

European Cities Hotel report

Spring 2015



SUMMARY

■ London hotel room supply more constrained than Paris.

■ Current estimates suggest that all seven gateway cities (London, Paris, Dublin, Amsterdam, Berlin, Madrid and Rome) reported increases in overseas visitors in 2014.

■ All seven cities reported a growth in revenue per available room (RevPAR) over 2014. Dublin leads with 11.3%.

■ Improving operational performance is helping to boost transaction activity with volumes up 4.4% to €5.2bn last year across all seven cities.

■ Activity beyond the luxury 'trophy' asset segment is starting to take hold in the more 'mature' markets.

■ Overseas investors continue to be prevalent across European cities spending €3.4bn across the seven cities, with those from Asia Pacific being the most active accounting for 48.4%.

■ The fall in the Euro in the wake of the ECB's launch of Quantitative Easing (QE), has improved pricing for non-euro investors, indicating an increase in overseas investment over 2015.

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“Improving operational performance is luring back investors and enticing them to look beyond the luxury 'trophy' assets that dominated activity in the early years of the financial crisis”
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Tim Stoye, Savills Hotels

→ London supply more constrained than Paris

■ The woes that faced the Eurozone during the financial crisis and the subsequent dampening of international travel within the region have subsided. Current estimates suggest that of the seven gateway cities examined for this report (London, Paris, Dublin, Amsterdam, Berlin, Madrid and Rome) all reported an increase in overseas visitors in 2014 or at the very least similar numbers to 2013.

■ For some markets, such as London and Paris, this will represent new record highs in terms of international visitors putting pressure on already relatively constrained stock levels.

■ Examining hotel bedroom supply relative to average annual overseas visitor numbers (2011-13), London with 6.0 units per 1,000 visitors would appear to be one of the most under supplied relative to its other European peers particularly in light of the size of its visitor market (see Graph 1).

■ Dublin and Amsterdam hotel markets would also appear to be relatively under supplied with 4.9 and 5.5 units per 1,000 overseas visitors respectively. In Dublin this has been exacerbated by strong visitor growth, with 9.8% reported in 2013, and lack of development as the appetite and ability to secure debt for new projects over the last five years has been restrained.

■ Paris, while being relatively better supplied than London as a whole has a

more constrained luxury segment. The city has 0.6 luxury hotel bedrooms per 1,000 overseas visitors. London has 0.9 bedrooms.

Dublin tops RevPAR growth in 2014

■ All seven markets reported a growth in revenue per available room (RevPAR) over 2014, with those with lower average daily rates (ADR) tending to report the strongest uplifts.

■ Some of this strong performance can be attributed to growth off a low base, however, a resurgence in visitor numbers has also played a key role.

■ Dublin reported the most significant uplift in RevPAR of 11.3% helped by an upturn in visitor numbers. Madrid also saw international tourist arrivals improve over 2014. Total visitor numbers to the Spanish capital were up 7.6% last year. This is mirrored in the 10.2% growth in RevPAR for the year.

■ The higher value markets of London, Paris and Rome where ADR's are above €140 reported more muted improvements in RevPAR. Paris saw only a 1.1% uplift due to sub 1% growth in occupancy and ADR. Rome's RevPAR was up a more impressive 2.6%, however, this was driven by occupancy improvements as average rates marginally fell over 2014.

■ Of the larger tourist markets, London was the better performer with a 3.3% uplift in RevPAR in local currency terms, largely driven by a 2.7% increase in ADR. This is

notable considering it had the highest average occupancy of all seven city markets (83.0%) as the ability to drive both occupancy and rates becomes more constrained at this level. This performance further highlights London's relative under supply, despite the 12.9% increase in stock seen over the last three years.

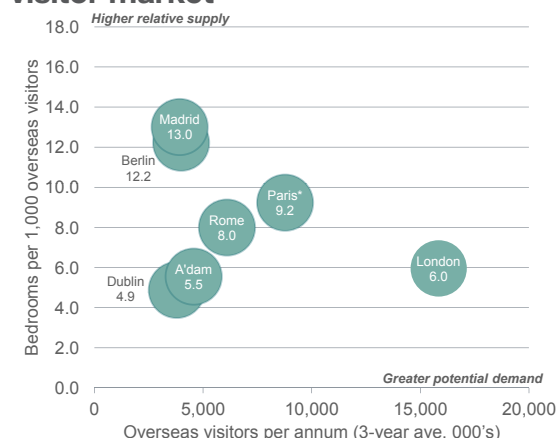
Improving operational performance boosting transaction activity

■ The expansion of low cost airlines and the growing affluence of emerging economies means that Europe will remain the largest regional destination globally with numbers forecast to increase 10% to 620m by 2020 (UNWTO). As already noted this is already feeding through to hotel demand. It is also luring back investors.

