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2018 EUROPEAN
HOTEL VALUATION INDEX

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Highlights

Economy

The background is one of strong economic growth in the Western world, as 2018 is expected to be as good as 2017, with robust business and consumer confidence. Wobbles in the stock market, inflationary pressures and potential interest rate increases, however, call for caution over the medium term.

Consolidation

Having digested the historical Marriott/Starwood takeover, the world watches as the travel industry gives weight to more strategic investments to remain technologically relevant in an ever-evolving context. The idea is for established companies to add new 'layers' to their core competencies. See, for example, AccorHotels (again!) investing in Potel & Chabot (a catering business) or Booking.com acquiring Evature (specialists in artificial intelligence). It will be interesting to assess the added value of such acquisitions in the medium term.

Tourism Dynamics

Never mind some geopolitical upheaval here and there, international travel is in rude health. International tourist arrivals in Europe reached 671 million in 2017 (51% of global movements), a noteworthy 8% up on 2016 for such a mature region. Southern and Mediterranean Europe saw impressive growth of 13%, Western Europe 7% and Northern Europe and CEE a slightly more subdued 5% each. Rebounds in visitation from Brazil and Russia, following years of decline, certainly helped. Further terrorist attacks and anti-tourist sentiment (Barcelona, Venice and San Sebastian) could yet provide some surprises.

Hotel Performance

From a RevPAR point of view, 2017 was memorable. Europe saw growth of 10% over the year, with a third of the markets in our index going well above this. This is the result of impressive performances in the Iberian Peninsula and Russia, combined with no market experiencing serious declines in RevPAR. In addition, the hotel pipeline in Europe remained modest at 6%, whilst it was in double figures for every other continent. Modest new supply and strong demand bode well for 2018, economic or geopolitical shocks notwithstanding.

Disruptors

Inflation (think UK mainly) and payroll increases are a challenge to the bottom line, as operational costs squeeze profits. Meanwhile, travel is increasingly viewed as an 'experience'; hence the interest in areas with further revenue potential, such as the intense enthusiasm for F&B operations as a newly refreshed and vital complement to accommodation. Improved margins, however, require conscientious know-how and planning to materialise, as the struggle of various high-street names (such as Byron in the UK) has recently shown. As time progresses during 2018 towards 'Brexit Day' (29 March 2019) when the UK formally leaves the European Union, we are hopeful of many of the current uncertainties surrounding the impact of this being resolved.

Transaction Volume

Hotel transactions in 2017 were close to the record levels of 2015, with €21.7 billion compared to €23.7 billion two years ago. This (second largest ever) volume represents an increase of 22% on 2016. For reference, the pre-crisis level was just over €20 billion in 2006. Spain's climb into the hall of fame to second position in terms of investment (behind the UK), as well as increased capital flowing in from the USA, were some of the highlights of 2017. The returns from hotel real estate continue to attract interest from private equity and institutional investors seeking to invest increasing levels of funds. Please refer to our sister publication *2017 European Hotel Transactions* for more details.

Capitalisation Rates

As the profusion of both debt and equity chased hotel investments, driving hotel yields lower and even closer to fixed-income products, cap rates continued their downward journey throughout 2017. Inflation and higher interest rates on the horizon could mean this era is soon to end.

Hotel Values

European values, as an aggregate, were barely 5% below their top level in 2007, with half of the cities in our index having reached or surpassed the peak. There is still room to grow for most Eastern and Southern European markets, as well as the UK (in euro terms, due to currency fluctuations which have seen value drops since the 2016 Brexit referendum).

The European Hotel Valuation Index

Without batting an eyelid, it's safe to say 2017 was a spectacular year. The headwinds from geopolitical uncertainty and instability proved surmountable, providing an upswing in confidence among investors, developers and lenders compared to a year ago. While 2016 was a year of cautiousness with flat average European hotel values, in 2017 hotel values across Europe grew by 3.9%.

In terms of absolute values, various markets did well, with Brussels, Budapest, Florence and Warsaw reaching new heights compared to previous peaks. From a percentage growth in value perspective, interestingly, none of the top ten markets in 2017 are amongst the top ten most valuable markets, which points towards a continued narrowing of the value gap between the priciest and the cheapest markets. The top five double-figure growth winners included Lisbon and Madrid in the Iberian Peninsula, our two Russian markets and Budapest.

Declines in value in 2017 were much more modest than in 2016. Looking at the bottom of the index, in euro terms there was little change in its composition, which included Sofia, Bratislava, Bucharest and St Petersburg. Excluding Birmingham, which was affected by the depreciation of the pound, the other four markets recorded value growth in 2017, albeit from a low base. Percentage declines in euro value included our four UK markets, two Swiss markets, Istanbul and Stockholm.

Winners and Losers

We have shortlisted the winners and losers in terms of percentage change in value in 2017 and presented them in a 'top and bottom' chart (see pages 6 and 7). Like 2016, currency dynamics continued to have a strong impact on value changes, especially in the British markets. Therefore, we also present top and bottom markets in local currency value change.

