MARCH 2019

2019 EUROPEAN
HOTEL VALUATION INDEX

Magalí Castells
Senior Associate

Sophie Perret, MRICS
Director





HVS.com

HVS London | 7-10 Chandos St, London W1G 9DQ, UK

HVS

Highlights

Economy

What a difference a year makes. Political crises, market volatility and profit warnings make for a rather different backdrop to that of a year ago. While some argue that a market correction (or even a downturn) is already occurring, there is a common consensus that if this is not yet the case it is likely to materialise at some point in the next 18-24 months. In this context, European economic growth is expected to continue to moderate to just over 1.5% by 2020 (OECD).

Tourism Dynamics

Tourism is still in rude health. Globetrotter numbers continue to rise, and it is well known that 'all roads lead to Rome'. As a result, Europe maintains its share of just over 50% of global tourist movements and received 713 million visitors in 2018, 6% up on an already exceptional 2017. The extremes in terms of performance were the sunny Southern European countries with a 7% increase and cloudy Northern Europe which remained flat as a result of low arrival numbers to the UK. The continued recovery of markets, such as Russia and some Arab markets, as well as increasing outbound travel from other emerging markets, such as India, present further opportunities for Europe as a global tourism magnet.

Brexit

Amidst the foggy uncertainty of Brexit, a few things have become clear, including the stockpiling of goods ahead of a potential 'no deal' exit on 29 March and a number of larger companies (that haven't already done so) fleshing out their strategies should this be the ultimate outcome of the ongoing negotiations. In parallel, however, a recent survey of British Property Federation members indicated that industry leaders have become more optimistic regarding the long-term outlook for UK real estate – at the expense, nevertheless, of new developments for 2019. With just a few weeks to go, the business community is eagerly awaiting a conclusion to this long process that will allow them (hopefully!) to plan more accurately for the short to medium term.

Hotel Performance

Despite a slow December across European markets and some country-specific challenges (such as the 'gilets jaunes' movement in France), 2018 was generally a profitable year for hotels. Europe experienced another year of solid RevPAR performance, with an aggregate increase in euro terms of around 5%. While the continued recovery of markets such as Paris and Brussels in Western Europe were significant, the likes of Istanbul and the Russian markets also had solid performances in euro terms (and even better ones in local currency). On the back of continued robust demand, the European pipeline remains one of the more modest in the world at 8%, which is reassuring for 2019 performance, financial and political turmoil aside.

Transaction Volume

Total European hotel transaction volume reached €18.6 billion in 2018, a 14% decline on 2017's volumes. The decrease is in part due to the lessened participation of HNWI and Asian buyers, which was not fully compensated by the increased appetite of solely hotel-focused real estate investment companies and REITs. Institutional investors continued to be net buyers, heavily investing in Germany, which was the second most popular market for transactions after the UK. London, Dublin and Amsterdam were (in that order) the most liquid cities in Europe. For more details please refer to our sister publication *2018 European Hotel Transactions*.

Hospitality Investment

Interestingly, the hospitality sector, including not only hotels but also student accommodation and senior living, attracted a record level of investment in 2018, to reach almost 30% of all investment volume according to RCA. This represents a doubling of its share compared to the previous peak in 2007. Attractive returns as well as a desire for diversification are some of the drivers for this trend.

Capitalisation Rates

As funds keep on cumulating and both equity and debt continue to chase opportunities, the perception that the cycle is past its peak and that most deals are too pricey becomes more prevalent. Capitalisation rates remained stable for the year, as strong performance underpinned cash flows, although caution regarding changing economic conditions are also factored in by investors.

Hotel Values

More than a decade since the peak values of 2007, it is interesting to note that our index only records a handful of markets that have seen values increase in real terms. Of these, only Munich and Frankfurt experienced compound annual growth of more than 1% during this period. We still see upside potential in Eastern and Southern European markets, while currency fluctuation is still the main reason for the lowish euro values of UK markets compared to peak performances.

The European Hotel Valuation Index

Just when we thought that 2017 had been an outstanding year in terms of hotel values, 2018 was yet another spectacular year for the market, setting new highs. While geopolitical uncertainty and instability remain present in Europe, the influence on investors, developers and lenders within the hotel sector seems to be continually lessening. European hotel values registered an impressive 3.9% growth in 2017 and this positive trend continued throughout 2018 with hotel values growing by an additional 3.0%.

Individual value changes in 2018 were much more modest than in 2017, with none of the top or bottom performers reaching double figures. The top five growth winners included all-time favourite Lisbon, Moscow following the FIFA World Cup boom and other more consolidated markets recovering their leading positions after some troublesome years, such as Paris, Brussels and Berlin.

All in all, 2018 was a very positive year for the European hotel market with it experiencing value growth and recoveries in many cities, as well as the opportunity to 'level-off' for some markets where values were still somewhat depressed against the European average. Only six out of the 33 markets analysed experienced a value drop. Surprisingly, the bottom of the index in local currency was composed of relatively mature and consolidated markets (such as Barcelona and Geneva), as well as other more volatile ones (like Warsaw). However, it is worth noting that all five bottom markets recorded positive value growth in 2017. Percentage declines in euro included the previously mentioned markets, but with Stockholm occupying Warsaw's place due to currency dynamics.

Winners and Losers

We have shortlisted the winners and losers in terms of percentage change in value in 2018 and presented them in a 'top and bottom' chart (see page 6). Similar to the previous two years, currency dynamics continued to have an impact on value changes. Therefore, we also present the top and bottom markets in local currency value change.

