption in the region against pre-Ukraine war levels.

This will provide some welcome respite for operators' bottom lines, however, it's unlikely that costs will return to 2019 levels anytime soon. For example, utility costs per available room are still 39% above where they were in 2019. In addition, while food inflation has been slowing, it will remain ahead of the headline rate with staff availability, and as a result wage costs are also under pressure. It will be these pressures on margins that keep ADR's elevated, as some operators will prefer to pursue an ADR strategy rather than drive occupancy.

Operators can help to offset these headwinds to profitability by stepping up improvements to operational efficiencies; something often seen with the stronger and better capitalised operators. For owner-operators who are not as well placed, we expect this squeeze on margins will lead to a renewed focus on exit strategies.

These margin challenges will not be universal. The depth of demand at the ultra-luxury end of the market suggests that for the very best luxury hotels in key destination markets, the prospects for ADR growth are stronger, offsetting continued cost pressures. Limited-service hotels, particularly at the budget end, and serviced apartments, where staffing requirements and onsite F&B offerings are non-existent or kept to a minimum, will also prove to be more immune. In the case of serviced apartments, their growing consumer appeal and typically higher margins, coupled with a higher indicative yield compared to equivalent hotels, are enhancing the sector's attractiveness to investors.

Fig 2: Eurozone CPI trend and forecast



Source: Oxford Economics

Ultra-luxury hotels step up expansion

Demand for luxury stays was strong post-pandemic. Luxury hoteliers, looking to capitalise on the seemingly inelastic demand of their clientele, raised room prices, which saw ADR's increase as much as 38% in the case of London.

Attempting to capitalise on this period of strong demand, luxury brands have been expanding across Europe, with new locations being secured on an asset light, management contract basis.

Savills have collated data for a select number of luxury hotel providers including the Mandarin Oriental, Four Seasons and Belmond. Our forecasts show that, in terms of room numbers, between 2023 and 2028, there is to be an expected 49.3% increase in existing luxury hotel stock in Europe, equating to a total of c.4,000 new rooms coming to market.

In the five years preceding the pandemic, total luxury provision across the select brands saw an average year-on-year growth rate of approximately 2.6%. Between 2023 and 2028, growth is set to more than double, with the five-year average growth rate predicted to sit at 6.7%.

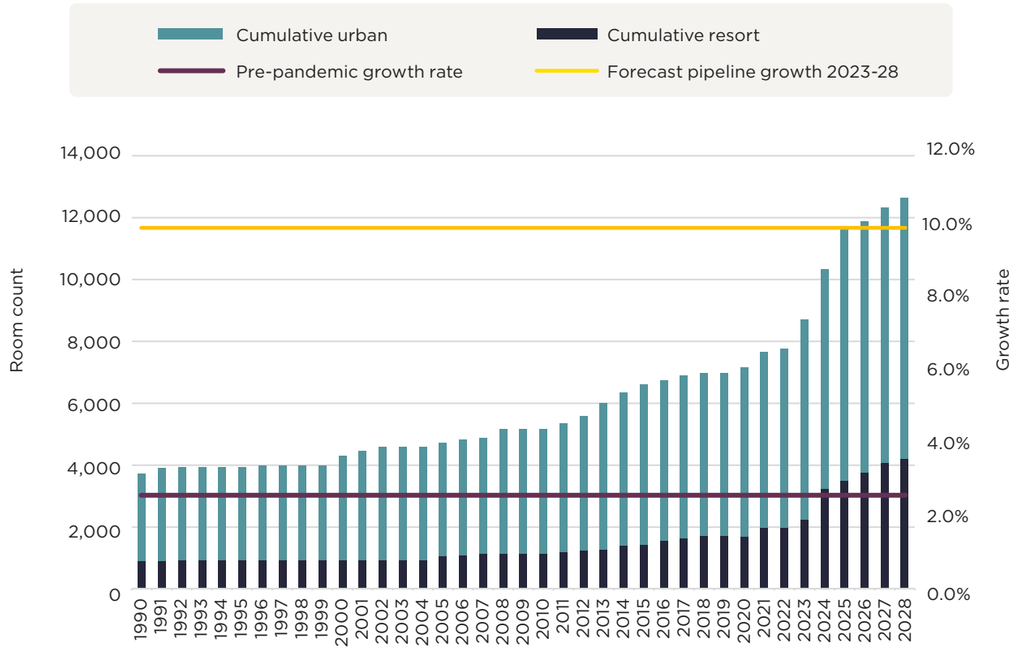
This is underpinned by rapid expansion from Mandarin Oriental, who are set to open a total of nine new hotels across Europe, building upon their pre-existing stock of 13. Additionally, Six Senses are set to triple their current European provision, with the opening of 15 new hotels by 2028.