CHANGES IN VALUE

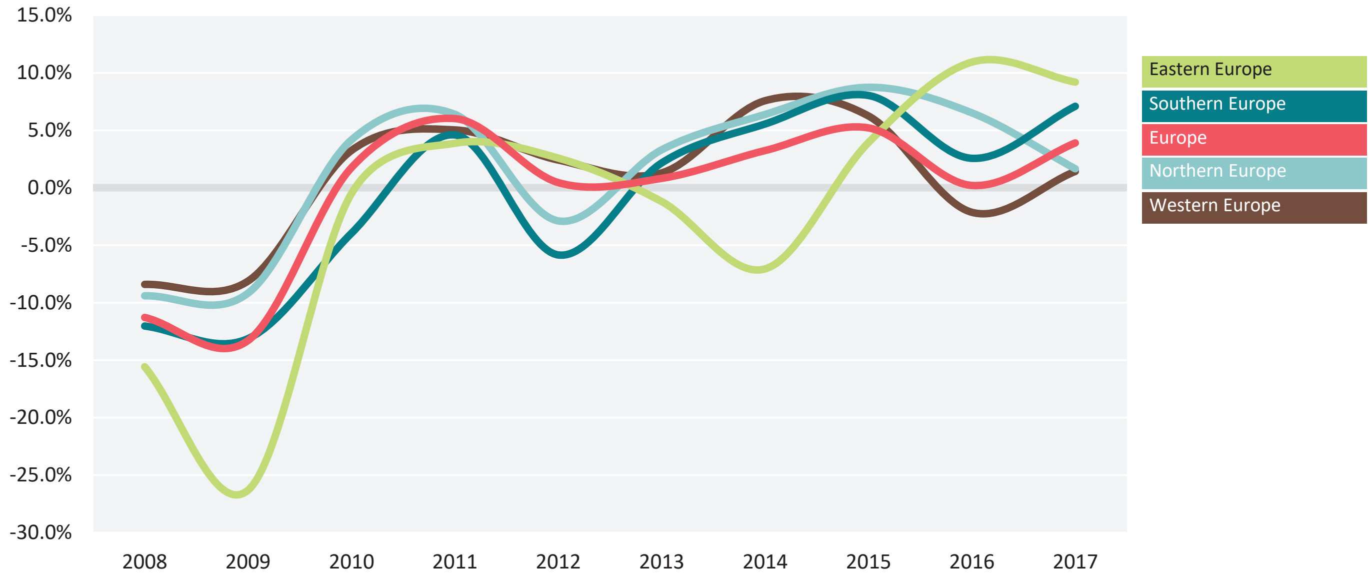
Strong Performers

2017 indicated a continued value growth momentum for Eastern Europe but at a slightly slower pace than 2016 – 'only' 9% growth compared to the 11% reached in 2016. After several years of geopolitical challenges, currency depreciation and sanctions, St Petersburg and Moscow finally rose from the ashes, both recording double-figure value growth in 2017. While Budapest and Prague drove value growth in the Eastern European region in previous years, most regional markets have now followed suit and are striving to reach former value peaks. Given the improved infrastructure, accompanied with affordability and strong economic growth, these markets are currently taking full advantage of the robust tailwinds. Meanwhile, the Southern European region is a mixed bag. On one hand, the political instability hampering Turkey's economy

Strong performances continue in the Iberian Peninsula, together with Athens, driving solid growth for Southern Europe.

Year-on-Year Change

IN VALUES PER ROOM BY REGION 2008-17



Source: HVS – London Office

Note: Based on euro calculations

Hotel Values

PERCENTAGE CHANGE IN HOTEL VALUES IN EURO

		2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	CAGR [1] 2008-17
1	Lisbon	-11.8	-14.0	-2.7	11.1	-10.0	6.0	10.3	11.1	10.2	**14.7**	3.6%
2	St Petersburg	-25.0	-47.6	9.2	11.3	11.5	4.9	-31.6	-2.6	2.6	**14.4**	-5.8%
3	Madrid	-16.8	-18.2	-7.4	2.6	-6.8	-5.6	14.3	14.2	11.0	**14.1**	1.4%
4	Budapest	-17.1	-16.8	-0.8	4.0	-0.5	2.5	7.5	8.0	9.9	**12.2**	2.6%
5	Moscow	-4.8	-38.8	4.2	3.8	11.6	-4.2	-37.9	-13.2	5.5	**11.5**	-8.5%
6	Athens	-2.5	-14.0	-29.3	5.9	-23.8	7.6	5.9	12.6	10.6	**11.0**	-2.8%
7	Brussels	1.7	-11.8	0.1	3.7	-1.5	1.5	4.0	3.5	-6.7	**10.6**	0.2%
8	Sofia	-16.0	-27.1	0.5	-9.2	0.3	-6.8	7.1	7.5	16.0	**9.9**	-1.0%
9	Warsaw	-4.0	-18.2	5.1	8.7	5.7	-6.4	-7.0	2.4	10.1	**8.6**	0.6%
10	Prague	-21.0	-20.3	1.6	3.7	4.7	0.0	5.7	9.4	9.9	**8.5**	2.2%
11	Barcelona	-19.4	-15.0	3.3	2.4	1.3	5.0	6.3	10.9	13.8	**7.1**	3.6%
12	Florence	-25.3	-12.5	9.1	3.3	-1.1	9.3	8.0	9.7	1.8	**6.4**	3.5%
13	Amsterdam	-14.9	-16.0	10.4	6.4	-2.8	4.8	8.6	8.6	6.7	**5.8**	3.3%
14	Paris	-5.9	-3.6	4.2	10.9	4.6	1.7	4.9	-0.5	-8.1	**4.7**	2.0%
15	Bratislava	-15.2	-18.8	-15.9	4.0	-6.2	0.0	-6.3	10.7	18.9	**4.6**	-1.7%
16	Milan	-13.6	-13.0	-12.4	3.9	-4.1	3.6	5.7	10.1	-3.7	**4.4**	-0.9%
17	Frankfurt	-7.9	-0.1	19.4	6.9	2.4	4.7	2.2	8.6	-2.0	**4.0**	5.0%
	EUROPE	**-11.3**	**-13.3**	**1.8**	**6.0**	**0.4**	**0.8**	**3.2**	**5.2**	**0.2**	**3.9**	**0.8%**
18	Bucharest	-21.4	-22.9	-8.0	4.6	-6.6	0.4	5.9	9.3	14.6	**3.7**	-0.5%
19	Berlin	0.2	-0.8	4.4	-2.6	2.6	-0.4	6.3	8.1	1.7	**3.3**	2.4%
20	Munich	-7.0	-10.2	14.7	4.6	8.3	6.7	7.8	3.7	-1.1	**3.2**	4.0%
21	Hamburg	-3.2	-2.5	4.4	6.3	-0.3	2.2	6.7	5.3	7.8	**3.0**	3.6%
22	Dublin	-18.6	-20.2	-5.4	6.1	5.5	6.6	13.2	13.4	15.5	**2.7**	3.6%
23	Rome	-17.6	-10.2	1.9	6.0	-2.4	2.3	3.7	4.5	0.5	**2.3**	0.9%
24	Copenhagen	-6.4	-2.2	-0.9	4.1	-0.5	4.9	9.1	8.9	7.8	**2.2**	3.6%
25	Vienna	-5.2	-18.4	-1.7	3.0	2.6	-4.8	7.3	5.3	4.3	**2.0**	-0.3%
26	Geneva	17.3	-9.6	-1.4	13.1	-3.5	-5.4	6.5	0.9	-4.0	**-0.1**	-0.6%
27	Zürich	5.6	-4.5	12.1	11.1	-5.1	1.9	6.6	0.9	-6.2	**-0.4**	1.6%
28	Edinburgh	-27.1	-7.6	2.8	1.7	4.5	2.5	7.3	10.7	-6.7	**-0.7**	1.5%
29	London	-23.1	0.9	8.4	12.0	6.5	0.0	8.5	2.9	-13.9	**-2.5**	2.3%
30	Stockholm	-6.9	-9.4	3.0	8.7	-5.4	0.2	1.5	8.7	5.0	**-3.0**	0.9%
31	Istanbul	10.8	-8.0	5.8	1.6	0.3	-11.0	-9.9	-8.9	-23.7	**-3.4**	-6.7%
32	Birmingham	-22.7	-13.1	-12.0	-6.7	3.3	0.6	11.0	12.9	-6.8	**-4.1**	-2.0%
33	Manchester	-21.9	-12.2	-4.4	0.2	3.8	0.2	13.5	11.6	-3.9	**-5.8**	0.0%