CHANGES IN VALUE

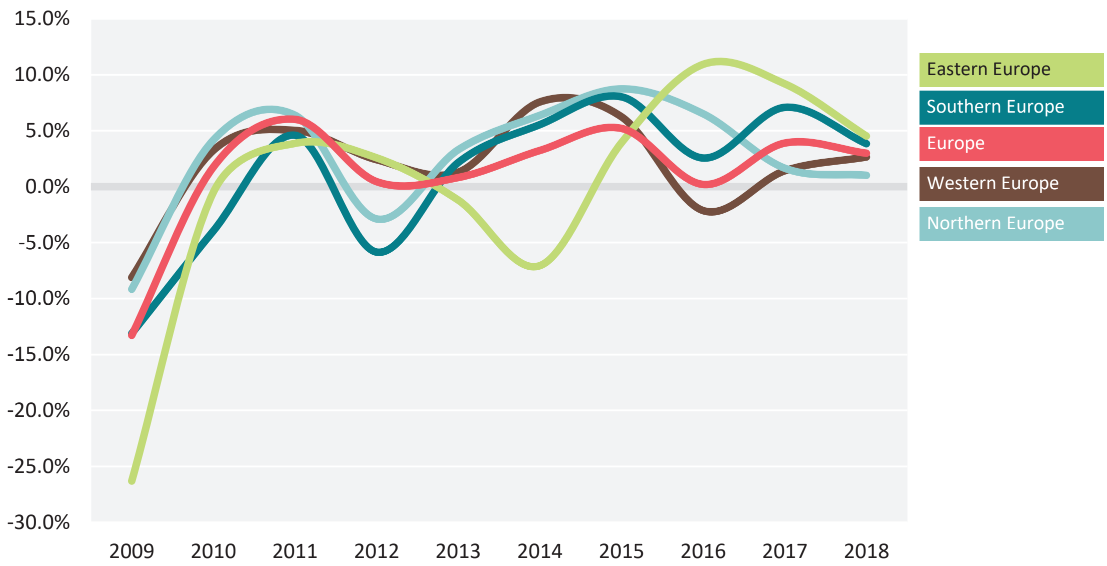
Strong Performers

Figures for 2018 indicate the consolidation and slowing down of value growth for Eastern and Southern Europe with increases of 5% and 4%, respectively, compared to the 9% and 7% achieved in 2017. While St Petersburg, Moscow and Budapest registered double-figure growth in 2017, 2018 was yet another strong but more modest year (excluding the World Cup boom). The recovery and growth of some mature markets, including Paris, Berlin and Vienna, has led to the rise of Western Europe after two troublesome years. Meanwhile, Southern Europe continues to enjoy an overall positive trend with a more stable individual performance of its markets. Following the boom experienced by Athens, Lisbon and Madrid in 2017 (double-figure growth), 2018 was somewhat more moderate. In addition, the negative trend affecting Barcelona due to the current political pressures, has impacted the region as a whole. Nevertheless, after five consecutive years of decline, Istanbul has finally re-emerged. The situation has calmed down slightly; two years have passed since the attempted coup d'état (July 2016) and security measures have increased.

Growth has been evenly split between the regions, narrowing the values per room growth gap in Europe

Year-on-Year Change

IN VALUES PER ROOM BY REGION 2009-18



Source: HVS – London Office

Note: Based on euro calculations

Hotel Values

PERCENTAGE CHANGE IN HOTEL VALUES IN EURO

		2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	CAGR[1] 2009-18
1	Lisbon	-14.0	-2.7	11.1	-10.0	6.0	10.3	11.1	10.2	14.7	8.9	6.3%
2	Moscow	-38.8	4.2	3.8	11.6	-4.2	-37.9	-13.2	5.5	11.5	8.2	-2.5%
3	Paris	-3.6	4.2	10.9	4.6	1.7	4.9	-0.5	-8.1	4.7	7.3	3.2%
4	Brussels	-11.8	0.1	3.7	-1.5	1.5	4.0	3.5	-6.7	10.6	6.7	2.3%
5	Berlin	-0.8	4.4	-2.6	2.6	-0.4	6.3	8.1	1.7	3.3	6.6	3.3%
6	St Petersburg	-47.6	9.2	11.3	11.5	4.9	-31.6	-2.6	2.6	14.4	6.3	1.9%
7	Budapest	-16.8	-0.8	4.0	-0.5	2.5	7.5	8.0	9.9	12.2	6.0	5.3%
8	Sofia	-27.1	0.5	-9.2	0.3	-6.8	7.1	7.5	16.0	9.9	5.9	3.2%
9	Vienna	-18.4	-1.7	3.0	2.6	-4.8	7.3	5.3	4.3	2.0	5.8	2.6%
10	Prague	-20.3	1.6	3.7	4.7	0.0	5.7	9.4	9.9	8.5	5.8	5.4%
11	Athens	-14.0	-29.3	5.9	-23.8	7.6	5.9	12.6	10.6	11.0	5.7	-0.6%
12	Munich	-10.2	14.7	4.6	8.3	6.7	7.8	3.7	-1.1	3.2	5.7	5.9%
13	Dublin	-20.2	-5.4	6.1	5.5	6.6	13.2	13.4	15.5	2.7	5.6	6.9%
14	Rome	-10.2	1.9	6.0	-2.4	2.3	3.7	4.5	0.5	2.3	5.3	2.7%
15	Madrid	-18.2	-7.4	2.6	-6.8	-5.6	14.3	14.2	11.0	14.1	4.9	4.2%
16	Amsterdam	-16.0	10.4	6.4	-2.8	4.8	8.6	8.6	6.7	5.8	4.5	5.8%
17	Milan	-13.0	-12.4	3.9	-4.1	3.6	5.7	10.1	-3.7	4.4	4.5	1.1%
18	Istanbul	-8.0	5.8	1.6	0.3	-11.0	-9.9	-8.9	-23.7	-3.4	4.3	-5.4%
19	Birmingham	-13.1	-12.0	-6.7	3.3	0.6	11.0	12.9	-6.8	-4.1	3.5	-0.1%
	EUROPE	**-13.3**	**1.8**	**6.0**	**0.4**	**0.8**	**3.2**	**5.2**	**0.2**	**3.9**	**3.0**	**2.7%**
20	Copenhagen	-2.2	-0.9	4.1	-0.5	4.9	9.1	8.9	7.8	2.2	2.9	4.2%
21	Bucharest	-22.9	-8.0	4.6	-6.6	0.4	5.9	9.3	14.6	3.7	2.4	2.7%
22	Bratislava	-18.8	-15.9	4.0	-6.2	0.0	-6.3	10.7	18.9	4.6	2.3	0.9%
23	Florence	-12.5	9.1	3.3	-1.1	9.3	8.0	9.7	1.8	6.4	2.1	5.3%
24	Frankfurt	-0.1	19.4	6.9	2.4	4.7	2.2	8.6	-2.0	4.0	1.3	5.1%
25	London	0.9	8.4	12.0	6.5	0.0	8.5	2.9	-13.9	-2.5	1.2	2.3%
26	Zürich	-4.5	12.1	11.1	-5.1	1.9	6.6	0.9	-6.2	-0.4	0.6	2.2%
27	Edinburgh	-7.6	2.8	1.7	4.5	2.5	7.3	10.7	-6.7	-0.7	0.3	2.4%
28	Warsaw	-18.2	5.1	8.7	5.7	-6.4	-7.0	2.4	10.1	8.6	-0.7	2.8%
29	Manchester	-12.2	-4.4	0.2	3.8	0.2	13.5	11.6	-3.9	-5.8	-1.5	1.3%
30	Hamburg	-2.5	4.4	6.3	-0.3	2.2	6.7	5.3	7.8	3.0	-2.5	3.6%
31	Geneva	-9.6	-1.4	13.1	-3.5	-5.4	6.5	0.9	-4.0	-0.1	-3.5	0.1%
32	Stockholm	-9.4	3.0	8.7	-5.4	0.2	1.5	8.7	5.0	-3.0	-4.3	1.5%
33	Barcelona	-15.0	3.3	2.4	1.3	5.0	6.3	10.9	13.8	7.1	-4.9	4.9%

