

Commercial Research – 2020

Q
SPOTLIGHT
Savills Research

European Hotel Trends Outlook



● Recovery outlook ● Investment overview ● Pricing movements



Hotel occupancy rates across Europe averaged 38.6% in Q3 2020, an improvement from the record lows of 15.3% in Q2

Who's leading the recovery and why?

Whilst various temporary lockdowns have put the brakes on recovery momentarily, domestic demand on the whole has been driving the broader recovery across much of the European hotel market in recent months.

Hotel demand in Q3 2020 improved off the back of record lows recorded in Q2 2020.

The Covid-19 pandemic triggered a seismic shift in the global travel industry, with various lockdowns preventing international travel throughout Europe, resulting in historic lows in regards to hotel occupancy rates. According to the UNWTO, global international tourist arrivals in 2020 are expected to decline by c.70% compared to 2019 levels. However, the staggered reopening of hospitality sectors across Europe through the summer months coupled with pent-up demand to travel has kick-started the recovery process for a number of locations.

In Q3 2020, European average occupancy rates grew to 38.6%, representing a marked improvement off the back of the historic lows of 15.3% recorded in Q2 2020. Regions with less stringent lockdowns or earlier lifting of restrictions have enjoyed slightly more robust operational recovery. For example, Northern Europe has not been as adversely impacted by the virus and subsequent restrictions compared to the rest of Europe, and has therefore reported a higher average occupancy rate since April (see chart below).

Despite recent operational improvements, we can expect the various temporary lockdowns across Europe to put the brakes on any further recovery in Q4, albeit at a far less severe level compared to the extensive lockdowns earlier in the year.

Leisure-led domestic travel laid the foundation for recovery, while international and corporate demand remains necessarily subdued.

The risk of quarantine has largely increased the reluctance to travel internationally this year, therefore operational improvements are being primarily steered by domestic demand. The International Civil Aviation Organisation (ICAO) reported that European airline seat capacity for

domestic demand improved to -23.2% year-on-year in August, surpassing the global fall of -37.9%, as well as outstripping the -58.0% decline in capacity for international trips in Europe.

As a result, markets less exposed to international visitation have experienced a far more pronounced post-lockdown recovery. Some coastal regions across the UK, France and Germany witnessed occupancy rates in excess of 90% over weekend periods through the late summer months, driven by sizeable domestic traveller demand.

Regions with a larger dependence on international travel, typically Southern European fly-to locations, have suffered weaker recovery thus far. For example, international demand in Greece and Croatia accounted for approximately 73% and 89% of total arrivals in 2019 respectively, according to UNWTO, compared to just 25% in the UK. As a result, occupancy across Southern Europe remained comparatively suppressed in Q3 2020, averaging 34.5%, below the 38.6% European average.

Cross-border demand has begun to return, propelled largely by drive-to and rail-connected intraregional movement. For example, international arrivals across the DACH region (Germany, Austria and Switzerland) has been supported by strong transportation connections, as well as a local relaxation of cross-border restrictions amidst similar virus infection rates.

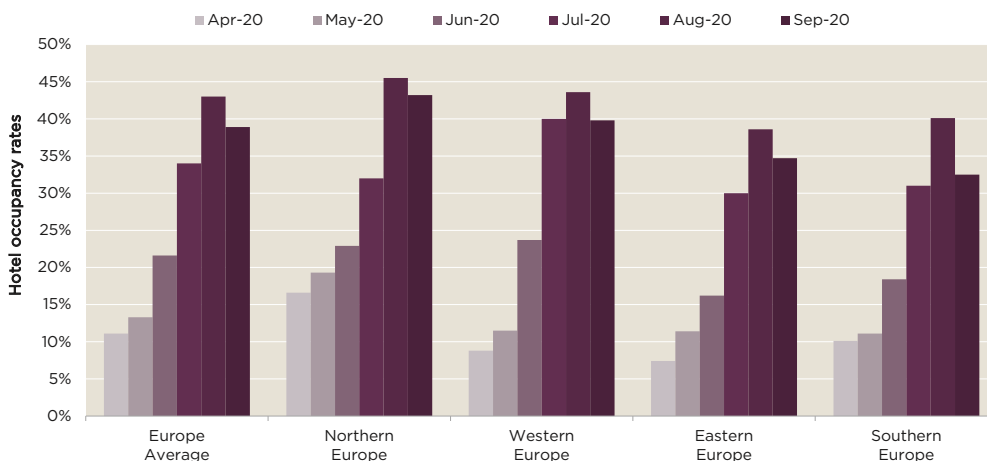
Germany outperforms the wider market.