Source: HVS – London Office

[1]*Compound Annual Growth Rate*

Local Hotel Values

PERCENTAGE CHANGE IN HOTEL VALUE IN LOCAL CURRENCY

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	CAGR [1] 2008-17
Birmingham	-10.3	-2.5	-15.3	-5.4	-2.6	4.0	5.6	1.7	5.1	**2.7**	-0.9
Bucharest	-13.3	-11.2	-8.6	7.2	-3.8	-0.5	6.6	9.3	15.9	**5.3**	1.9
Budapest	-17.1	-7.2	-2.7	12.3	-3.1	6.7	10.0	9.5	9.5	**11.3**	4.9
Copenhagen	-6.4	-2.1	-0.9	4.0	-0.3	4.9	9.1	8.9	7.7	**2.1**	3.6
Edinburgh	-15.3	3.6	-1.0	3.1	-1.5	6.0	2.1	-0.3	5.3	**6.3**	2.6
Geneva	13.2	-13.9	-9.9	-2.5	-2.1	-3.3	5.5	-12.1	-1.8	**1.8**	-4.4
Istanbul	17.7	4.7	-2.3	18.0	-0.4	-2.4	3.9	-5.8	-15.3	**18.7**	1.6
London	-10.7	13.1	4.4	13.4	0.4	3.4	3.2	-7.3	-2.8	**4.3**	3.4
Manchester	-9.3	-1.6	-7.9	1.6	-2.2	3.6	8.0	0.5	8.5	**0.8**	1.1
Moscow	-4.8	-14.8	-5.3	-13.5	8.3	2.1	-24.0	12.9	16.7	**-1.1**	-2.9
Prague	-29.0	-15.6	-2.7	0.8	7.2	4.4	10.9	8.3	9.0	**5.3**	2.8
Sofia	-16.2	-27.1	0.5	-9.1	0.3	-6.8	7.1	7.5	16.0	**9.9**	-1.0
St Petersburg	-25.0	-27.1	-0.8	-7.2	8.3	11.8	-16.3	26.7	13.5	**1.5**	-0.1
Stockholm	-5.4	2.4	-7.4	2.8	-8.9	-0.7	7.1	11.9	6.2	**-1.7**	1.1
Warsaw	-11.1	0.9	1.1	7.4	8.0	-6.4	-7.4	2.5	14.7	**6.1**	2.8
Zürich	2.0	-9.1	2.5	-4.2	-3.7	4.2	5.7	-12.1	-4.1	**1.5**	-2.3