Source: HVS – London Office

[1]*Compound Annual Growth Rate*

Local Hotel Values

PERCENTAGE CHANGE IN HOTEL VALUE IN LOCAL CURRENCY

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	CAGR[1] 2009-18
Birmingham	-2.5	-15.3	-5.4	-2.6	4.0	5.6	1.7	5.1	2.7	**4.4**	-0.2
Bucharest	-11.2	-8.6	7.2	-3.8	-0.5	6.6	9.3	15.9	5.3	**4.5**	3.8
Budapest	-7.2	-2.7	12.3	-3.1	6.7	10.0	9.5	9.5	11.3	**9.3**	6.8
Copenhagen	-2.1	-0.9	4.0	-0.3	4.9	9.1	8.9	7.7	2.1	**3.1**	4.2
Edinburgh	3.6	-1.0	3.1	-1.5	6.0	2.1	-0.3	5.3	6.3	**1.2**	2.3
Geneva	-13.9	-9.9	-2.5	-2.1	-3.3	5.5	-12.1	-1.8	1.8	**0.3**	-2.8
Istanbul	4.7	-2.3	18.0	-0.4	-2.4	3.9	-5.8	-15.3	18.7	**44.7**	5.3
London	13.1	4.4	13.4	0.4	3.4	3.2	-7.3	-2.8	4.3	**2.1**	2.2
Manchester	-1.6	-7.9	1.6	-2.2	3.6	8.0	0.5	8.5	0.8	**-0.7**	1.2
Moscow	-14.8	-5.3	-13.5	8.3	2.1	-24.0	12.9	16.7	-1.1	**21.8**	1.0
Prague	-15.6	-2.7	0.8	7.2	4.4	10.9	8.3	9.0	5.3	**3.2**	5.1
Sofia	-27.1	0.5	-9.1	0.3	-6.8	7.1	7.5	16.0	9.9	**5.8**	3.2
St Petersburg	-27.1	-0.8	-7.2	8.3	11.8	-16.3	26.7	13.5	1.5	**19.6**	5.6
Stockholm	2.4	-7.4	2.8	-8.9	-0.7	7.1	11.9	6.2	-1.7	**2.2**	1.1
Warsaw	0.9	1.1	7.4	8.0	-6.4	-7.4	2.5	14.7	6.1	**-0.6**	2.6
Zürich	-9.1	2.5	-4.2	-3.7	4.2	5.7	-12.1	-4.1	1.5	**4.5**	-0.8