Urban or Resort: Stick or Twist?

While rooms in urban locations currently account for 74.7% of total stock, taking into consideration pipeline developments, this share is set to drop to 67.1% by 2028. Despite some brands remaining focused on urban locations for a majority of openings, others are taking steps to diversify their portfolio into resorts. Notably, Rosewood is set to open their first resort location in 2024, with the launch of a 98-bed Hotel on the outskirts of Salzburg, Austria.

Pre-pandemic, the five-year average growth rate in rooms in resort locations outstripped that of urban locations, sitting at 3.7% and 1.8% respectively. Looking forward, this trend continues, with the resort average growth rate at 10.3% per annum through to the end of 2028, slightly exceeding that of urban locations at 9.4%.

Fig 3: Luxury supply (total cumulative rooms)



Source: Savills Research

Top 3 European cities in terms of ultra-luxury* room stock as at the end of 2028

Source: Savills Research (Note*: based on select luxury brands including Mandarin Oriental, Aman, Belmond, Four Seasons, One & Only, The Peninsula, Rosewood, Shangri La, Six senses, St Regis)

Extended Stay: what are the best opportunity cities?

Serviced apartments, aparthotels, extended stay, have all come into their own post pandemic. This segment was one of the first to bounce back from the pandemic, and when compared to the wider hotel market, serviced apartments typically enjoy higher occupancy. For example, year-to-date London serviced apartment occupancy as at October 2023 stood at 81.4%, which was marginally ahead of the 79.6% seen in the wider market. Some of this was driven by a greater appreciation of a more 'isolated' hospitality offer in a post-pandemic environment.

Greater consumer awareness of the serviced apartment concept and brands has also helped to drive operational performance. This is then being matched by greater investor awareness. As well as higher occupancy, the sector has other features that are attracting growing investor interest. The lower staffing requirements and higher margins typically associated with the sector are further driving investor appetite, particularly in the current high interest rate environment.

Nonetheless, despite the sector's evident appeal, investors still face a challenge: the lack of purpose-built investable stock. Although there has been an increase in supply in recent years, with London reporting an addition of over 3,000 units in the past six years, viable investment opportunities remain relatively scarce.

To illustrate this, over the last decade, serviced apartment volumes in the UK have totalled £2.7bn, representing just 5% of total hospitality transaction volumes. Investors have increasingly been dealing with this challenge by buying into operational platforms and/or entering into strategic partnerships. For example Brookfield acquired the SACO, now Edyn, platform in 2018.

More recently we have seen investments by APG into CityID (2020) with LaSalle Investment Management entering into a reported €500 million strategic partnership with Numa Group in 2022. This approach provides the platform with the ability to expand its footprint while providing investors with exposure to the sector and the support and intel of an existing operator.

A number of platforms are also now looking to new markets to grow their footprint. In the case of Numa, their acquisition of Yays Group in November 2023 gave them immediate exposure to the Benelux region. On the whole, serviced apartments currently only account for a small share of total hospitality provision; for example, in the UK, a relatively mature market by European standards, serviced apartments are only 4% of total hospitality stock. As a result, most markets in Europe will offer attractive scope for expansion.