Source: HVS – London Office

[1]*Compound Annual Growth Rate*

Hotel Valuation Index

2008-17

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
1 Paris	3.259	3.142	3.274	3.632	3.798	3.861	4.052	4.030	3.705	**3.880**
2 London	2.760	2.786	3.018	3.380	3.599	3.599	3.904	4.018	3.461	**3.375**
3 Zürich	2.510	2.397	2.686	2.984	2.833	2.886	3.077	3.106	2.912	**2.899**
4 Geneva	2.669	2.414	2.379	2.690	2.597	2.457	2.616	2.639	2.534	**2.531**
5 Rome	2.150	1.929	1.967	2.085	2.034	2.082	2.159	2.257	2.268	**2.321**
6 Florence	1.681	1.471	1.605	1.658	1.640	1.793	1.936	2.124	2.161	**2.300**
7 Amsterdam	1.689	1.419	1.567	1.667	1.620	1.698	1.844	2.002	2.135	**2.259**
8 Barcelona	1.465	1.245	1.287	1.317	1.334	1.400	1.489	1.651	1.880	**2.013**
9 Milan	2.080	1.809	1.585	1.647	1.579	1.636	1.729	1.904	1.833	**1.913**
10 Munich	1.243	1.116	1.281	1.340	1.451	1.548	1.670	1.731	1.712	**1.768**
11 Madrid	1.556	1.273	1.179	1.210	1.127	1.064	1.216	1.389	1.542	**1.760**
12 Copenhagen	1.176	1.150	1.140	1.187	1.182	1.240	1.352	1.472	1.588	**1.623**
EUROPE	**1.492**	**1.294**	**1.317**	**1.396**	**1.402**	**1.414**	**1.459**	**1.535**	**1.538**	**1.598**
13 Dublin	1.146	0.915	0.865	0.918	0.968	1.033	1.169	1.326	1.532	**1.573**
14 Edinburgh	1.293	1.195	1.228	1.249	1.305	1.338	1.437	1.590	1.483	**1.473**
15 Hamburg	1.070	1.043	1.089	1.158	1.154	1.179	1.258	1.325	1.430	**1.472**
16 Stockholm	1.319	1.196	1.231	1.338	1.265	1.268	1.287	1.399	1.469	**1.425**
17 Frankfurt	0.892	0.892	1.064	1.138	1.165	1.220	1.247	1.355	1.327	**1.381**
18 Prague	1.135	0.904	0.919	0.953	0.997	0.997	1.054	1.153	1.267	**1.375**
19 Berlin	1.009	1.000	1.044	1.017	1.043	1.039	1.104	1.193	1.214	**1.254**
20 Vienna	1.285	1.049	1.031	1.062	1.090	1.038	1.114	1.174	1.225	**1.249**
21 Warsaw	1.154	0.944	0.993	1.079	1.141	1.069	0.994	1.017	1.120	**1.216**
22 Lisbon	0.849	0.730	0.710	0.789	0.710	0.753	0.830	0.922	1.016	**1.166**
23 Budapest	0.913	0.760	0.754	0.784	0.780	0.800	0.860	0.929	1.021	**1.145**
24 Brussels	1.125	0.992	0.993	1.029	1.014	1.029	1.071	1.109	1.035	**1.144**
25 Moscow	2.403	1.471	1.533	1.591	1.775	1.701	1.057	0.917	0.968	**1.079**
26 Istanbul	1.990	1.831	1.938	1.968	1.975	1.757	1.583	1.442	1.100	**1.063**
27 Manchester	0.971	0.853	0.815	0.817	0.847	0.850	0.964	1.076	1.034	**0.974**
28 Athens	1.223	1.051	0.743	0.787	0.599	0.645	0.683	0.769	0.850	**0.944**
29 St Petersburg	1.604	0.840	0.917	1.021	1.139	1.195	0.817	0.796	0.817	**0.935**
30 Bucharest	0.923	0.712	0.655	0.685	0.640	0.643	0.681	0.744	0.852	**0.884**
31 Bratislava	0.960	0.780	0.656	0.682	0.640	0.640	0.600	0.664	0.789	**0.826**
32 Sofia	0.864	0.630	0.633	0.575	0.577	0.537	0.575	0.618	0.717	**0.788**
33 Birmingham	0.881	0.766	0.674	0.629	0.650	0.654	0.726	0.820	0.764	**0.733**

Source: HVS – London Office *Note: Based on euro calculations*

continues to have a strong impact on Istanbul values. On the other hand, the Iberian Peninsula continues to ride the crest of the wave, together with Athens, with double-figure growth driving a solid increase of 7% year-on-year in the region.

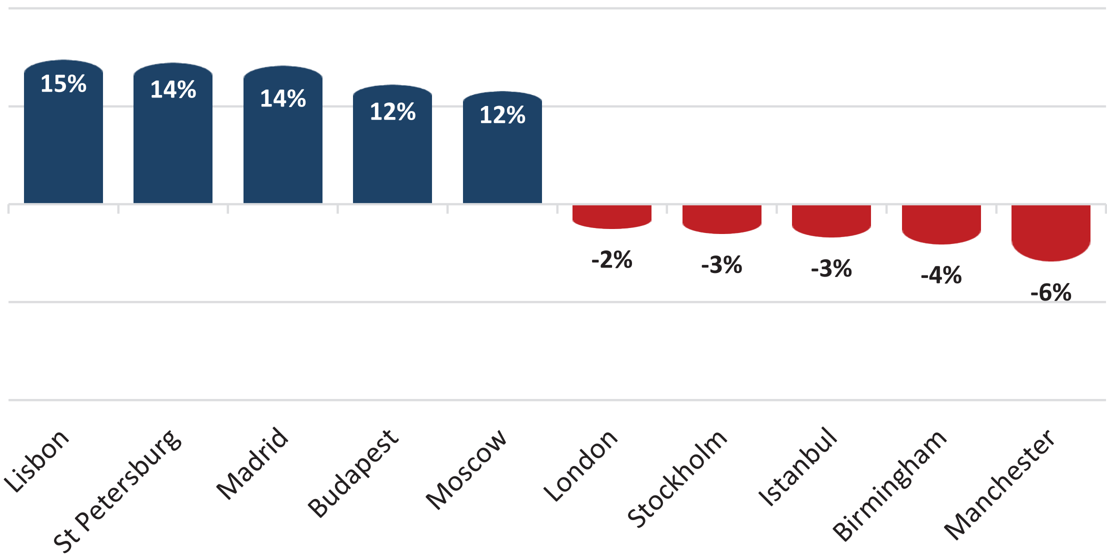
Ranked as one of the safest destinations in Europe, **Lisbon** has benefitted from the unfortunate circumstances many destinations across Europe experienced in the wake of terrorism resulting in safety and security concerns. Impressively, Lisbon experienced a fourth consecutive year of double-figure hotel value growth, climbing to the top position in terms of percentage growth. Whilst Lisbon's hotel supply changed significantly with another 1,300 rooms added (7% of total supply) in 2017, demand grew at an even higher rate of almost 10% and underpinned the growth in occupancy and an even greater increase in average rate at 16% year-on-year. Portugal, and particularly Lisbon, is increasingly in the sights of international investors, developers and lenders after the debt rating upgrade from Standard & Poor's in September 2017, providing further confidence in the market and reduced cost of debt. Going forward, strong market fundamentals bode well for this market, where there is also the potential for the upgrade of a number of existing hotels. A challenge ahead might be supply growth, as more than 2,000 rooms (10% of total supply) are expected to enter the market in the coming years, which might somewhat subdue RevPAR growth in the near future.