Source: HVS – London Office

[1]*Compound Annual Growth Rate*

Hotel Valuation Index

2009-18

		2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
1	Paris	3.142	3.274	3.632	3.798	3.861	4.052	4.030	3.705	3.880	4.162
2	London	2.786	3.018	3.380	3.599	3.599	3.904	4.018	3.461	3.375	3.416
3	Zürich	2.397	2.686	2.984	2.833	2.886	3.077	3.106	2.912	2.899	2.917
4	Geneva	2.414	2.379	2.690	2.597	2.457	2.616	2.639	2.534	2.531	2.443
5	Rome	1.929	1.967	2.085	2.034	2.082	2.159	2.257	2.268	2.321	2.443
6	Amsterdam	1.419	1.567	1.667	1.620	1.698	1.844	2.002	2.135	2.259	2.360
7	Florence	1.471	1.605	1.658	1.640	1.793	1.936	2.124	2.161	2.300	2.348
8	Milan	1.809	1.585	1.647	1.579	1.636	1.729	1.904	1.833	1.913	1.998
9	Barcelona	1.245	1.287	1.317	1.334	1.400	1.489	1.651	1.880	2.013	1.915
10	Munich	1.116	1.281	1.340	1.451	1.548	1.670	1.731	1.712	1.768	1.868
11	Madrid	1.273	1.179	1.210	1.127	1.064	1.216	1.389	1.542	1.760	1.846
12	Copenhagen	1.150	1.140	1.187	1.182	1.240	1.352	1.472	1.588	1.623	1.669
13	Dublin	0.915	0.865	0.918	0.968	1.033	1.169	1.326	1.532	1.573	1.661
	EUROPE	1.294	1.317	1.396	1.402	1.414	1.459	1.535	1.538	1.598	1.646
14	Edinburgh	1.195	1.228	1.249	1.305	1.338	1.437	1.590	1.483	1.473	1.477
15	Prague	0.904	0.919	0.953	0.997	0.997	1.054	1.153	1.267	1.375	1.454
16	Hamburg	1.043	1.089	1.158	1.154	1.179	1.258	1.325	1.430	1.472	1.436
17	Frankfurt	0.892	1.064	1.138	1.165	1.220	1.247	1.355	1.327	1.381	1.399
18	Stockholm	1.196	1.231	1.338	1.265	1.268	1.287	1.399	1.469	1.425	1.363
19	Berlin	1.000	1.044	1.017	1.043	1.039	1.104	1.193	1.214	1.254	1.336
20	Vienna	1.049	1.031	1.062	1.090	1.038	1.114	1.174	1.225	1.249	1.322
21	Lisbon	0.730	0.710	0.789	0.710	0.753	0.830	0.922	1.016	1.166	1.269
22	Brussels	0.992	0.993	1.029	1.014	1.029	1.071	1.109	1.035	1.144	1.221
23	Budapest	0.760	0.754	0.784	0.780	0.800	0.860	0.929	1.021	1.145	1.214
24	Warsaw	0.944	0.993	1.079	1.141	1.069	0.994	1.017	1.120	1.216	1.208
25	Moscow	1.471	1.533	1.591	1.775	1.701	1.057	0.917	0.968	1.079	1.168
26	Istanbul	1.831	1.938	1.968	1.975	1.757	1.583	1.442	1.100	1.063	1.109
27	Athens	1.051	0.743	0.787	0.599	0.645	0.683	0.769	0.850	0.944	0.998
28	St Petersburg	0.840	0.917	1.021	1.139	1.195	0.817	0.796	0.817	0.935	0.994
29	Manchester	0.853	0.815	0.817	0.847	0.850	0.964	1.076	1.034	0.974	0.959
30	Bucharest	0.712	0.655	0.685	0.640	0.643	0.681	0.744	0.852	0.884	0.905
31	Bratislava	0.780	0.656	0.682	0.640	0.640	0.600	0.664	0.789	0.826	0.845
32	Sofia	0.630	0.633	0.575	0.577	0.537	0.575	0.618	0.717	0.788	0.834
33	Birmingham	0.766	0.674	0.629	0.650	0.654	0.726	0.820	0.764	0.733	0.758

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

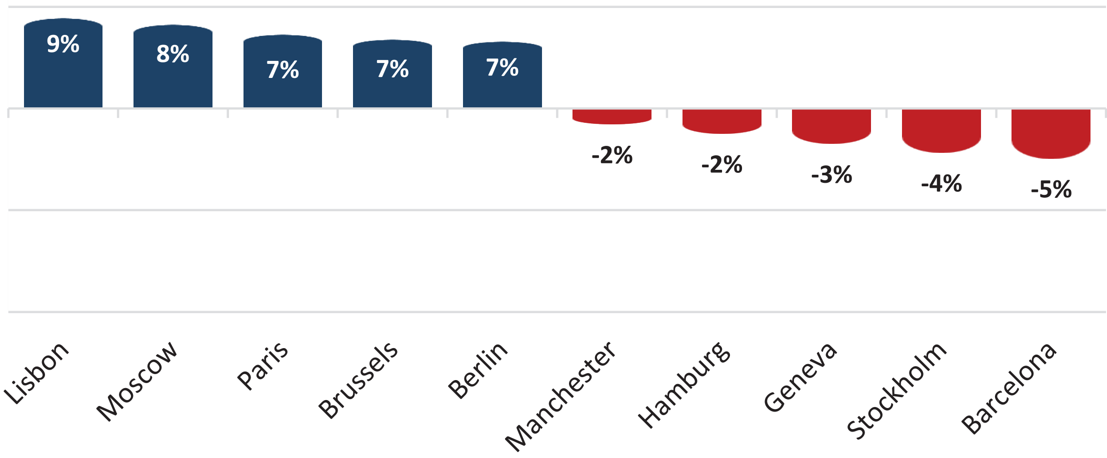
For the second consecutive year, **Lisbon** has been ranked as the fastest-growing market in Europe. Considered to be one of the safest cities in Europe, a favourite leisure destination and an increasingly popular business and conference hub, this market has been on the rise since 2013. As a result of its increased popularity, Lisbon was named the World's Leading City Destination at the World Travel Awards 2018. Tourism demand in Lisbon grew throughout 2018, albeit at a slower pace due to a decline in demand from the UK (weaker pound) and the European markets (resurgent competition from North African markets). These visitation dynamics, together with a surge in supply, slowed down the increase in occupancy for the city; however, average rates continued to rise by more than 5%, mainly driven by visitors from the USA and Brazil. A challenge ahead could be supply growth, as more than 2,200 rooms (10% of total supply) are expected to enter the market in the next three years, which might somewhat subdue RevPAR growth in the near future. In addition, it is worth mentioning that Lisbon Portela Airport reached a record 29 million passengers in 2018 and is currently operating at full capacity, therefore limiting the number of arrivals.

As we predicted in last year's report, the FIFA World Cup was a major boon for the Russian markets, especially **Moscow** which recorded an impressive growth of 8% in euro terms in this year's index, making it to second place after Lisbon. **St Petersburg**, with 6% growth, was ranked in sixth position, just a step away from entering the top five (in euro terms). However, in local currency, the growth recorded for both markets was even more pronounced (both in double figures and in the top five) given the softening of the rouble against the euro following further US sanctions in April. The main driver behind this incredible performance was of course the FIFA World Cup being held in Russia from 14 June to 15 July (and the extra demand from workers, players and tourists in the few weeks before and after the tournament), resulting in outstanding RevPAR growth in Moscow for both months of more than 180% in euro (more than 195% in local currency).