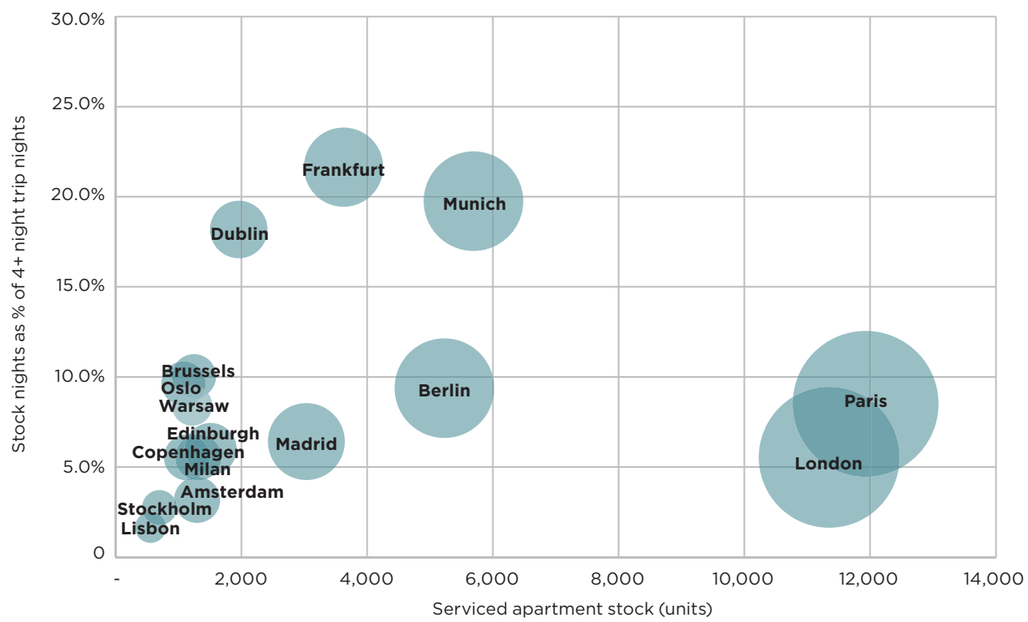
Looking at serviced apartment stock nights as a share of total commercial nights for trips of four nights or more in the major European Capitals, the most relatively undersupplied markets would appear to be Lisbon and Stockholm. For these markets, serviced apartment stock nights are only 1.6% and 2.8% of total nights. Frankfurt, Munich and Dublin are at the other end of the spectrum.

However, in the case of Dublin and Munich, where there is a strong corporate as well as leisure growth story and the actual stock is only 2,000 and 5,500 units respectively, there is still some opportunity for further expansion.

Even in Paris and London, where stock is over 11,000 units, there is a relative undersupply and an opportunity to capture a greater share of the longer-stay market.

The size of the potential opportunity that exists across European markets is likely to be exacerbated by the expansion of co-living in some markets, and the ability of serviced apartments typically enjoy this demand pool and that of hotels (subject to local government regulation) to the benefit of both top line and bottom-line performance.

Fig 4: Serviced apartment stock nights as percentage of total nights in commercial accommodation (trips of 4+ nights)



Source: Savills Research; Eurostat (Note: size of bubble reflects size of total stock)

Investment market outlook

There are some early signs that investment activity has bottomed out

Total hotel transaction volumes across Europe (incl. UK) in 2023 totalled €13.33bn, 26% down year-on-year. There are, however, some reassuring signs that suggest activity has already bottomed out.

In the second half of 2023, investment activity exhibited promising signs of recovery, marked by consecutive quarterly increases. Notably, regional volumes surged by 20% quarter-on-quarter during Q3, a noteworthy development given that Q3 traditionally experiences subdued activity.