Germany's comparatively quick response to the pandemic allowed for an earlier than average reopening of services, with travel bans on non-essential trips being lifted for 31 countries as early as 15 June. This led to a much quicker reopening of hotels compared to other European counterparts, supported further by Germany's huge domestic demand base and stronger economic recovery.



UNWTO are expecting global international tourist arrivals to fall by c.70% year-on-year in 2020

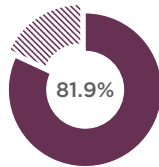
Monthly hotel occupancy rates by European subregion demonstrates the level of recovery since the record lows reported in April 2020.



Source Savills Research, STR

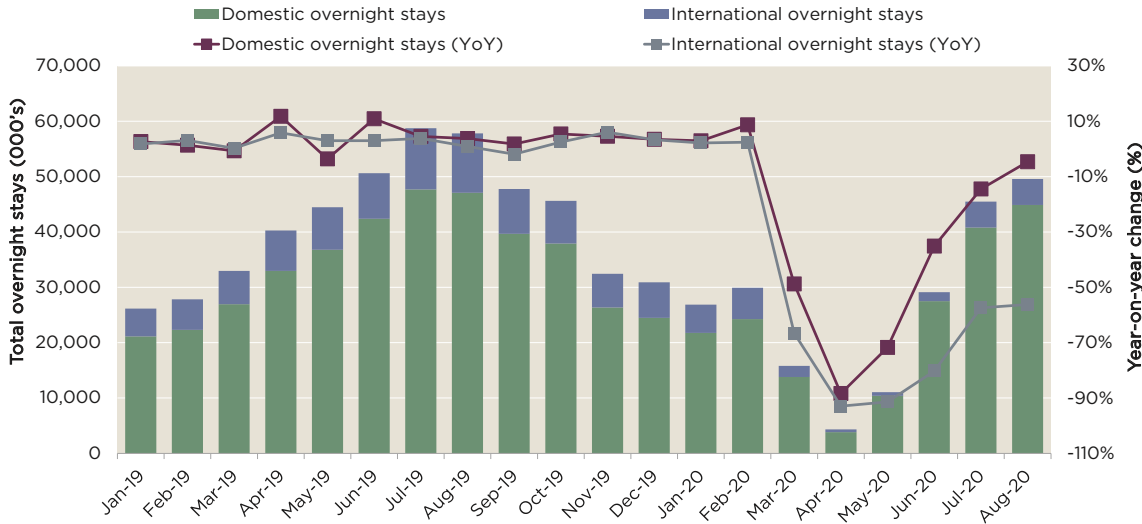


European domestic airline capacity reduced by -23.2% year-on-year in August, compared to -58.0% for international capacity

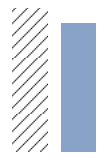


Domestic visitors were accountable for an 81.9% share of total overnight stays in Germany in 2019.

Monthly overnight stays in Germany highlights the substantial recovery seen by domestic demand compared to international travellers.



Source Savills Research, Destatis



Domestic overnight stays in Germany reached 44.9m in August 2020, a decrease of -4.7% year-on-year

Hotel demand across Germany has historically been supported by domestic travellers – in 2019, 405.7 million domestic overnight stays were reported, accounting for an 81.9% share of total overnight stays (see chart above). Over the same period, Germany tracked 76 million outbound tourism trips, many of which are likely to redirect attention to domestic markets this year and into 2021, forming a sizeable base upon which to kick-start the hotel recovery.

As a result, Germany witnessed a relatively sharp V-shaped recovery to domestic overnight stays, which reached almost 45 million in August 2020, representing a relatively modest year-on-year decline of -4.7% and boasting the largest monthly domestic demand since August 2019. This rebound has supported improvements to occupancy rates, which exceeded the European average in September, to report 43.8%.