Half of our index, 17 out of 33 European markets, have reached their previous hotel value peaks

Top and Bottom Five

PERCENTAGE CHANGE IN HOTEL VALUES IN EURO



Source: HVS – London Office

Already a popular summer destination, St Petersburg benefitted less than expected from the World Cup (although it still achieved strong RevPAR growth in euro of 30% in July). However, the city managed to achieve overall RevPAR growth of 6% in euro in 2018 on the back of very strong average rate growth, somewhat at the expense of occupancy. Owing to the international exposure Moscow gained from the World Cup and the short-term impact of the tournament, the city achieved an impressive average rate increase of 20% (in euro). Not all of the supply planned for 2018 materialised, with some projects delayed and others put on hold; however, more than 2,900 rooms have entered the market in the last two years. Following this substantial increase in room supply, and with no major international events planned for 2019, we remain reasonably cautious regarding Moscow's future performance.

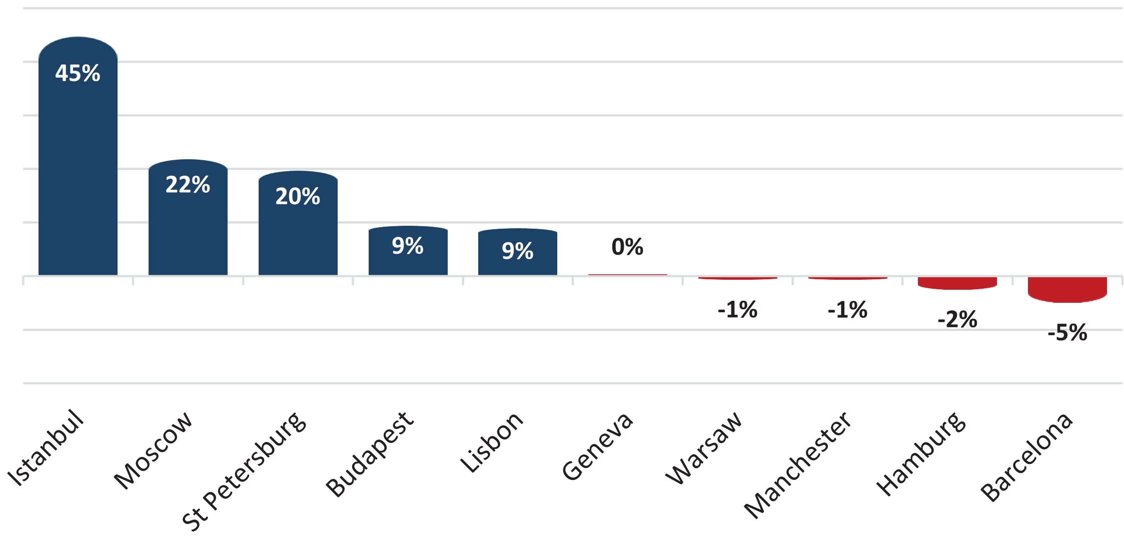
The capital of France returned to the top five growers in this year's index. The recovery from some slower years following the terrorist attacks, increased perception of security and strong momentum in arrivals and overnights resulted in spectacular growth in hotel performance for **Paris**, with values per room up by 7% in 2018. However, there is still potential for further growth as RevPAR remained 17% below its previous peak in 2014 (nominal terms). Although the Parisian market enjoyed 11 months of impressive growth until November, RevPAR levels dropped in December due to the disruption caused by the gilets jaunes movement in the capital, which forced the closure of several businesses and tourist attractions. While Paris hotel supply has remained relatively static over the past two years, the improved performance and recovery of the market have attracted more investors and developers to the city, boosting the pipeline with more than 3,200 rooms planned for central Paris over the next three years.

Much like Paris, **Brussels** experienced another outstanding year following the decline resulting from the terrorist attacks. The city registered a 7% rise in values per room in 2018, powered by increases in both occupancy and average rates. The terrorist attacks in March 2016 had a negative effect on visitation resulting in an 18% decrease in RevPAR for the market that year. Although 2017 already saw some signs of recovery, mainly owing to business demand generated by various EU entities based in the city, 2018 finally saw the return of the leisure segment to Brussels, resulting in an overall year-on-year increase in visitation of 10.5% (year-to-October). Given that hotel supply in Brussels remained broadly stable from 2011 to 2018, with a 1.3% compound annual growth rate, and that there are currently just a few proposed hotels in the pipeline for the next three years (1.5% of the current supply), we remain optimistic about the future trading performance of this market.

After two years of relative stability, **Berlin** recorded an impressive 7% growth in hotel values in 2018. Owing to its strong focus on creative industries, start-ups and student population, as well as benefitting from a strong MICE market, Berlin's popularity continues to grow apace. The city boasts an impressive pipeline of new projects, and in 2018 more than 1,300 rooms entered the market. This new supply has been compensated by a remarkable increase in arrivals and bednights of 4% and 5%, respectively, year-to-November. Looking forward, the hotel pipeline is likely to remain strong, putting further pressure on the existing hotels as well as on infrastructure and, most notably, airport operations in the short term. However, despite this new supply,

Top and Bottom Five

PERCENTAGE CHANGE IN HOTEL VALUES IN LOCAL CURRENCY



Source: HVS – London Office

the long-term forecast looks positive for the German capital, with the much-anticipated opening of the new Berlin Brandenburg Airport (further delayed until 2021), which should help capacity issues and boost the city's appeal.