Investor interest in Lisbon has recently picked up, following the debt rating upgrade in September 2017

After years of hopefulness, we are finally in a position to give better news about **St Petersburg** and **Moscow**. Following several years of steep declines in hotel values and economic difficulties, the Russian economy has finally returned from the ashes and started to accelerate upwards. St Petersburg and Moscow both recorded double-figure value growth in this year's index at 14% and 12%, respectively. However, in local currency, the growth recorded was relatively flat

Top and Bottom Five

PERCENTAGE CHANGE IN HOTEL VALUES IN EURO



Source: HVS – London Office

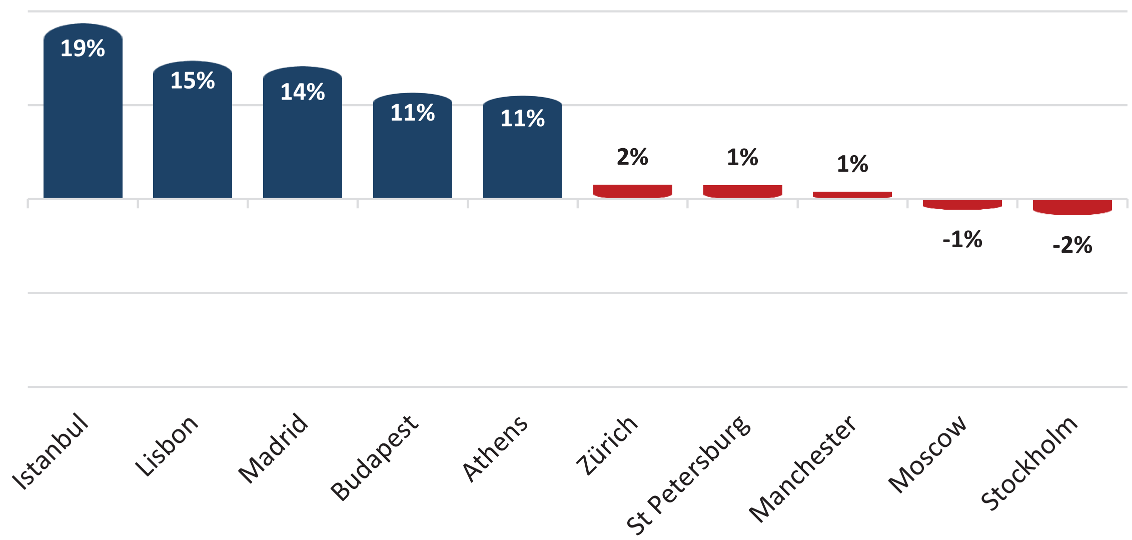
given the strengthened rouble against the euro, which explains why St Petersburg and Moscow feature both in the top five (euro) and bottom five (local currency). Thanks to the combination of a recovery in oil prices, monetary easing and a continued strengthening rouble, there is light at the end of the tunnel for the Russian economy. Impressive tourism arrival growth over the last year (23% for Moscow and 25% for St Petersburg) was driven by improved confidence in the domestic market as well as the cheaper rouble. Chinese tourists also continue to be one of the key international source market for both Russian cities. St Petersburg recorded RevPAR growth on the back of very strong average rate growth, somewhat at the expense of occupancy. Only two new hotels opened in 2017 (the Hilton St Petersburg Expoforum and the Lotte Hotel St Petersburg). A balanced mix of domestic and international demand, both business and leisure, enabled hotels to yield higher rates (+20%). The Moscow market is primarily driven by domestic MICE and corporate demand, which has been limiting the potential for increases in average rate (+7%). New supply exceeding 2,500 rooms in 2017 also put a cap on average rate growth. Overall, the days of gloom seem to finally be over. However, following years of sharp declines, hotel values have a long way to go before returning to past glory levels. With the FIFA World Cup in 2018, we are hopeful to see further growth coming this way.

