Commercial Research – 2022

SPOTLIGHT
Savills Research

European Hotel Trends Outlook

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- Inflationary pressures
- Hotel operational performance update
- Investment overview

Average weekly increase in hotel booking made in June 2022 vs June 2019

Will the inflation squeeze derail the recovery?

For the next two quarters at least, the recovery in operational demand looks set to continue

This year looked to be the year that the recovery in the European hotel market was set to accelerate. But, will rising inflation and the subsequent squeeze on disposable incomes hamper this?

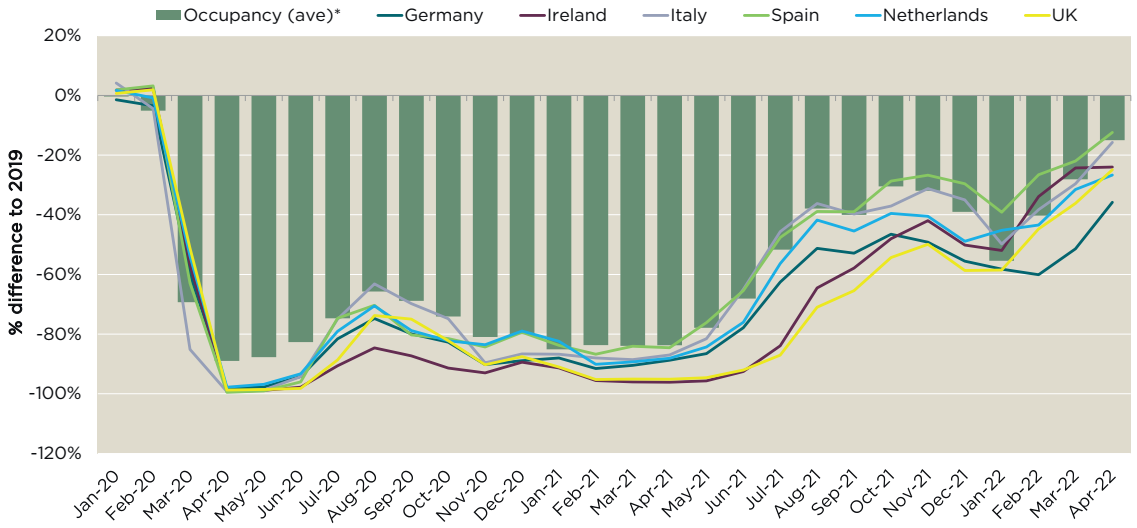
Looking at recent travel and booking data suggests that inflationary concerns are not yet tempering demand and the recovery. Air passenger arrivals for a number of key destination markets in Europe have resumed their upward trajectory after the Omicron outbreak at the end of last year. This has correlated with an improvement in hotel occupancy. Based on the data we have available, Spain and Italy are leading this recovery with air passenger arrivals 12.4% and 15.7% below equivalent 2019 levels in April 2022 respectively. More recent data for both markets has seen this improve further with May arrivals within 10.7% and 10.4% of equivalent 2019 levels respectively. Likewise, occupancy for these markets have seen a corresponding improvement with Spain hotel occupancy standing 15.3% and Italy at 13.1% below that recorded in May 2019. Ireland hotel occupancy in May 2022 came in at only 6.6% below 2019 levels, supported in part by the country's relatively constrained supply but also the fact that a significant share of stock is under contract to the Government for refugee and homeless usage. Arrivals into Germany have been lagging, a reflection of a slower recovery in business travel and the country's tighter restrictions in response to the Omicron outbreak, which has been reflected in slower recovery in hotel occupancy.

The positive demand momentum that is currently being seen in a number of European markets looks set to continue into the remainder of the year. The upward trend in hotel bookings across key destination markets in Europe continues following a short downwards blip in late March, a possible knee-jerk reaction to the acceleration in Eurozone inflation that month. Southern European markets are leading this with indicative bookings made in June only 11.5% below 2019 levels. Greece, for example, already has booking numbers ahead of 2019 with bookings made in June 24.2% above that seen pre-pandemic according to data from Sojern.

Clearly consumers are prioritising holidays in the face of rising inflation particularly after the last two years when international holidays were virtually impossible. This chimes with a recent consumer survey from JPMorgan that suggested that people are planning to prioritise experience spend, that is spend on holidays and eating out, in the face of rising inflation and reduced disposable incomes. This has clearly been seen in recent spend data in the UK. Barclaycard's consumer spending index, for example, saw spend on travel agents and airlines increase 24.2% and 6.2% respectively month-on-month in May.