When looking at the top markets in local currency, there is one city that stands out from the rest: **Istanbul**. Following a severe RevPAR decline of more than 40% (in euro) 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 and 2018 a year of further growth, especially in local currency (+45%), with more moderate growth in euro terms (+4%). The Turkish lira depreciated even further in 2018 (-30%) and boosted demand to Istanbul, mainly driven by visitors from Russia, Asia and the Middle East who now perceive Turkey as an affordable destination. This rebound in visitation led to RevPAR growth of more than 20% in euro (more than 70% in local currency). There is still a long way to go before reaching its peak levels in terms of hotel values; however, the soft opening of Istanbul's new airport in October 2018 (full opening planned for March 2019) and a continued recovery in visitation will play a major role in revitalising the city. In addition, developers' interest has continued to revive and more than 2,800 rooms (5% of the current supply) are planned to come into the market in the next two years.

Finally, **Budapest** also made it into our top five markets in local currency. The CEE region continues to be of utmost interest for international investors, who see it as an opportunity to leverage attractive yields. The Hungarian economy has been growing steadily since 2013, with GDP growth reaching 4% in 2018, one of the highest in the EU and ahead of countries such as the UK, France and Germany. In the past three years, Budapest has seen a significant increase of more than 12% in visitation, which translated into phenomenal RevPAR growth of close to 9% in 2018 in local currency, with rate levels reaching new peaks (nominal prices). Visitation to Budapest is mainly driven by international travellers, who accounted for more than 85% of the total number of visitors in 2018. Going forward, an extensive pipeline and other challenges similar to those of other CEE countries, including the shortage of qualified personnel, will certainly have an effect on the trading performance of the city.

Challenged Markets

The combination of increasingly protectionist political movements and socio-political instability, the economic deceleration of the Eurozone and strong supply growth all led to the decrease in values per room for several relatively mature European cities in our index, including Barcelona, Hamburg and Geneva. Manchester and Stockholm complete the euro 'losers' list. In the local currency table, Warsaw occupies Stockholm's place, which appears near the bottom of the euro list mainly due to currency dynamics.

Barcelona... where do we start? It's not surprising that an all-time favourite like Barcelona had a challenging 2018. The city enjoyed eight consecutive years of RevPAR growth until 2017, mainly due to increased demand and popularity as well as the introduction of the hotel moratorium in May 2015 which limited new supply to the market and was therefore beneficial to the performance of existing hotels. However, it cannot be all sunshine and roses, and in 2018 the city was badly affected by the instability generated by the Catalan independence movement. The civil unrest and demonstrations that followed the 1 October 2017 Catalan Independence Referendum had a direct impact on tourism and resulted in performance declines for 2018. Although occupancy levels remained stable during this period, this was to the detriment of average rate, which dropped by around 4%. The conference segment was the most affected as events tend to be booked some time in advance and several chose a more stable destination. There is still a palpable fear that sustained political instability will continue to negatively affect the Catalan region and Spain overall. Nonetheless, Barcelona remains one of the most successful European short-break destinations and is likely to stay as such over the years to come, regardless of the political and governmental changes that may lie ahead.

A surprise in this year's bottom list is **Geneva**, which was classified as the third worst performing market in euro terms. It also found itself in the local currency bottom list, although it registered a 0.3% growth in values, showing a somewhat stable performance rather than declining as a result of the currency dynamics. Geneva benefits from relatively stable business demand throughout the week; however, the hotel market continues to suffer from its inability to capture the leisure segment at weekends and on public holidays. Hotel supply has remained broadly stable in recent years and the market is predominantly occupied by luxury and upscale products. However, 2017 and 2018 saw the addition of several economy and midscale properties, which have put pressure on the market and resulted in a reduction in average rates in local currency of around 2% in 2017 and 5% in 2018.

The German markets have always been known for their stability as even during the global financial crisis they maintained a relatively constant performance. As such, **Hamburg**'s inclusion in this year's bottom list has been yet another revelation. It is the result of substantial new supply putting pressure on occupancy and rate levels, taking RevPAR down by 2.5% in 2018. However, the market remains firmly in investors' sights; Hamburg had Germany's highest volume of individual property transactions in 2018 with a total of eight single hotels exchanging hands. The Reichshof Hamburg, which transacted in October 2018 for €100 million (€360,000 per key), was the third highest per-key transaction in Germany for the year. For further details on Europe's hotel transactions, please refer to our sister publication *2018 European Hotel Transactions*.

ISTANBUL: BACK ON TRACK?

This is the second year in a row that **Manchester** has been featured in our 'losers' list, for much the same reasons as last year. In a euro currency analysis, Manchester recorded a decrease of 2% in values per room, while values remained fairly flat (-1%) in local currency. Although the city maintained a very strong occupancy level of around 80% for the fifth consecutive year, average rates stagnated in 2018 as a result of a substantial increase in hotel supply (12% of total supply since 2017), similar to other UK markets. However, we remain confident in Manchester's ability to absorb this additional room supply and recover rate levels. In addition, the overall UK hotel market remained strong throughout 2018 despite the proximity of the official Brexit date in March this year.

Transactions in 2018 exceeded 2017 levels by £800 million in the UK, being the most liquid market in Europe again, and demonstrating strong investor interest despite political uncertainties

Stockholm is one of those markets that was significantly impacted by currency dynamics in 2018. Although the city recorded a 2% value increase in local currency, it was classified as the second worst performing market in euro terms. The central bank of Sweden's decision to maintain a negative interest rate of 0.25% in 2018 further weakened the Swedish krona against the euro. The complications recently faced in creating a government have resulted in certain political instability in the country and may have impacted Sweden's international reputation. A substantial number of new hotels entered the market in 2017 and 2018; however, RevPAR levels have remained fairly stable, affording Stockholm its long track record and solid growth in business and leisure demand.

