Guest Editorial

European hotel industry performance in 2008

Journal of Retail and Leisure Property (2009) **8**, 153–158.
doi:10.1057/rlp.2009.6

As part of our series of quarterly papers, which aim to observe the latest trends in key hotel industry sectors, this editorial presents a snapshot of current trends in the market with regard to values, acquisitions and disposals, as well as funding and development. The snapshot is drawn from two of Hotel Valuation Service (HVS's) core annual papers.

HVS's European Hotel Valuation Index (HVI, written by Adamantia Phoca and Tim Smith) is an annual review of European hotel value trends. The survey shows that hotel values dropped heavily, decreasing by 10.8 per cent in 2008, compared with an increase of 2.6 per cent in 2007. Values per room decreased almost across the board with only a few exceptions.

HVS's European Hotel Transaction Review (written by Cristina Balekjian, Elke Geierregger and Saurabh Chawla) analyses the single asset and portfolio hotel transactions that shaped 2008. The review highlights a major decrease in the volume of portfolio transactions and analyses the impact of the global economic downturn on hotel investment. After maintaining high levels of investment in 2007, transactions activity dropped by two-thirds, to just over €6 billion, in 2008.

The London office of HVS annually publishes the HVI and the European Hotel Transactions Survey. The former monitors annual trends in the values of, mainly, four-star and five-star hotels in 36 major European markets. In addition, it ranks each market relative to a European average and reports the average value per room. The latter records all single asset and portfolio transactions in Europe above €7.5 million, the minimum amount set for a transaction to qualify for inclusion in our survey, and provides buyer profiles for both single asset and portfolio transactions.

The year 2008 will be remembered for being the year of two halves. The first half continued in much the same way as 2007, only to collapse towards the end of the year. The impact of the worldwide credit crisis and the associated lack of confidence cannot be overestimated. The lack of available debt has dramatically reduced the number of transactions, which, in turn, has made purchasers more cautious and therefore depressed values further. Provided that many of these factors ease in 2009, some of the loss in value may be reversed during the year. The year 2008 continued to showcase the momentum of the European hotel market, even with the inclusion of additional Eastern European markets, when compared to other real estate classes. The top-five set of the most

Figure 1: Total European hotel investment volumes 2000–2008 (€ billions).¹

expensive European cities in which to buy a hotel contains many of the same players as previous years. Our analysis of values per room in euros (Figure 1) shows that Paris has regained the top spot at €566 200 per room. Riga and Tallinn remain at the bottom of the index with values per room of €95 200 and €95 900, respectively.

As shown in Figure 1, after a record year in 2006, in terms of the volume of hotel investment, activity in the European hotel market declined by approximately 7 per cent in 2007. In 2008, it fell back enormously to just over €6 billion, a drop of two-thirds.

We have seen declining hotel investment activity earlier, the last time in 2002, when the European hotel market dropped as a consequence of the 9/11 attacks in 2001. In the European Hotel Transactions report published in 2002, HVS noted a drop of more than 50 per cent in hotel transactions from the 2001 levels. However, this was primarily driven by plunging values as a direct result of inferior hotel trading performance leading to a gap in the asking and bidding prices. The decline was relatively short-lived, and thus transaction volumes started to increase again in 2003.

At the time that this report goes to print, the situation remains severe and deep. Banks have almost turned off the lending tap allowing only a few dribbles here and there. For those lucky enough to secure funding, the borrowing is a lot more expensive, which in turn affects their financial leverage. This, combined with overall poor economic growth and a bleak outlook for many EU countries, has also led to inferior hotel trading performance, further impeding transactions from all angles.

Within single asset investment, the profile of buyers has also seen a more balanced spread of investment among the different investor types, with real estate investors rising to the top of the single asset investor table. We expect the presence of high net-worth individuals and institutional investors in hospitality investment to increase in the future. We also expect to see the emergence of Sovereign Wealth Funds (SWFs) from the Middle East as these begin to diversify their portfolios and invest in hotels in the West. When we consider portfolio transactions, we note a shift in the main investor type when compared to the previous year. We note the resurgence of hotel operators as one of the main prevailing contenders, even though private equity funds remained one of the top investors in terms of portfolio investment volumes. However,

private equity funds, with their highly leveraged buyouts, will find it increasingly difficult to remain at the top in the current economic climate.

HOTEL VALUES

The Europe-wide decrease in value of 10.8 per cent and increase in yield of 42 basis points is not as great as some might have expected or indeed predicted for 2008. It is probably of no surprise that the top-five performers include the two Swiss cities of Zürich and Geneva, with high barriers to entry and stable economies, and Brussels, which is becoming even more dependent on the EU, but also benefits from improved transport links. Istanbul has shown significant growth, mainly because of the high-quality accommodation that has recently been opened, the increase in visitation and the greater diversification of its feeder markets.

Figure 2 shows that in 2008 Geneva had the greatest percentage growth in value, at 17.3 per cent.

Values per room in Istanbul grew by 10.8 per cent to €345 700, the second strongest percentage value growth in 2008.

Zürich experienced the third strongest value growth at 5.6 per cent, resulting in a value of €436 200 per room, overtaking Rome and Milan.

The top two most expensive cities in which to acquire a hotel have swapped places. Paris has moved into the number one spot in our value per room rankings, despite dropping to €556 200 in 2008, a decrease of 5.9 per cent. Values per room in London have also dropped, reaching just €479 600; this 23.1 per cent drop in value was caused by the double impact of a weakened currency (the drop is only 11.3 per cent in sterling) and deteriorating trading conditions. Geneva jumps to third place, having overtaken Moscow, Zürich, St Petersburg, Rome and Milan, reaching €463 700 per room.

