UK Commercial – 2019

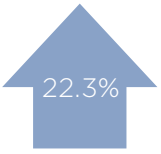
SPOTLIGHT

Savills Research

European Hotel Trends Outlook

savills

- Boost in U.S. and Chinese arrivals
- Robust investor appetite
- Prime yields compressing



Forecast growth in U.S. visitor arrivals to Europe between 2018 and 2023.

Economic and geopolitical matters are shaping travel trends in Europe

Arrivals to EU destinations still reporting growth despite geopolitical headwinds influencing travel trends across key source markets.

International arrivals in EU tourist accommodation have grown extensively over the last five years, reaching an estimated 419.8 million in June 2019 on a rolling 12 month basis. This is up 2.1% compared to the same period a year before. However, the rate of growth is slowing from its peak in late 2015, according to Eurostat (see chart below).

Brexit uncertainty may be generating economic headwinds for the UK and EU, but is also influencing tourism trends across the EU. The UK is the second largest source market for tourism in the EU, behind Germany, with 74.8% of all outbound UK visits heading to EU destinations in 2018. However, the unfavourable fall to the value of the pound post-EU referendum has resulted in a slowdown in outbound visits to Europe, with arrivals from the UK declining by 1.6% year-on-year in June 2019, on a rolling 12 month basis.

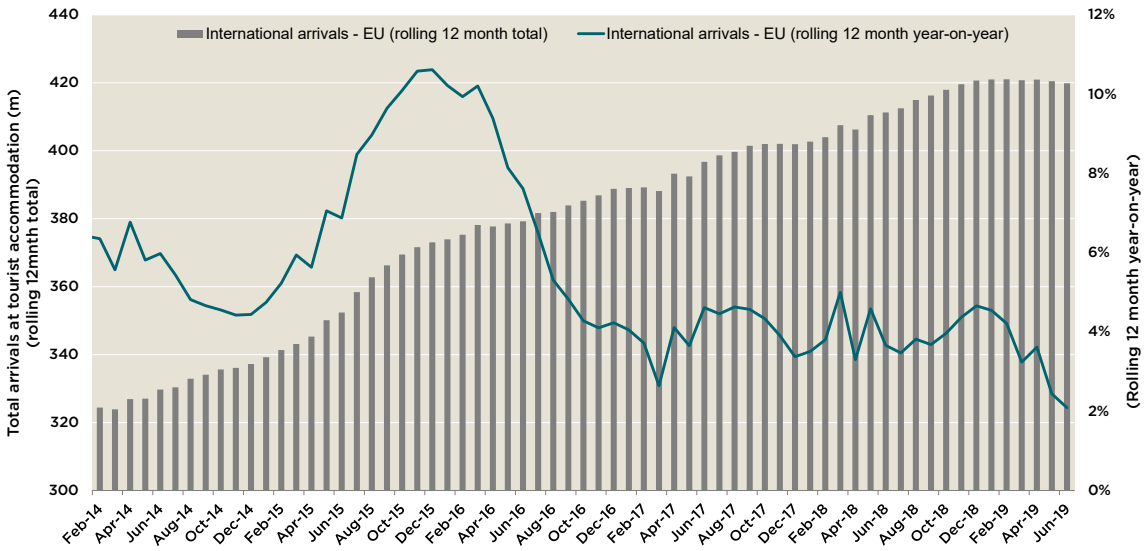
While UK arrivals are declining, total arrivals into Europe have been bolstered by source markets further afield. Arrivals from the U.S. have grown extensively, in line with the strong dollar against both the euro and pound compared to a year ago. According to Tourism Economics, the U.S. has contributed to an 11% share of growth in European tourism during the first few months of 2019 (the highest share of any non-EU country). This influx of U.S. visitors to Europe is expected to increase, with Tourism Economics forecasting a growth of 22.3% between 2018 and 2023.

This is helping to maintain strong operational performance in some tourism markets. In Spain, year-to-date arrivals (as of July 2019) from the U.S. are up 26.9% compared to last year, in line with significant RevPAR growth in both Barcelona and Madrid over the same period. Similar trends are being experienced across both Greece and Italy, supporting the 7.7% year-on-year RevPAR growth in July for Southern Europe recorded by STR - the fastest growing region in Europe.