The capital of Spain returned to the top five in this year's index. The combination of a favourable macroeconomic environment in Spain and strong momentum in arrivals and overnights led to **Madrid** continuing to show spectacular growth in hotel performance, with values per room up by 14% in 2017. Whilst Madrid's hotel supply has remained broadly static over the past three years, the already established hotels fully capitalised on the growing number of arrivals (+3%), with particularly strong growth in international arrivals (+8.5%). This allowed for robust increases in both occupancy and average rate. However, there is still potential for further growth as RevPAR remained 10% below its previous peak (in nominal terms). Nevertheless, the numerous years of strong RevPAR growth recorded in Madrid have attracted more investors to the city, boosting transaction volumes and new hotel projects coming online in the next few years. Some notable transactions in 2017 included the Four Seasons (to open Q1 2019) for €170 million (€850,000 per room), the Edificio España for €272 million (€420,000 per room) and Gran Hotel Velazquez for €58 million (€410,000 per room).

In the last few years, the CEE region has seen a significant inflow of capital as more investors go further afield in their quest for attractive yields, supported by the increased willingness of lending institutions, both domestic and international. Hungary's capital, **Budapest**, has gained international recognition as a 'must-see' destination in Europe, which translated into phenomenal RevPAR growth of close to 15% in 2017, with rate levels reaching new peaks (nominal prices). The city has experienced significant growth in passenger numbers in the last three years, fuelled by the expanding number of low-cost carriers, outperforming regional competitors such as Vienna, Prague, Bratislava

Top and Bottom Five

PERCENTAGE CHANGE IN HOTEL VALUES IN LOCAL CURRENCY



Source: HVS – London Office

and Warsaw, in growth terms. 2017 was further boosted by the World Aquatics Championships and the Junior Swimming Championships, attracting some 485,000 spectators. Going forward, challenges similar to those of other CEE countries remain, including the shortage of qualified personnel. In Hungary, hoteliers are experiencing skyrocketing payroll expenses, but the pressure remains as emigration continues to dent the labour pool. This is likely to remain a serious drawback for hotels in Budapest, to balance the personnel needs associated with strong demand growth while protecting profit levels.

As highlighted earlier, currency dynamics continued to have a significant impact in 2017. One example is **Istanbul**, which makes a dual appearance both in the top five (local currency) and bottom five (euro). In a local currency analysis, Istanbul recorded positive hotel value growth. Following a severe RevPAR decline above 40% in 2016 – owing to a combination of terrorist attacks, Turkey's involvement in the civil war in Syria and its unstable relationship with Russia – 2017 was a year of recovery. The return of Russian tourists, as the flight ban was lifted, and cheaper currency boosted the demand to Istanbul, leading to a recorded RevPAR growth of more than 30% compared to 2016. Although Istanbul has experienced some recovery, there is still a long way to go before reaching its peak levels in terms of hotel values.

Challenged Markets

The toxic mix of continued terrorist attacks, the currency depreciation caused by Brexit uncertainty (still!) and strong supply growth all led to a decrease in values per room, in euro, for the British cities in our index. Similarly to last year, these cities appear on the bottom of the euro list mainly due to currency dynamics. Istanbul and Stockholm complete the 'losers' euro list. In the local currency table, Zürich, St Petersburg and Moscow join the twice present Manchester and Stockholm.

Despite the terrible Manchester Arena bombing in May 2017, visitation levels to **Manchester** only saw a limited impact in the first few weeks following the attack, partly cushioned by the increased overseas visitor numbers derived from

LISBON: NOT ONLY THE SUN SHINES BRIGHTLY ON THE CITY

the weakened sterling. In a euro currency analysis, Manchester recorded a decrease of 6% in values per room, while values remained flat in local currency. We remain confident about Manchester: healthy occupancy levels at around 80% recorded in the last four years, with continued average rate growth, notwithstanding the substantial increases in supply (7% since 2016), corroborate the strong hotel fundamentals in the market.

Similarly, **Birmingham** continued to see value growth in pounds sterling, although it lost ground in euro terms. The significant investment in infrastructure, such as the £600-million improvements to Birmingham New Street Station and several developments at the airport, has been made to fully capitalise on the growing number of visitors (+12% growth in passenger numbers in 2017). The city recorded modest RevPAR growth of around 2.5% in local currency in 2017, as the leisure segment continues to be attracted by the growing number of events and cultural offers in this market. With a very modest pipeline (less than 5% of current supply) and the anticipated arrival of the High Speed 2 (HS2) rail network in 2026, the future looks promising for Birmingham's hotel market.

Some pressure on the top line was to be expected for **Stockholm**, following a large inflow of new supply in 2017. The city saw a moderate decline in both occupancy and average rate, resulting in a RevPAR decrease of around 3%. This is not the first time Stockholm has experienced such supply increases, the last time being in 2011. Underpinned by a long track record of solid growth in both business and leisure demand, hotels in the Swedish capital tend to quickly recover within the following months/year, which is likely to also be the case on this occasion.

On the same note as the other British cities, **London** recorded a continued softening of values from a euro perspective due to currency fluctuations. From a local currency analysis, the city experienced decent growth of slightly above 4%. The increased 'value-for-money' that London offers, combined with a strong global economy (and an exceptionally healthy Europe next door), have continued to encourage international travellers to visit London for both business and leisure purposes. The UK capital experienced a strong start to the year, but softened in the second half as new rooms came into the market competing for attention. Despite the uncertainty around Brexit, investors' confidence in the market remained strong; transactions in 2017 exceeded 2016 levels by £610 million as international investors continued to profit from the weak sterling. Looking forward, 2018 is expected to see further RevPAR growth, but at a more modest pace. The biennial Farnborough International Air Show returns and the launch of Crossrail during 2018 and beyond should enable hotels and attractions in Greater London to maintain a solid performance. However, the combination of increasing wages, rising food and utility costs and the impact of higher property taxes and business rates will continue to put pressure on operating margins over the next 12 months, potentially hindering hotel values.