Perhaps one concerning factor for Germany remains the historically sizeable corporate demand for larger conferences and events, which is expected to be among the slowest segments to recover. Germany hosted by far the most international Meetings, Incentives, Conferences and Exhibitions (MICE) last year in Europe, according to the ICCA. This has driven widespread hotel development across key MICE markets in recent years, which could pose further headwinds in corporate-dominant markets such as Cologne and Frankfurt.

One element of relief however, is Germany's relatively strong economic bounce post-Covid. Cities such as Berlin were also tracking similar mid-week occupancy compared to weekend levels in September according to STR, suggesting corporate demand has already returned to some markets.

What are the next six months likely to bring?

The winter season will provide an unquestionably difficult period for much of the European hotel market in line with the ongoing lack of corporate and long-haul demand, whilst further lockdowns across Europe are temporarily limiting internal movement once again. While tenant protection measures could protect some suffering operators in the immediate term, countries with weak fiscal support packages for the hospitality sector are likely to experience an uptick in permanent hotel closures.

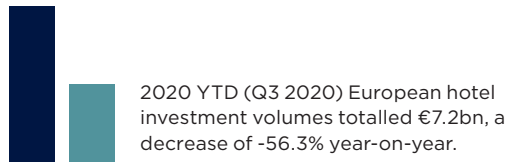
While the immediate outlook appears uncertain, many sources are in agreement that hotel occupancy will improve over the medium-term off the back of the historic falls experienced this year, and in line with anticipated improvements to traveller confidence.

Recovery rates are likely to vary throughout Europe, depending largely on individual governmental approaches to controlling the virus as well as the timing of a possible vaccination. With this in mind, a full recovery to hotel demand is not expected to return across Europe until at least 2023, according to STR, with RevPAR recovery likely to take until at least 2024 to reach the levels experienced in 2019 for most markets. Nonetheless, this isn't to say that certain staycation-orientated markets including Germany and the UK won't considerably outperform in the interim, as well as particular product segments such as extended stay.



Hotel occupancy rates in Germany reached 43.8% in September, exceeding the European average of 38.9%

🗨️ Recovery is likely to vary throughout Europe, depending largely on governmental approaches to controlling the virus, with certain product segments as well as staycation-orientated markets likely to outperform. 🗨️



The hotel investment outlook

Covid-19 has adversely impacted investment volumes, however pricing shifts have begun opening attractive investment opportunities.

Difficulties in obtaining debt amidst weak operational performance has acted as a significant barrier to entry for many investors. As a result, year-to-date (Q3 2020) European hotel investment volumes decreased by -56.3% year-on-year, reaching €7.2 billion. In addition, 43.8% of this was accounted for by deals made pre-Covid (January-February). Nonetheless, the longer-term benefits of hotel investment have supported ongoing investor interest levels, resulting in a number of key deals completing since lockdown.

Cross-border transactions continue to dominate the investment landscape, accountable for a 60.4% share of 2020 volumes. This exceeds the 54.4% share witnessed in 2019, despite ongoing travel restrictions limiting opportunities for long-haul investors this year, in some cases.

The UK remains the most liquid hotel investment market in 2020, largely upheld by a handful of prime London assets. Germany, however, has recorded a far less pronounced year-on-year decline of -34.1% according to RCA, totalling €1.43 billion. This is in line with both a comparatively strong economic and operational recovery.

Investment experiences a retrenchment to prime cities.

Akin to previous downturns, hotel investment has experienced a flight-to-quality, sustaining interest for prime city centre trophy assets with a degree of capital preservation. This has cemented the position of cities such as London, Paris and Berlin as top investment markets this year, despite the acknowledged slower recovery outlook across cities. A spate of deals since lockdown involving key trophy assets reinforces this trend, including The Ritz to Qatari buyers in March and Sigma Group acquiring the Bauer Palazzo Venice in May.

Covivio's recent €573 million acquisition of eight prime hotel assets across key tourist markets such as Rome and Prague also underlines this trend, with a number of assets due to be renovated for further value-add opportunities. Selective

value-add and development projects continue to attract funding, pointing to ongoing confidence over the longer-term.