Warsaw, which is ranked in the sixth worst position in euro terms, enters the local currency list in fourth worst position following Stockholm's recovery in Swedish krona. After three consecutive years of growth, 2018 was a difficult year for the Polish capital. Like the challenges faced by other European markets, the 1,100+ additional rooms (8% of current supply) that entered the market in 2018 put pressure on the top line and resulted in a slight drop in occupancy while average rates remained fairly stable. Due to these occupancy and rate dynamics, the hotel market registered a drop in RevPAR of around 4% (local currency) for the year. Going forward, an additional 2,600 guest rooms are expected to open in 2019 and 2020. This is testament to the growing interest from investors in this market (while challenging performance in the short term).

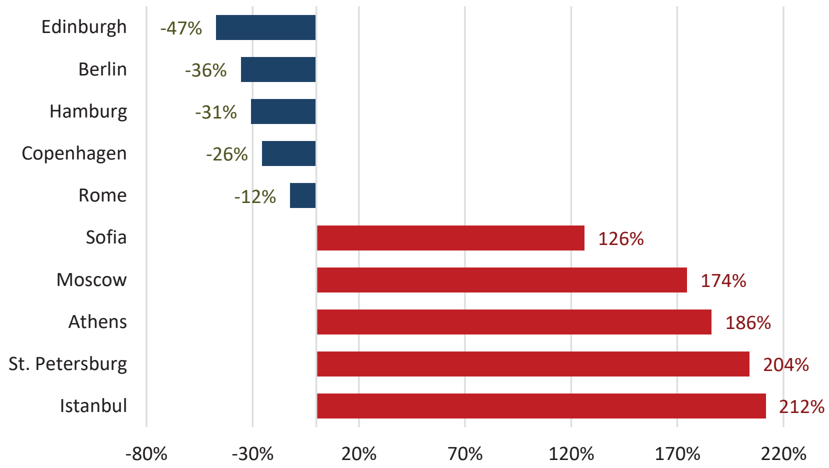
Volatility Index

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, Sofia has a volatility index of 126%, which means that hotel values are 126% 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 are 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).

The following chart shows the five most and five least volatile European markets over 10 years (2009-18) in local currency (to remove the impact of currency fluctuation) with Europe as a whole set at 0%.

Volatility Ratio

2018



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

Source: HVS – London Office

The most volatile markets remain largely the same as those presented in the 2018 HVI, except for Istanbul that entered the list (replacing Madrid) in first position. As a result, St Petersburg and Athens were pushed back to second and third position owing to their value recoveries over the last couple of years. Additionally, Moscow remained the fourth most volatile with Sofia following in fifth position. In terms of the least volatile, Edinburgh (which was not present in 2018) topped the list, pushing back Berlin, Hamburg and Copenhagen. Rome replaced Paris in fifth place due to the challenges the French capital has faced in recent years. As shown in the graph, hotel markets with 'stabilised' values per room, such as some German markets or Copenhagen, are unlikely to fluctuate much, while markets such as Athens, St Petersburg or Moscow, which have seen significant changes in value over the last decade (declines in value followed by strong recoveries), show larger-than-average variations as they tend to revert to their fair values.

Outlook

Sure, Brexit is THE big unknown force lurking out there. And, yes, wobbles in the stock market in December, increasing interest rates, ongoing trade disputes and slowing GDP growth in Europe also contribute to a somewhat pessimistic outlook. But at odds with all this, demand for hotel accommodation remains vigorous across most markets. So, while it might be true that economic growth for this cycle is past its peak, it would be too dramatic to expect hotel demand to suddenly fall away. Furthermore, new supply remains modest (except for some active pockets, such as London, Manchester and various German markets), which should prop up fundamentals, even in the event of diminishing demand volumes.

Across the pond, the USA is seeing moderating economic growth. This doesn't, however, mean that the Fed will walk away from further interest hikes in 2019. The Bank of England or the European Central Bank walking this path seems unlikely given the regional circumstances. Perhaps low interest rates will indeed remain the European reality for a bit longer after all?

As we ponder the impact of eventually rising interest rates versus strong cash flow performance, and consider the impact of these factors on the risk premium, it is ever more likely that increasing interest rates will be the part of the equation we need to focus on the most in the short to medium term as that will likely mean upward pressure on cap rates. The likelihood of serious changes on this front should, however, remain low if no economic downturn materialises.

So that might be that, but surely the ever-growing amount of capital chasing deals has resulted in pricey assets, which challenge the equilibrium of risk/reward, even more so if economic slowdowns or cost pressures were to be modelled in. So where/what are investors focusing on? Think conversion and repositioning opportunities with clear upside in Western Europe, some resort destinations will also suffice and, yes, there are the CEE countries – see the recent acquisition by AccorHotels of the Orbis portfolio, or international brands' increasing appetite for opportunities in these markets.

An early sense in the USA that larger upside opportunity deals with strong returns are gone (might the Lone Star Real Estate VI fund be the precursor to 'small is beautiful'?), there are still opportunities in Europe in the non-performing loan space (6.5% of loan ratio for European banks, compared to 1.1% in the USA). US opportunity funds are keen buyers, and 2019 could be another big year for these deals, especially for Southern European markets. The Dogus portfolio is one recent high-profile example.

Meanwhile, there are always exciting innovations and disruptors ready to challenge preconceived notions of the hospitality 'model'. In addition to the continued growing interest in hotels' alternative concepts – hostels, serviced apartments, co-living, co-working, extended stay, student accommodation, you name it – there are further optimisation opportunities with technology. Exploring voice-search capabilities, AI-based advertisement, or self-check-in kiosks are some of the options. Ikea is starting to lease out office furniture in Switzerland – maybe hotel furniture is next? Rather more radically, Alibaba Group has recently unveiled its take on the 'hotel of the future', the FlyZoo. This hotel will be mainly operated by robots, with a high reliance on facial recognition technology (although humans will still clean the rooms!).