The current strength in the lead indicators of demand has led Tourism Economics to forecast that overnight stays across the EU will total 95% of 2019 levels this year. However, it is 2023 that may prove to be more difficult. Weaker economic growth next year and the strength of the current demand bounce could mean we see momentum slow next year.

Figure 1: Air passenger numbers and hotel occupancy for select markets Spain and Italy leading the recovery in air passenger arrivals



Source Savills Research, Eurostat, STR Costar

Note: average occupancy for Germany, Ireland, Italy, Spain, Netherlands, UK*

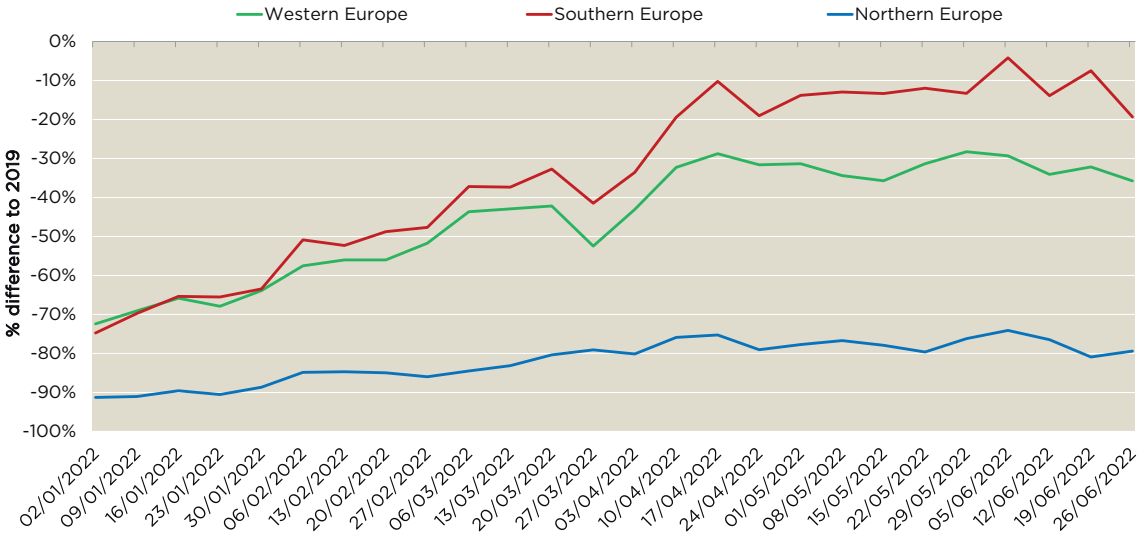
Staycation demand remains, but growth slows

With international travel now back as an option for holidaymakers, will staycation demand, particularly in Europe's largest source markets, the UK and Germany, return to pre-covid levels? In the case of the UK, airport travel chaos and expectations of continued disruptions over the coming months has led to anecdotal reports of a surge in travel bookings to popular staycation markets. This was observed in UK hotel booking data from SiteMinder with a surge in hotel bookings the week during and immediately after the reports of the disruption at UK airports. However, it is unlikely we will see the same scale of demand as that of the summer of 2021, albeit it will remain ahead of 2019 levels. This is reflected in operational data with expectations suggesting that RevPAR values in key leisure markets, such as Cornwall & Devon, will remain significantly above 2019 equivalents although year-on-year (YoY) growth will be more subdued, unsurprising considering the scale of growth last year. The positive for staycation markets is that this trend could become more entrenched, an acceleration of a trend we were seeing before the pandemic with rising 'experience' spend and carbon footprint concerns.

> **Based on the outlook for demand we expect to see RevPAR return to pre-covid levels across a number of markets in southern Europe over the summer months.**

Figure 2: Booking trends by destination region in Europe (based on select markets)

Traveller preference is currently focused on Southern Europe



Source Savills Research, Sojern

Is hotel performance back at pre-covid levels?

While occupancy on the whole remained below pre-pandemic levels in May, stronger growth in ADR (Average Daily Rate) meant that RevPAR (Revenue Per Available Room), an indicator of overall performance, in a number of key European markets moved back in line or above pre-covid levels.

On a country level, France reported strong month-on-month RevPAR growth in May meaning that compared to May 2019 RevPAR was up almost 24%. Much of this can be attributed to Paris with RevPAR 34% above May 2019 and is likely to be primarily driven by more constrained supply rather than a stronger recovery in international demand when compared to other European cities. Ireland was another lead performer with RevPAR in May 8.5% above that in 2019, a trend that was mirrored in Dublin with RevPAR 8.7% above 2019. Based on the outlook for demand we expect to see RevPAR return to pre-covid levels across a number of markets in southern Europe over the summer months. Italy, for example, reported May RevPAR values 1.9% ahead of those in the same month in 2019.