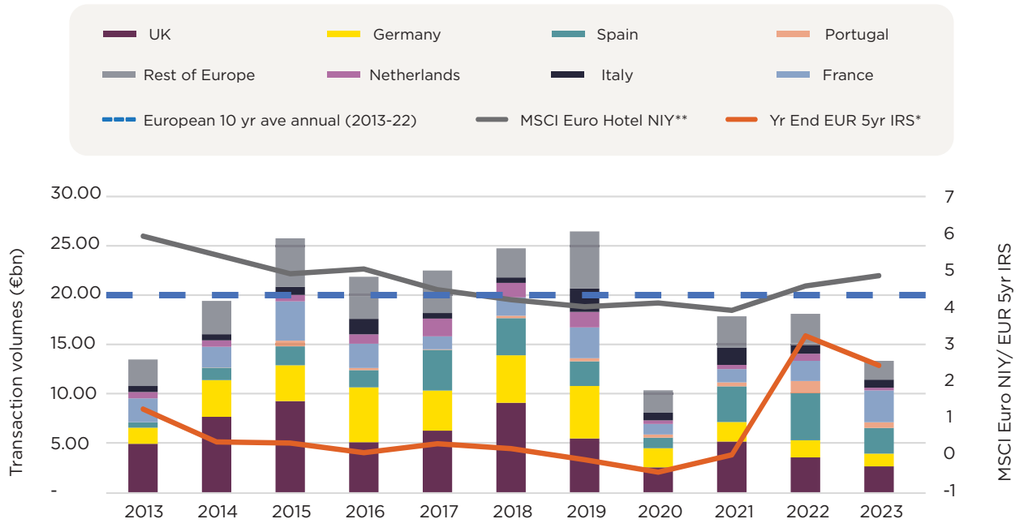
Although second-half volumes still experienced a year-on-year decline of 19%, this represented a significant improvement compared to the steep 32% decline in the first half of the year.

The UK made a comeback and became the largest hotel investment market in 2023, after Spain had overtaken the UK in 2022 to become the largest market.

Last year the UK recorded €2.62bn of hotel transactions, marginally ahead of the €2.61bn recorded for Spain. This was driven by a marked increase in UK activity in the final quarter, helped by a reduction in borrowing costs and improved investor sentiment. With more than €1bn of UK hotel assets already transacted this year, full year volumes are expected to surpass 2023 levels.

While activity slowed in Spain last year compared with 2022 levels, sentiment remains robust with a continued appetite for leisure-focused assets with a repositioning angle, focused on luxury and upper-upscale categories, something we are seeing in other Southern European markets too, such as Portugal and Italy.

Fig 5: European transaction volumes vs yield and 5-year Interest Rate Swap (IRS)



Source: Savills Research; MSCI (Note: *EUR 5yr IRS for 2023 as of 31st December 2023; **MSCI yield to Q3 2023)

Has pricing stabilised?

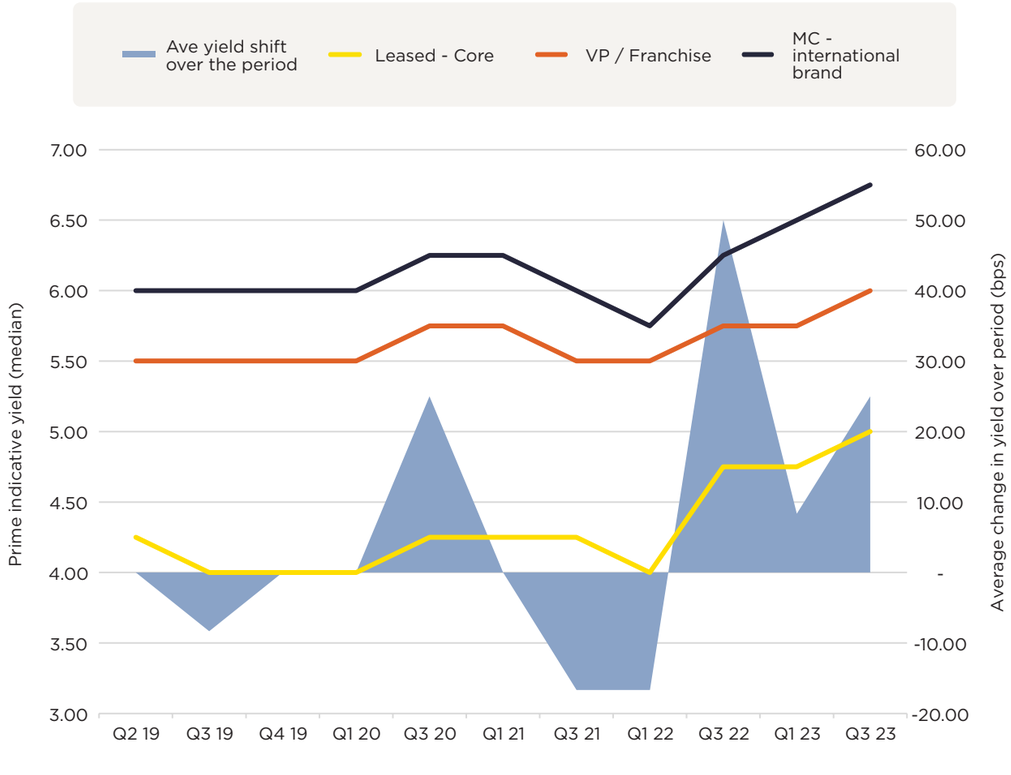
Savills prime hotel yield series, encompassing 25 city markets across Europe and spanning leased, Management Contract, and VP / Franchise operating structures, saw outward yield shifts largely across the board in Q3 2023.