At the other end of the table, Tallinn (€95 900) and Riga (€95 200) have switched places as the bottom two in the rankings, whereas Lisbon (€147 500), Birmingham (€155 100), Frankfurt (€155 000) and Manchester (€168 700) are among the poorest performing Western European markets.

Figure 2: Top and bottom five 2008 – Percentage change in hotel value per room (€).²

HOTEL ACQUISITIONS AND DISPOSALS

As shown in Figure 3, in 2008 HVS recorded a total of 77 transactions involving single hotel assets, each of more than €7.5 million, the minimum amount that we have set for a transaction to qualify for inclusion in our survey. Although the number of hotel deals in 2008 started off at levels similar to those of the previous year, we noticed that the market began to decline after the summer months through to the end of the year. As the year unravelled, the world moved further into the economic downturn, which unsurprisingly had an effect on the number of deals made in the hotel sector, turning it into a weaker investment market. In general, there was a decrease of a third in the number of transactions in 2008. (The number of transactions in 2007 was 117.) While in 2007 we saw a shift from single asset investment to portfolios, the case for 2008 differs quite significantly. With banks reluctant or unable to lend, financing became an enormous obstacle for any larger deal in single asset and portfolio activity. As a result of the general deceleration in activity, we have seen a decrease of 7.3 per cent in the average price per room, reaching a total of €217 000. In 2006 and 2007, we saw a number of trophy assets being traded for a per-room price above €900 000, including the Four Seasons Milan (€1.7 million per room), the Chateau de Bagnols in France (€1.2 million per room) and Blakes in London (€999 000 per room). In 2008, on the other hand, we have seen only one such transaction: the sale of the JW Marriott Capri Tiberio Palace Resort & Spa (€993 000 per room).

Although the absolute number of portfolio transactions has reduced from 52 to 24, roughly half, the average deal size has also drastically reduced. Between 2003 and 2007, the average number of hotels per deal was 28; this average decreased to a mere eight properties per deal in 2008. Notable exceptions include 39 properties across Sweden and Finland acquired by CapMan, the acquisition of 16 Italian hotels by Blackstone, and Whitbread snapping up 21 Express by Holiday Inn properties across the United Kingdom.

The highest value per room in 2008 was achieved by the sale of the JW Marriott Capri Tiberio Palace Resort & Spa on the Mediterranean island of Capri, in Italy. The Italian real estate company, Aled SpA, acquired the luxury resort for approximately €61 million, or €993 000 per room, under a sale and leaseback agreement.

Figure 3: European single asset transactions 1997–2008.¹

FUNDING AND DEVELOPMENT

Despite the transactions market being relatively sluggish last year, European assets, in general, remain a major attraction for investors all over the world. The credit crunch has not affected investors' preference to look abroad for suitable assets, rather than in the country where they are based. We expect that investors, today more than ever, will take an opportunistic view and look for the best deal available, even if it means forfeiting the ease of buying closer to home.

It is widely expected that SWFs will play a more important role over the next few years. SWFs are defined as pools of money derived from a country's reserves, which are set aside for investment purposes that will benefit the home country's economy. Very often Middle Eastern funds are organised as SWFs. For example, 2008 witnessed the sale of 50 per cent of the Jurys Inn group to Oman Investment Fund by Quinlan.

CONCLUSIONS AND OUTLOOK

In contrast to 2007, when we saw an increase in large-scale investment made by private equity funds, as hotel operators continued their move away from asset ownership, 2008 has seen some return of hotel operators as buyers, as well as an increase in activity from institutional and other real estate investors. The increase of hotel operators in the hotel investment arena demonstrates a clear strategy for growth by investing in existing properties. Interestingly enough, Travelodge came up with a rather novel idea of acquiring hotels through a campaign to the public, by offering, through its website, £500 per room upon introduction to a possible hotel site.

There is no question that since the last quarter of 2008 we have entered a period of recession. The question is: how long will it last? Many operators traded well and close to budget until autumn 2008. However, with the basic valuation formula of passing net income levels over initial returns in mind, it is evident that both factors are putting negative pressure on resulting values, as the former decreases and the latter has started to move out. It will certainly be interesting to watch the direction and the percentage change of these components during 2009. However, we strongly consider that the much-feared further fall in values during the next 12 months can be contained to a large extent once we see a freeing of the financial restraints and a subsequent increase in transactions and investment appetite.

The trend for the year ahead is de-leveraging and investing in prime locations, established markets and good-quality products. Development prospects remain high, especially for many emerging markets, although it seems that they will have to be postponed for a few months. Overall, the HVI 2009 shows an ever-increasing maturity of the European hotel market and that interest in developing and operating hotels across the whole continent continues. Values generally remain well ahead of those recorded in 2000. Long may it continue, and we will look forward to the rest of 2009 with fascination and anticipation.

The situation of investors in 2008 was similar to that of a 'deer in headlights', where they were shocked and somewhat confused to see the events unfold, and found it impossible to decide on how best to react. As

we now move through 2009, the outlook appears to be more encouraging, especially for the latter part of the year; however, it will be some time before the scars from the current economic climate begin to fade. And, we suspect, things have to worsen still before the hotel transaction market in Europe gets appreciably better.

REFERENCES

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