■ 2013 reported the largest increase in activity across the seven cities with volumes up 37.9% driven largely by the doubling in transaction volumes in London and Paris.

■ A more muted uplift in total volumes of 2.3% to just over €5bn was seen in 2014. However, the improvement in investor confidence saw activity levels in the smaller markets increase as stock availability in the primary investor destinations of London and Paris tightened. For example, Berlin, Dublin, Madrid and Rome all reported a more significant expansion in investor activity in 2014 compared to the year before.

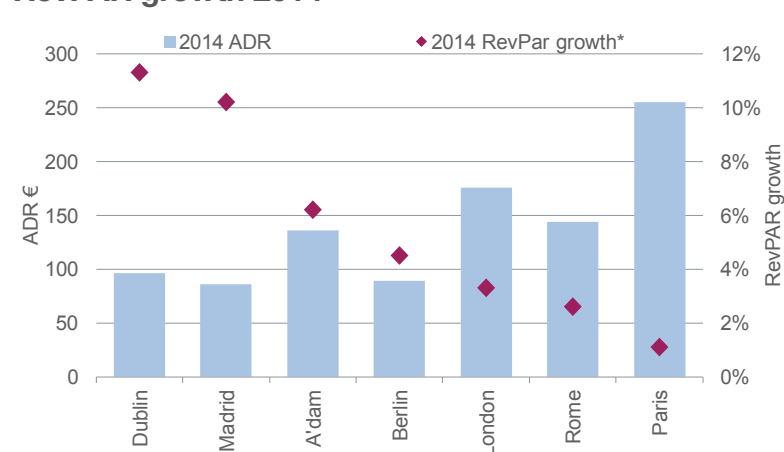
GRAPH 1
Bedroom supply relative to overseas visitor market



Graph source: Savills; AMPM; National Tourist Statistics

Note*: Paris visitor numbers relates to overnight hotel stays only

GRAPH 2
RevPAR growth 2014

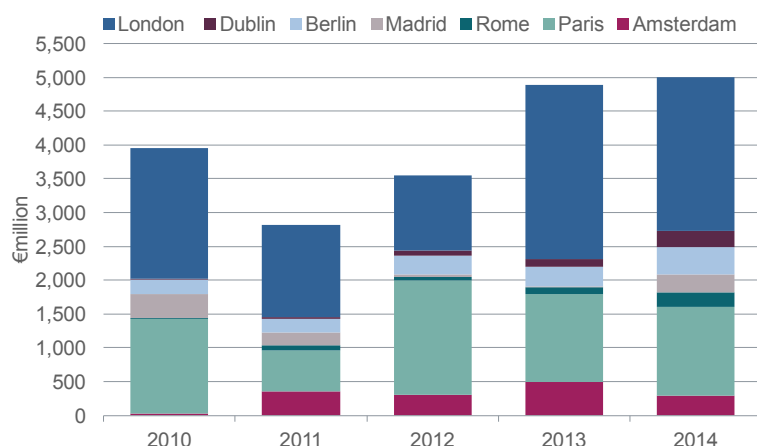


Graph source: STR Global

Note*: London RevPAR growth is in local currency not Euros

GRAPH 3

Investment volumes



Graph source: Savills; RCA

■ Despite stronger growth in transaction activity in the smaller cities, London and Paris remained the largest target markets for hotel investment in 2014. London accounted for 45.5% of volumes across the seven key gateway markets with €2.3bn transacted. This was down on the €2.6bn sold in 2013 as improved investor confidence boosted activity in the UK regional markets.

■ Paris reported a marginal 0.8% increase in transactions in 2014. In volume terms it saw just over half the volumes transacted in London with €1.3bn (Graph 3).

■ London's dominance of European hotel investment activity is largely due to the fact that hotels are a more established asset class in the UK. The UK's more accommodating

employment and taxation systems have also been an added attraction. The greater availability of institutional grade stock and the sheer size of the London property market is also key. Previously considered as 'alternative', hotels are increasingly being accepted as a mainstream option in the UK particularly for long income funds.

■ The move towards 'mainstream' is also gaining traction in other European markets. Dublin, Amsterdam and Berlin are currently leading in this regard although the lack of institutional grade product in Amsterdam is generating barriers to investment.