Strong performance over the summer months, however, is unlikely to translate into full-year performance ahead of 2019 due to the Omicron lag at the start of the year and the headwinds to disposable incomes which is expected to generate challenges as we move into Q4. Having said this, the pace of inflation is giving hoteliers the confidence to increase ADRs significantly, which may provide an additional boost to RevPAR performance. As already noted, the recovery momentum is expected to slow next year due to a weaker economic backdrop. For certain markets, this may mean we do not see annual RevPAR rates recovering to pre-covid levels until 2024, with those markets with a sizeable component of leisure demand leading the way.

Mitigating rising energy costs may be key to driving greater energy efficiency

Record high inflation may not be deterring consumers from booking their summer holiday, but it is generating headwinds when it comes to operator costs and profitability.

According to HotStats, European GOPPAR (gross operating profit per available room) was 30% below pre-covid levels in March, improving again in April to be within €11 off its pre-pandemic number. Albeit this recovery is not universal across the board. In March, the extended stay sector reported GOPPAR 21% above pre-covid levels, driven by a faster operational recovery and leaner cost model. Luxury hotels, whilst still in negative with GOPPAR 7.8% below March 2019, were still well ahead of limited and full service hotel segments pointing to strong operational recovery, with particularly strong ADR growth, considering the higher cost base in this part of the market.

While GOPPAR is likely to improve as demand picks up, the ability to move this back into positive territory will be mitigated by a rising cost base. Perhaps one of the biggest challenges to this is the rising cost of energy. According to HotStats data, total utility costs per available room in March were 27% above those seen in April 2018, the point at which they started tracking utility costs. In the UK, the cost increase has been as much as 50%. With energy costs to remain high for some time, coupled with rising labour costs, particularly for housekeeping and F&B functions, the headwinds to operator profitability shows no signs of abating in the near future. But, this could be a positive driver to improving energy efficiency in the sector. Technology advancements means that the payback period on energy reduction projects has reduced in recent years. This, alongside the high cost of energy, may be enough of an incentive to improve energy efficiency in the hotel sector; good news for margins and the planet.

From an owner's perspective this should also have positive implications from a value and borrowing perspective as ESG credentials move up the agenda for investors and lenders. It could mean we see greater downward pressure on yields and better borrowing terms on 'greener' assets going forward.

In April, European GOPPAR reported an €11 difference to pre-pandemic levels

Difference in utility costs per available room between March 2022 and April 2018

European hotel investment volumes reached €3.54 billion in Q1 2022

The European hotel investment outlook

Investor appetite remains, but softening economic indicators and rising cost of debt to temper transactional activity.

European hotel transaction activity improved in 2021 with volumes of €16.14 billion, 61% above that seen the previous year, albeit still 36% below the €25.32 billion reported for 2019. The momentum in transactional activity seen last year continued into the first quarter of 2022 with Q1 2022 volumes at €3.54 billion. While this was 20% below the five year Q1 average, it remains respectable considering it was an improvement on the pre-covid differential reported for 2021.

The big shift in the investment market in 2021, and which has continued into 2022, is that Spain now outpaces Germany in terms of transactional activity. The biggest hotel market remains the UK, accounting for 47% of activity in Q1 2022. Second was Spain where volumes increased 95% year-on-year in Q1 2022 to total €751.5 million, 58% above the pre-pandemic quarterly average. The rising emergence of Spain has been helped by the quicker recovery in leisure demand but also greater availability of stock brought about by pandemic uncertainty; previously a challenge to historical activity due to the dominance of private owners.

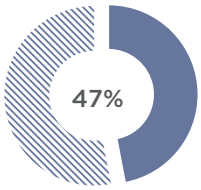
While total European activity remains relatively subdued against pre-pandemic levels there remains significant capital targeted at the sector, highlighting its strong longer-term fundamentals. As a result, where we would have traditionally seen a flight to safety, the weight of capital has meant the shift to secondary markets has been much quicker than usual. This has already been seen in the UK with private equity money looking beyond London to grow their platforms, albeit this has also been supported by quicker operational recovery in some regional markets, particularly those with a significant leisure demand component. This has heightened competitive tension, meaning we are seeing more potential buyers at every asset value point, placing downward pressure on prime yields in some parts of the market. For example, average prime yields for leased assets across the European cities we track reported a 14bps (basis point) compression year-on-year in Q1 2022. While average prime leased hotel yields remain 11bps above pre-pandemic levels (Q1 2020), there are a number of markets that buck this trend. For example, average prime yields for leased assets in the UK, Iberian Peninsula, Italy and Nordic markets are at or below pre-pandemic levels. Germany, in contrast, has prime yields at least 25bps above Q1 2020, a reflection of weaker operational performance and transactional activity particularly as the domestic funds already have a good allocation to German hotels.