Chinese visitors to Europe expected to grow as a result of political tensions with Hong Kong and the U.S.
HSBC suggest that the political protests in Hong Kong could reduce Chinese tourist arrivals to the city by 350,000 this year. Similarly, political tension between China and the U.S. has dampened Chinese arrivals into the U.S., which were down 5.7% in 2018. It appears however, that European destinations have benefited. The European Travel Commission noted that Chinese holiday bookings to the EU were up 16.9% year-on-year for the period between January and April 2019.

While traditional destinations, such as France, Italy and the UK, will benefit, emerging markets in Central-Eastern Europe could see a much more pronounced growth in Chinese arrivals. In 2018, Central-Eastern EU destinations recorded a 10.6% growth in Chinese arrivals, outstripping the 5.1% average across all EU markets. New direct flights from China to Central-Eastern European markets, such as the Shanghai-Budapest route launched by China Eastern Airlines in June, has facilitated this growth along with favourable changes to Visa schemes. This has also been the case for countries such as Serbia and Montenegro, with Chinese arrivals growing 38.6% and 83.1% respectively year-on-year between January and July 2019.

International arrivals in EU tourist accommodation establishments



Source Savills Research; Eurostat

Could the no-fly movement take off?

Greater consumer awareness around environmental issues, in particular the carbon footprint associated with air travel, is leading some travellers to opt for less carbon-intensive travel alternatives. In Sweden, the "flight-shaming" movement resulted in airport passenger numbers declining by 4% year-on-year in July 2019, according to Swedavia.

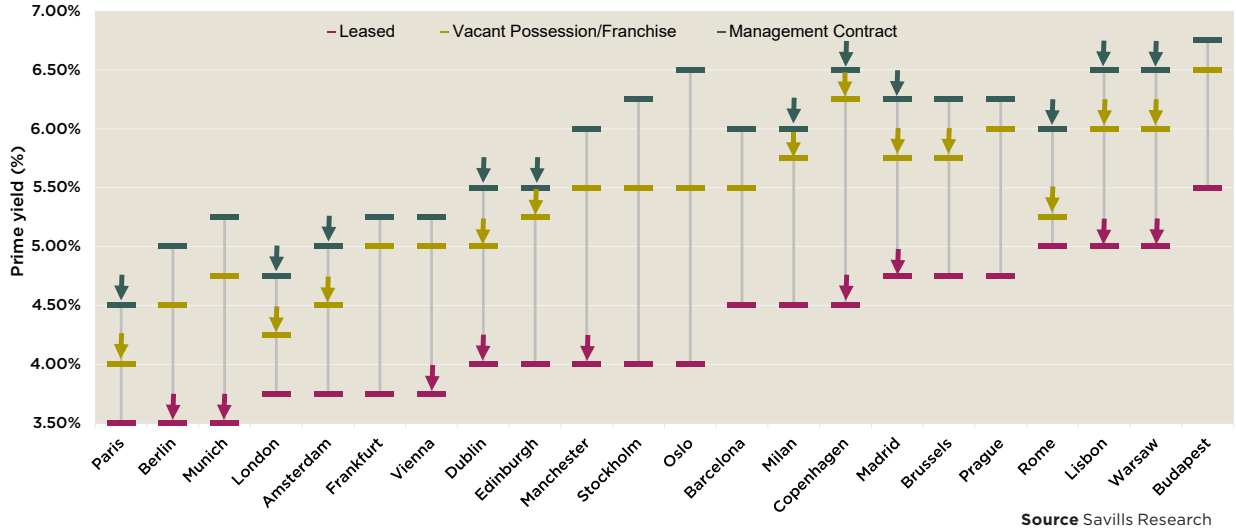
Rail companies have begun capitalising on this trend. For example, Deutsche Bahn (German Rail) saw revenue rise 24% following a social media campaign titled "No Need to Fly - Around the World in Germany", comparing well-known global landmarks with German lookalikes.