■ These more mature hotel investment markets have also seen an increase in transaction activity beyond the luxury 'trophy' assets that dominated volumes at the height of the financial

crisis. Yet, while the focus on 'trophy' assets has waned quality product in prime/core locations remains vital.

■ This is reflected in the return of domestic investors, particularly operators and institutional funds to some city markets. In London and Dublin 41.9% and 55.9% respectively of transaction volumes last year were accounted for by domestic investors (Graph 4). In London 73.1% of these were by institutional funds and operators.

■ In the case of Amsterdam, while non-domestic European investors dominated, these largely constituted of German institutional investors.

■ North American private equity was active across Europe again last year as they looked for value via 'distressed', primarily portfolio, assets with London and Paris being their primary destination markets in volume terms. Dublin was another key market for them as they accounted for 56.8% of all transaction activity in the city.

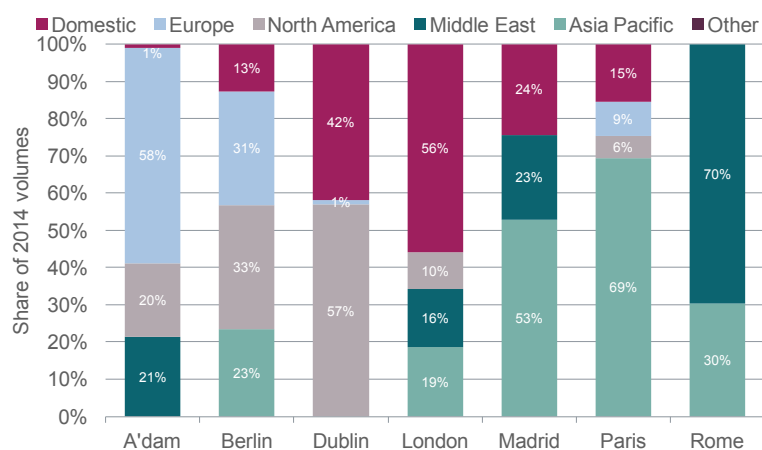
■ Acquisitions by Middle Eastern and Asia Pacific investors, focusing on 'prime' assets, continued to be prevalent in 2014. While London and Paris remained major focus markets, Rome and Madrid reported some headline deals. These included the €265m purchase of the Edificio España in Madrid, previously home to the Crowne Plaza, by the Chinese Dalian Wanda Group for conversion into a mixed scheme with luxury hotel. Qatar Holdings acquired the St Regis Rome for €110m.

■ The appetite for European hotels from Asia Pacific investors has been linked to the increase in tourism originating from the region into Europe. For example, Chinese visitors have become a significant source market for Paris with the city attracting 880,000 visitors in 2013, topping the list for Asian visitors for the first time. It was unsurprising therefore that Asia Pacific purchasers were the most active in Paris last year accounting for 69.4% of volumes.

■ The fall in the Euro in the wake of QE should entice further inward investment into Europe from non-eurozone countries in 2015, although the risk profile of investors will determine their areas of focus. ■

GRAPH 4

2014 Investment volumes by buyer nationality



Graph source: Savills; RCA

OUTLOOK

Investor confidence in the European hotel market is picking up pace, this will boost transaction levels over 2015

■ Operational performance improvements to gather pace driven by increasing visitor numbers, in both the leisure and business segments.

■ This improving performance is enhancing investor confidence. As a result transaction activity is likely to pick up pace over 2015.

■ Greater confidence and stock availability constraints may increasingly entice investors to look beyond the key gateway cities for opportunities. However, this is likely to be confined to those stronger growth cities outside the Capital cities that possess similar levels of liquidity.

■ The ECB's launch of Quantitative Easing (QE) in January and subsequent fall in the Euro means that activity by overseas investors from outside the Eurozone is set to increase in 2015.

■ We expect North American private equity investors to focus attention on the southern Mediterranean markets as they look for value add opportunities.

■ The more risk averse Asia Pacific and Middle Eastern investors should remain focused on northern Europe. Stock restraints and improving operational performance, however, may mean that they will increasingly look beyond the 'trophy' assets.

■ The slowing Chinese economy may dampen visitor numbers to Europe, but the overall impact will be negligible although Paris is likely to experience the biggest impact.

■ The more noticeable effect will be on the level of investment coming out from mainland China as investors look to European markets as a capital protection play in the face of economic uncertainty at home. As a result Chinese investors are expected to form a larger proportion of Asia Pacific investment this year.

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