Transactional activity to slow, before a pick up in Q4

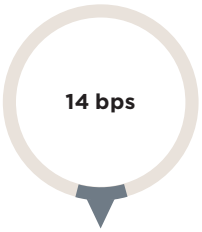
Despite continued improvements in operational markets, particularly leisure markets over the summer months, weakening economic sentiment coupled with rising debt costs, is likely to dampen total activity in the immediate term. Investors are likely to take a more considered approach resulting in a mismatch between buyer and seller expectations, slowing transactional activity, something we are already starting to see in certain markets. However, for strong, sensibly priced assets transactional momentum remains. Reduced activity could place upward pressure on yields in some parts of the market, but considering the weight of capital still targeting hotels and the appetite to spend this by the year end, could mean we see a very strong final quarter and the resumption of yield compression. As noted previously, the big question mark is for next year and how investor confidence holds up against much weaker economic metrics.

However, the mounting uncertainty this will generate will provide opportunities. With sterling and the euro both depreciating against the dollar we could see renewed activity from US private equity. And, for those looking for scale, platform acquisitions may prove particularly attractive. For example, USS recently acquired the real estate assets of Butlin's from Blackstone owned Bourne Leisure via a ground rent agreement. Likewise, Queensgate Investments are looking to sell its Generator Hostels Platform. Similarly, the perceived persistence of high energy costs, alongside labour challenges, could further heighten the appeal of limited service and serviced apartment product. So while we expect to see investor sentiment weaken somewhat, year end volumes may still surprise on the upside.

Year-on-year increase in Spanish hotel transaction volumes in 2021

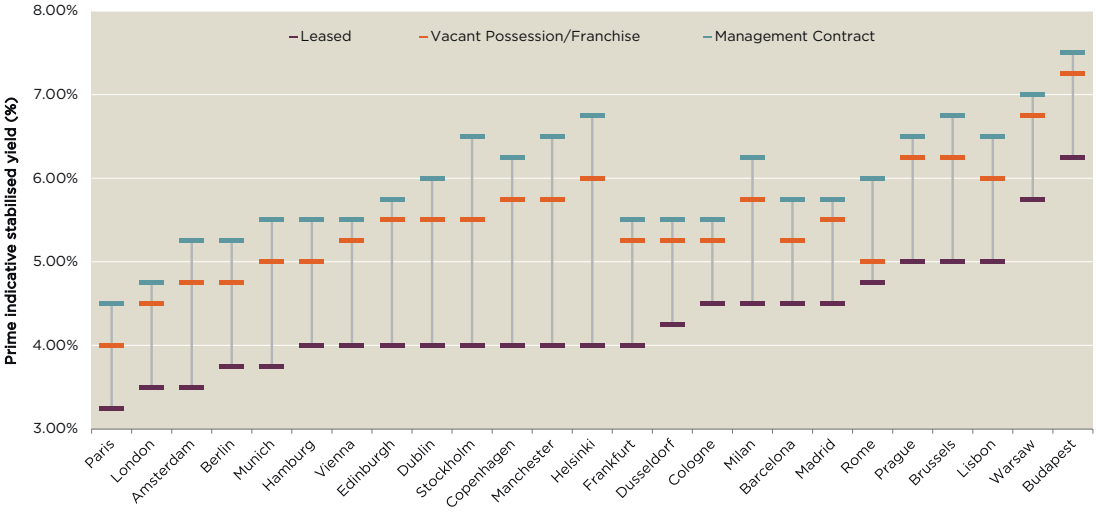


UK hotel transaction volumes accounted for a 47% share of total European volumes in Q1 2022



Average prime hotel yields reported a 14bps compression YoY in Q1 2022

Figure 3: European city hotel prime indicative yield comparison



Note yields based on a hypothetical hotel in a prime urban location. **Source** Savills Research

Savills Commercial Research
We provide bespoke services for landowners, developers, occupiers and investors across the lifecycle of residential, commercial or mixed-use projects. We add value by providing our clients with research-backed advice and consultancy through our market-leading global research team

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