Transactions in 2017 exceeded 2016 levels by £610 million in London, as the UK was the most liquid market in Europe again

All in all, 2017 was a very positive year for the European hotel market, which experienced value growth and recoveries for many cities, and the opportunity to 'level-off' for some markets whose values were still somewhat depressed against the European average. This strong performance across the board has resulted in a somewhat misleading situation whereby cities with low growth are classified as 'challenged' markets. **Zürich** is one of those markets, with local currency analysis recording a 1.5% increase, but classifying it as the fifth worst performing market in local currency. This is the result of new supply putting pressure on rates and taking RevPAR down by 1.5% in 2017. However, the market remains firmly in investors' sights, providing they are not deterred by the extremely high barriers to entry and the premiums that they generate. The destination is dominated by family-operated businesses with a relatively illiquid transaction market, with no notable transactions in 2017.

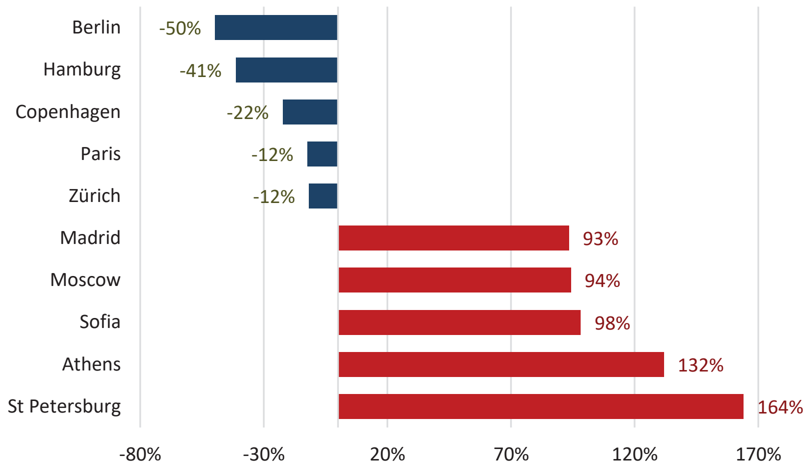
BUDAPEST: THE PARIS OF THE EAST?

Volatility Index

The volatility index is a tool to assess (to a certain extent) the fluctuation in value and the overall risk associated with a hotel investment. Hotels are not only a capital-intensive type of asset, but they might also be affected by external factors such as micro and macro market issues (oversupply, recessions, natural disasters, terrorism, and so forth). Any of these factors could have an impact on the profitability of the business; thus, it is critical to be able to quantify the overall level of risk associated with a hotel investment. A good indicator of investment risk is volatility, which provides a measure for variation in asset prices over time. Higher volatility implies higher risk. We have therefore included a volatility index, which calculates the standard deviation of the annual capital appreciation/depreciation in value divided by the average value (Europe) over the same period. For example, Madrid has a volatility index of 93%, which means that hotel values are 93% more volatile than the value of a typical hotel in Europe. A higher level of volatility would be more acceptable in cases where the returns were also high. A market with the highest negative volatility would, in fact, be the most stable market, as it would change even less than the average (Europe).

Volatility Ratio

2017



Note: volatility is expressed in relation to the overall European average

Source: HVS – London Office

The following chart shows the five most and five least volatile European markets over ten years (2008-17) in local currency (to remove the impact of currency fluctuation) with Europe as a whole set at 0%.

The most volatile markets remained largely the same as those presented in the 2017 HVI, except that Madrid replaced Dublin as fifth most volatile and Moscow moved to the fourth most volatile position, replacing Sofia. In terms of the least volatile, Paris replaced Brussels in fourth place and Zürich replaced Manchester in fifth place. As shown in the graph, hotel markets with 'stabilised' values per room, such as some German markets or the French capital, are unlikely to fluctuate much, whilst markets such as Athens, St Petersburg or Moscow, which have seen significant changes in value over the last decade (declines in value in all cases), show larger than average variations as they tend to revert to their fair values.

Outlook

Some of our greatest fears were assuaged once the elections in France, Germany (finally!) and the Netherlands were out of the way, with disappointing results for the populist, anti-EU political parties. Generally, a sigh of relief emanated from the business community.

Furthermore, business and consumer confidence, as well as GDP growth in Europe, are all riding high. Hotel demand is strong across the majority of European markets, with low levels of new supply (with a few exceptions, such as London), which points to continuing robust performances across the board. Yes, the prospects from a RevPAR point of view for 2018 could hardly be more promising. What could possibly go wrong?

Well for one, it is likely that the very low cost of debt we have come to view as normal will soon (slowly but surely) come to an end as the US Federal Reserve pushes ahead with its gradual interest rate escalation, and as the Bank of England prepares the general public for further increases, following the first (marginal) rise in ten years in November 2017. Furthermore, inflation and higher interest rates will eventually also impact cap rates; this may happen sooner rather than later. We feel, however, that whilst some markets might experience cap rate decompression earlier (the UK, potentially), more 'laggard' markets could still benefit a while longer from lower yields, as they continue crystallising their value potential.

Whilst the somewhat unoriginal question of 'when will the cycle end?' does the rounds, not many are clairvoyant enough to find a credible answer – even academia has mixed views. Private equity investors continue to be net sellers for investments that have reached the end of the hold period, or indeed when the right buyer materialises (holding periods for various recent transactions have continued to be exceptionally short). But, as mentioned earlier, various markets in Europe still present a substantial upside. Could it therefore be that individual markets will continue to go through their micro-cycles of sorts, whilst the Big Cycle takes a bit longer to wind up?