This year we've witnessed a number of hotel groups increase interest in sale and leaseback agreements, in a bid to improve balance sheets. This includes Dalata's sale of the Clayton Charlemont to Deka in April for €65 million, with the Irish operator retaining proceeds as cash during periods of uncertainty during Covid-19. As demand uncertainty continues over the short-term, we could see more operators opt to progress with sale and leaseback deals.

What's been the impact on pricing?

A lack of transactional evidence creates complications in evaluating pricing, however current sentiment suggests Covid-19 has triggered a yield reversal, with most markets experiencing outward yield movement compared to pre-Covid levels (see chart below).

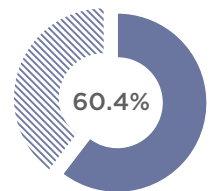
In line with investors seeking secure long-term income options in the face of a recession, prime yields on leased assets remain sharpest, averaging 4.46%. Thereafter, the average yield spread to vacant possession/franchise and management contracts has widened to 114bps and 157bps respectively.

The general outward movement of yields is unlocking attractive opportunities for well-positioned buyers. Multiple investors have recently closed on new funds aimed at targeting attractive pricing within the challenged hospitality sector. Amongst others, Azora and Schroders both finalised funds worth €680m and €425m respectively, eyeing opportunities across key European markets, emphasizing the sustained longer-term confidence in hotels.

While the yield shift may appear minimal for now, we can expect further widening in yield spread between those markets able to control the virus and allow cautious return in travel flows compared to those obstructed by further lockdowns, quarantine measures and economic pressures.

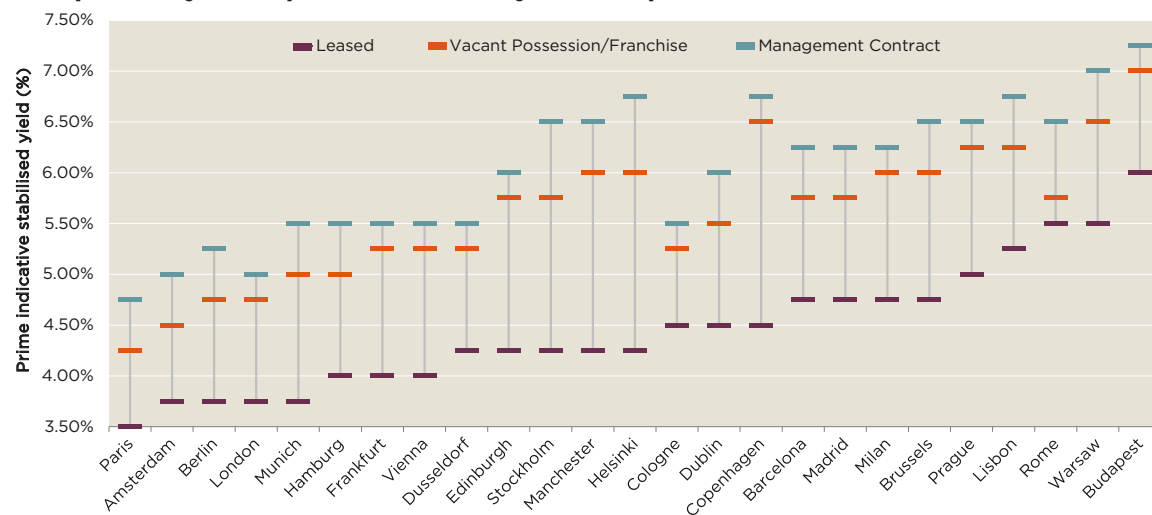


Germany accounted for a fifth of total European hotel investment in 2020 YTD, totalling €1.43bn



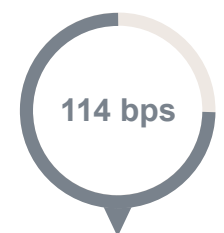
Cross-border investment accounted for a 60.4% share of European hotel investment volumes in 2020 YTD

European city hotel prime indicative yield comparison



Source Savills Research

Note yields based on a hypothetical hotel in a prime urban location.



Average yield spread between leased assets and VP/franchise hotels across Europe (up from 107bps in Q1 2020)



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