Acquisitions remained stimulating in 2018, as AccorHotels purchased Mövenpick (to name just one of its recent acquisitions), LVMH is now the proud owner of Belmond and IHG bought Six Senses. Strategic alliances were another value-enhancing approach, such as the partnership between Shangri-La Hotels & Resorts and Ctrip, the Chinese integrated travel services company. This allows Shangri-La to promote all of its hotels on Ctrip's platform, hence gaining substantial exposure to the Chinese market.

The bottom line? Go out and find the deal for you; there are still some good ones waiting. However, consider risk/reward in the current context, put in place a solid financial structure and ideally factor in a slightly longer exit window. Yes, there is opportunity, there always is, but 'caution' is the word of the day! Strategic thinking is as important as ever – or even more than ever.

– HVS –

Understanding the HVI

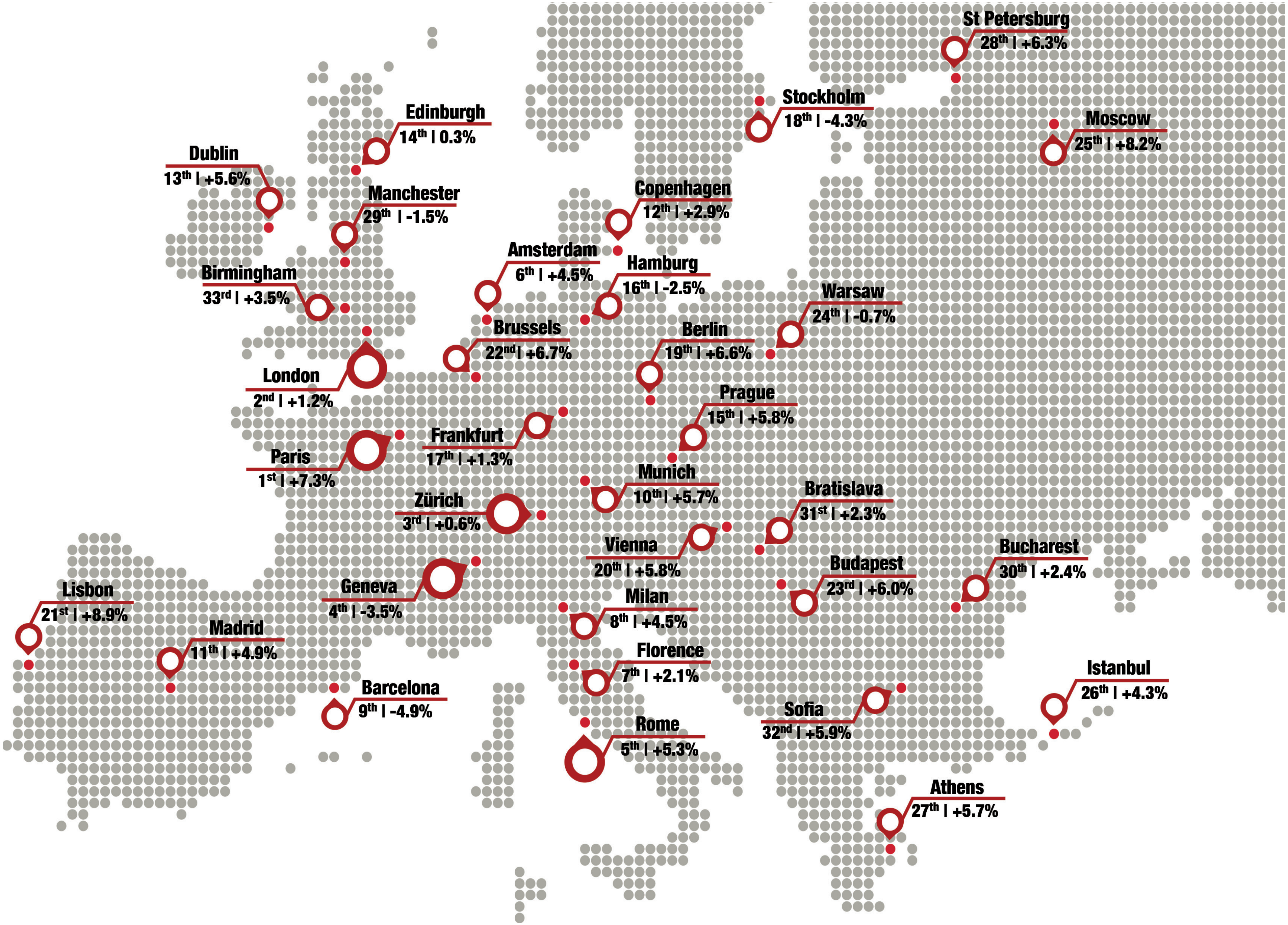
The HVI is a hotel valuation benchmark developed by HVS. It monitors annual percentage changes in the values of typically four-star and five-star hotels in 33 major European cities. Additionally, our index allows us to rank each market relative to a European average. All data presented are in euro, unless 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 2018 is therefore reflected in the capitalisation rates used and investment yields assumed.

The HVI assumes a date of value of 31 December 2018. 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 (€)



HVS

About HVS

HVS, the world's leading consulting and services organisation focused on the hotel, mixed-use, shared ownership, gaming, and leisure industries, celebrated its 35th anniversary in 2015. 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 60 offices and more than 500 professionals, HVS provides an unparalleled range of complementary services for the hospitality industry. HVS.com

Superior Results through Unrivalled Hospitality Intelligence. *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.

About the Authors

Magalí Castells is a senior associate at the HVS London office. Before joining HVS, Magalí gained operational and real estate development experience in Barcelona, Spain. She speaks English, Spanish, Catalan and French and holds an MSc in Hospitality Business from Ecole hôtelière de Lausanne. Prior to gaining her master's, she graduated with a bachelor's degree in Business Administration from ESADE Business School, Barcelona, with a focus on finance and real estate. Magalí has been at HVS for more than two years, in which time she has advised on several hotel valuations and feasibility studies throughout different markets within Europe.

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.