Whilst we wait for the answer to arrive, capital continues to accumulate to feverish heights (with further ongoing fundraising), and hotel real estate returns remain appealing compared to other asset classes. It is therefore most probable that hotel investment will continue unabated, as strong underlying fundamentals still drive value growth, especially for markets in Eastern and Southern Europe, which haven't yet returned to pre-crisis value levels. Cap rates could move in opposite directions for more mature markets as opposed to the 'upside potential markets'. Conservative loan-to-value levels are a counter-lever to compressed cap rates (which, it is worth remembering, are still within a safe margin compared to government bonds).

Moreover, investment will only become increasingly innovative. As we mentioned earlier, companies are partnering with startups of strategic relevance to complement core competencies. Hotels' uses are increasingly 'fluid' as they are viewed as converging points for co-living and co-working, thus impacting facilities (is this a lobby or an office?). As smartphones keep evolving and incorporating emerging technology tools, such as artificial intelligence, location services and cloud-based data, it poses the question: 'how does this impact usage and therefore hotels?'. To complicate things further (or provide more opportunities!), the lines between travel and residential are becoming increasingly blurred: The Student Hotel is just one example.

Contradictions abound out there, take your pick: 'this market is too pricey/that one has not yet reached potential', 'the deal has limited leverage/but interest rates could soon go up', 'high demand + limited new supply = great RevPAR ahead/but for how long?'; 'surely more tourism is good for the city/or is it?'. With so many unknowns, it is more imperative than ever that eyes remain wide open whilst the conscientious investor weighs the pros and cons and gets impartial, timely advice. Surely, there are serious gems waiting to be picked up, but you need to know where to look!

– HVS –

Understanding the HVI

The HVI is a hotel valuation benchmark developed by HVS. It monitors annual percentage changes in the values of typically four-star and five-star hotels in 33 major European cities. Additionally, our index allows us to rank each market relative to a European average. All data presented are in euro, unless otherwise stated.

The methodology employed in producing the HVI is based upon actual operating data from a representative sample of four-star and five-star hotels. Operating data from STR were used to supplement our sample of hotels in some of the markets. The data are then aggregated to produce a pro forma for a typical 200-room hotel in each city. Using our experience of real-life hotel financing structures gained from valuing hundreds of hotels each year, we have determined valuation parameters for each market that reflect both short-term and longer-term sustainable financing models (loan to value ratios, debt coverage ratios, real interest rates and equity return expectations). These market-specific valuation and capitalisation parameters are applied to the EBITDA less FF&E Reserve for a typical upscale hotel in each city. In determining the valuation parameters relevant to each of the 33 cities included in the European HVI, we have also taken into account evidence of actual hotel transactions and the expectations of investors with regard to future changes in supply, market performance and return requirements. Investor appetite for each city at the end of 2017 is therefore reflected in the capitalisation rates used and investment yields assumed.

The HVI assumes a date of value of 31 December 2017. Values are based on recent market performance, but the capitalisation rates reflect the expected future trends in performance, competitive environment, cost of debt and cost of equity. As our opinion of value remains an opinion of Market Value, we have attempted to remove all aspects of distress when analysing transactions and assessing the opinions of value. The parameters adopted assume a reasonable level of debt and investor sentiment. Conversely, the values reported may not therefore bear comparison with actual transactions completed in the marketplace. However, this is the best approach to retain the integrity of the HVI as a rolling annual index.

The HVI allows comparisons of values across markets and over time by using the 1993 average European value of €173,737 per available room (PAR) as a base (1993=1.000). Each city's PAR value is then indexed relative to this base. For example, if the index for Paris was 4.000 (€694,948/€173,737), the value of a hotel in Paris would be four times higher than the European average in 1993.

INDEX RANKING | PERCENTAGE CHANGE IN VALUE (€)

About HVS

HVS, the world's leading consulting and services organization focused on the hotel, mixed-use, shared ownership, gaming, and leisure industries, celebrated its 35th anniversary last year. Established in 1980, the company performs 4,500+ assignments each year for hotel and real estate owners, operators, and developers worldwide. HVS principals are regarded as the leading experts in their respective regions of the globe. Through a network of more than 40 offices and more than 350 professionals, HVS provides an unparalleled range of complementary services for the hospitality industry. HVS.com

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***Everywhere*.**

With offices in London since 1990, HVS London serves clients with interests in the UK, Europe, the Middle East and Africa (EMEA). We have appraised some 4,000 hotels or projects in more than 50 countries in all major markets within the EMEA region for leading hotel companies, hotel owners and developers, investment groups and banks. Known as one of the foremost providers of hotel valuations and feasibility studies, and for our ability, experience and relationships throughout Europe, HVS London is on the valuation panels of numerous top international banks which finance hotels and portfolios.

For further information about the services of the London office, please contact Sophie Perret, director, on +44 20 7878 7722 or sperret@hvs.com.

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Sophie Perret, MRICS is a director at the HVS London office. She joined HVS in 2003, following ten years' operational experience in the hospitality industry in South America and Europe. Originally from Buenos Aires, Argentina, Sophie holds a degree in Hotel Management from Ateneo de Estudios Terciarios, and an MBA from IMHI (Essec Business School, France and Cornell University, USA). Since joining HVS, she has advised on hotel valuations and investment projects and related assignments throughout the EMEA region and is responsible for the development of HVS services across Europe. Sophie completed an MSc in Real Estate Investment and Finance at Reading University in 2014 and is a member of the RICS. She co-chaired the Hotel & Resort Council of the ULI in Europe from 2014 to 2017 and is a regular speaker at industry events.