New high-speed rail routes connecting major European cities have significantly increased the appeal of rail travel. The London-Amsterdam Eurostar route launched additional daily services in June 2019 due to such high demand.

Rail travel is also increasingly appealing to those tourists seeking unique experiences. Chinese tourists, for example, are expected to be a key driver of rail usage across Europe with Eurail Group forecasting a 14% uptick in Chinese tourists purchasing Eurail passes in 2019.

> More markets have seen yield compression on non-leased hotels this quarter, as investors look to move up the risk curve in pursuit of higher yields.

European city hotel prime indicative yield comparison



Source Savills Research

Note: Yields are based on a hypothetical 4-star/upscale hotel in a prime urban location with stabilised performance. Direction of arrow indicates Q3 2019 yield shift.

Yield compression across Europe

Increasing investor appetite for hotels has led to yield compression across key European tourist markets.

Prime indicative yields have compressed across operating structures in key European markets

Hotels on non-leased operating structures have seen yield compression across the majority of markets tracked by Savills, as investors look to move up the risk curve in pursuit of higher yielding assets. Prime yields for hotels on VP (Vacant Possession)/Franchise terms saw a 25bps yield compression across 12 markets in Q3 2019, up from just three markets in Q2. For prime yields on an MC (Management Contract) basis, half of the reporting markets witnessed a 25bps inward shift, up from two in Q2.

Prime yields on leased assets remain the sharpest across all 22 markets tracked by Savills, averaging 4.26%. This is being driven by the continued attractiveness of long-term income security associated with this type of operating structure, particularly within more mature tourism markets.

Furthermore, the spread between government bonds and equivalent hotel yields remains attractive to investors across a number of European markets. This is notable in key German cities whereby leased hotel assets have become a more attractive investment option helped in part by the fact that government bonds are now trading at sub-zero yields. This has led to yields in markets such as Berlin and Munich becoming amongst the keenest in Europe, matching Paris at 3.50% for hotels on leased terms.

Restrictions to future hotel development within major tourist markets is increasing investor demand

A number of key tourist markets, such as Amsterdam and Barcelona, have been applying restrictions on future city centre hotel development as a means to regulate over-tourism. This, coupled with continued growth in tourism demand, will ultimately boost the operational performance of existing hotels therefore increasing the attractiveness from an investment perspective. In the case of Amsterdam, prime hotel yields on both VP/Franchise and MC terms sharpened by 25bps in Q3 2019, in response to growing investor interest.

Investor appetite across Europe remains robust, driven by cross-border investment

Hotel investment in Europe remains robust with year-to-date (Q3 2019) reaching almost €16.0 billion, an increase of 4.3% compared with the same period in 2018.

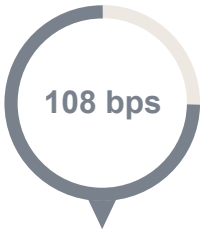
Over half (53.1%) of this activity has been driven by international investors, including key deals such as the Hilton Parkview Vienna, sold to a consortium from South Korea for €375m in July 2019. A number of large international investment funds are now deploying significant capital to the hotel sector, helped in part by low interest rates supporting relatively lower cost of debt.

High growth tourism markets remain an attractive option for investors seeking higher yields

Extensive stock growth coupled with growing tourism demand across rapidly expanding European tourism markets has opened new hotel investment opportunities, especially for investors looking beyond traditional markets in search of higher yields. For example, Lisbon has seen significant hotel investment growth, with year-to-date volumes already exceeding the total for 2018 by 151.0%, according to RCA. This is reflected in pricing with prime yields across each operating structure hardening by 25bps for the second consecutive quarter, the only market in Europe to do so.

Warsaw and Prague have experienced a similar trend, each seeing significant growth in investment volumes. Continued stock growth in some gateway and emerging markets does, however, pose some potential headwinds to performance due to short term absorption issues.

2019 YTD (Q3 2019) European hotel investment volumes, up 4.3% year-on-year



Average yield spread between leased assets and VP/franchise hotels across Europe (down from 111 bps in Q2 2019)

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