On average, yields softened by 25bps on Q1 2023 levels. As a result, prime headline yields on a median basis averaged 6.75% based on a Management Contract (international brand), 6.00% for VP/ Franchise model and 5.00% for leased assets.

The outward shift recorded in Q3 represented an acceleration on the 8 basis points softening reported in the preceding six months leading up to Q1 2023.

However, it marked only half that seen 12 months earlier in response to the rapid acceleration in debt costs in the second half of 2022.

Fig 6: Trends in average European yields



Source: Savills Research (Note: average yields on a median basis as tracked across 25 city markets. Prime yields are based on a hypothetical hotel in a prime urban location.)

With expectations that the current base rate cycle has peaked, evidenced by 5-yr SWAPs softening in recent weeks, we expect prime headline yields have largely stabilised and we expect yields will start to come back in late 2024, albeit this will be dictated by a reduction in base rates, which is expected in the latter part of 2024.

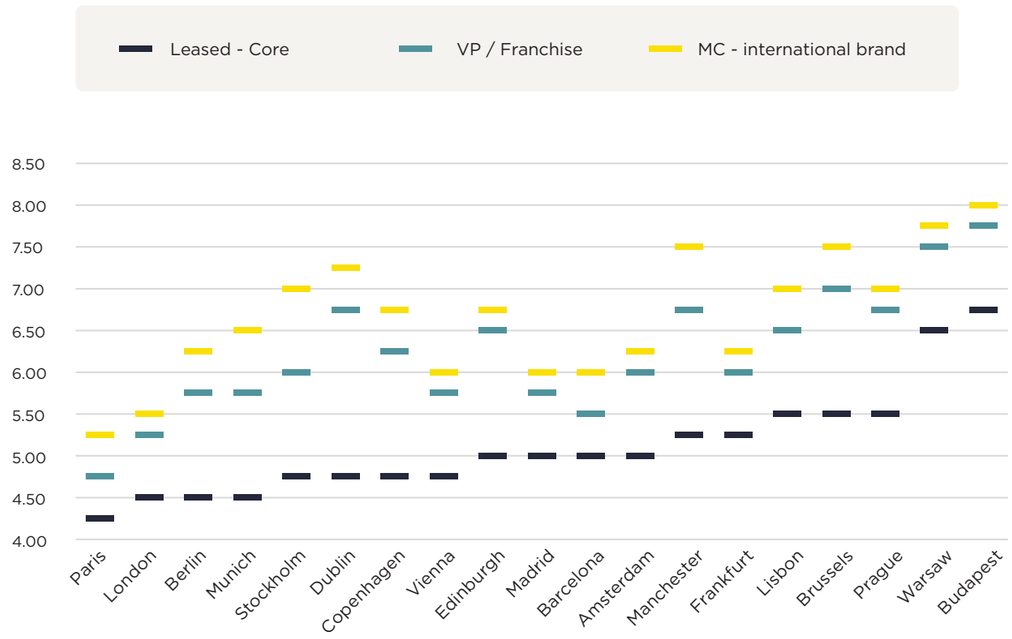
There remain markets however, where we expect further outward shifts prior to downward yield pressure returning. The markets most exposed to this are those with the keenest yields.

In the leased space, we expect the upward pressure should be kept to a minimum, helped by the returning appetite from institutional investors.

For those markets, and operating structures, where indicative yields are above debt costs, the upward pressure on yields will be less pronounced.

Southern European markets will likely buck this trend, helped by the strength of investor appetite for assets in those markets and the higher spread to debt costs relative to other markets.

Fig 7: European city hotel prime indicative yield comparison (select markets, as of Q3 2023)



Source: Savills Research (Note: Prime yields are based on a hypothetical hotel in a prime urban location.)

Navigating the debt market

The European hospitality sector has been navigating a complex and challenging landscape, including a changing debt market amidst a backdrop of rising interest rates and inflationary pressures.

There are several factors shaping the debt market and its impact on the industry. For instance, the conflict in Ukraine in February 2022 triggered a global response from central banks, leading to a two-year-long challenge with inflation. This resulted in rising interest rates globally, which significantly impacted debt costs for all real estate investors, and posed structural challenges for sponsors with leveraged assets and/or portfolios.

Whilst issues remain where assets were financed at moderate-high leverage based on tight investment yields, lenders are demonstrating a strong appetite to deploy capital for new acquisitions and development.

In fact, we see evidence that the hospitality sector stands to benefit from the challenges in traditional core sectors, such as offices, as lenders look to diversify their exposure.

Looking ahead, there are signs we may see interest rate cuts as we move through 2024, which could potentially ease the burden of debt costs for investors and enhance the viability of real estate investments. In addition, there are indications that hotel values could rise as profits increase, although the market has yet to fully reflect recent trading conditions.

Overall, the debt markets will play a large role in shaping the investment landscape for European hospitality in 2024. Correctly navigating the debt environment will present opportunities for those able to adapt their approach, and as the sector continues to adjust, careful monitoring and strategic decision-making will be essential for sustained growth and profitability in 2024.

Charlie Bottomley

Director
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Outlook

Top line performance to normalise, placing some pressure on margins

On the whole European RevPAR will continue to increase, although at a slower rate than seen over the preceding two years, placing some pressure on margins as cost growth continues, albeit also at a slower pace.

Transaction volumes to exceed 2023 levels

Slowing top line performance coupled with squeezed margins will drive exit decisions for some owner-occupiers. There is also starting to be a more realistic view on pricing, which will help support transaction activity, as will a gradual fall in borrowing costs.

Some marginal yield softening in some parts of the market over 1H, with downward pressure to materialise later in the year

Further decompression in yields is expected in those markets where the spread to debt costs is tighter. Southern Europe is expected to buck this trend.

Mid-cap private equity buyers to return to the market

While private buyers and owner operators were particularly active in 2023, and will continue to be so this year, we expect mid-cap PE will make a return in 2024. This will be supported by the relative appeal of the sector (strong demand fundamentals and operational performance) and the pressure to deploy capital.

SAVILLS EUROPEAN INVESTOR SENTIMENT SURVEY 2024

In this recently completed survey, we received responses from investors with an aggregate €700bn of real estate AUM.

40% — **of respondents are looking to increase their allocation to the Hospitality sectors over the next 3 years**

c.€10bn — **these investors expect to deploy €10 billion of capital into Hospitality in this period**

60% — **of investors targeting Hospitality want to invest in Serviced Apartments, followed by Lifestyle Hotels and Mid-Market hotels (45% each). A fifth of investors are looking to invest in Luxury Hotels**

47% — **of Hospitality investors will look to pursue a pan-European strategy, with 31% targeting Southern Europe**

80% — **of investors highlighted Geopolitical uncertainty as a key risk factor for future investment**

Savills Research

We are a dedicated team with an unrivalled reputation for producing insightful analysis, research and commentary across all real estate sectors throughout the UK, Europe, Americas, Asia Pacific, Africa, India and the Middle East.

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