Regular Feature

Hotels

European hotel industry performance 2006

Received (in revised form): 30 March 2007

Elke Geieregger

is Research Analyst with HVS International's London office, specialists in hotel valuation and consultancy in Europe, the Middle East and Africa. She holds a BA (Hons) in tourism management and is a part-qualified member of the Chartered Institute of Management Accountants (CIMA).

Elana Bader

is an Associate with the London office of HVS International. She joined the firm in September 2005 after completing a BSc in hotel administration at Cornell University.

Abstract

As part of our series of quarterly papers, which aim to observe the latest trends in key hotel industry sectors, this edition presents a snapshot of current trends in the market concerning values, acquisitions and disposals as well as funding and development.

Keywords:

European RevPAR, hotel values, hotel investment activity, hotel yield trends

Journal of Retail and Leisure Property (2007) **6**, 263–268.

doi:10.1057/palgrave.rlp.5100058

INTRODUCTION

HVS International annually publishes the European Hotel Valuation Index (HVI) and the European Hotel Transactions Survey. The former monitors annual trends in the values of, mainly, four-star and five-star hotels in 28 major European markets. Additionally, 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 €7.5m, 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 2006 was a breakthrough year for all of the markets involved in our HVI survey with no decreases in value per room recorded. All but eight markets have either reached their highest ever values or surpassed the high values achieved in 2000. The top five most expensive European cities in which to buy a hotel remain in the same order for the third

Elana Bader
HVS International
7-10 Chandos Street
London W1G 9DQ, UK
Tel: +44 (0)20 7878 7747
Fax: +44 (0)20 7878 7710
E-mail: ebader@hvs.com

consecutive year. Our analysis of values per room in euro reveals that London remains at the top with a value of €576,700 per room. Warsaw remains at the bottom of the value table at €119,900 per room, with Athens narrowly overtaken by Lisbon and slipping down the rankings to €135,600 per room.

As shown in Figure 1, the European hotel investment market moved from 'top gear into overdrive' in 2005 when comparing it to the activity seen in 2004. In respect of 2006, the market has not only maintained the momentum of 2005 but has, in terms of the total investment in hotel assets, surpassed it by almost 30 per cent and recorded more than double the volume of 2004.

The main ingredients responsible for this record volume include positive global economic conditions, an era of all-time low cost of debt, significant above-inflation growth in average rate and RevPAR, an ever-increasing pool of investors with seemingly insatiable appetites, the continued divestment of assets by operators and the acquisition of Hilton Group by Hilton Hotels Corporation.

The largest transaction by far in 2006 was the marriage of the two Hilton companies, at €4.8bn. This transaction alone accounted for nearly a quarter of the total transaction volume and together with a number of smaller portfolio acquisitions put hotel operators at the top of the list of investor types in 2006 with a total share of 34 per cent of transaction activity. Considering the divestment of assets of operators over recent years, one might, however, reasonably expect to see some of these assets returning to the market in the near future under sale and leaseback or sale and manageback agreements.

The strong flow of money into the European hotel market is coming in from all directions. Investors from the USA are being enticed by the greater differential achievable in Europe between the cost of debt and hotel yields than is currently available to them at home. Middle Eastern investors increasingly view hotel assets as something to invest their petrodollars in. Asian investors continue to see investment in Europe as a lower risk alternative to their own region, and the Europeans continue to embrace pan-European investment made ever easier for them by the

Figure 1: Total European hotel investment volumes 1999–2006 (€ millions)¹

expansion of the European Union and the impending expansion of the Eurozone.

HOTEL VALUES

Hotel values of 2007, expressed in euro, achieved a third consecutive year of growth. On average, values across Europe increased by 9.4 per cent in 2006, compared with an increase of 5.0 per cent in 2005. It is the first year in which all of the 28 markets covered in the index experienced increases in value since 2000, reflecting the health of the industry throughout Europe. The European average hotel value is now at its highest in the 14 years recorded by the HVI.

The European average is boosted largely by the extraordinary growth in value by the top markets, including London, Paris, Milan, Zürich and Geneva, as well as the strengthening of the remaining markets. All but two of the 28 markets under review achieved value increases in excess of inflationary growth. Only Prague and Hamburg showed little growth.

Values per room now exceed the peak of 2000 with the exception of eight of the 28 markets (Barcelona, Brussels, Copenhagen, Frankfurt, Hamburg, Madrid, Stockholm and Warsaw) although Brussels and Copenhagen have come close. Figure 2 shows that in 2006, for the fourth time in the last five years, Moscow had the greatest percentage growth in value, at 21 per cent.

Hotel values in Amsterdam had the second highest percentage growth in value in 2006, at 16 per cent, after the recovery in 2005 that followed four years of declining values. Amsterdam hotels now have an average value of €304,000 per room.

Lisbon has pushed itself up to third place on the growth table with an increase of almost 15 per cent over 2005, followed closely by Warsaw in fourth place (15 per cent). Nonetheless, Lisbon has the third lowest values per room at €139,300, followed by Athens (€135,600) and Warsaw (€119,900).

Figure 2: Top and bottom five 2006 — percentage change in hotel value per room²

Perhaps unsurprisingly, the top four most expensive cities in which to acquire a hotel remain the same. London is beginning to edge towards the €600,000 per room barrier, with the average value per room now at €576,700, an increase of 11.7 per cent. Paris, in second place, is only the second market since 2000 to break the €500,000 barrier (€528,200 per room, growth of 9 per cent), surpassing London's value per room last year. The gap between second and third place has shrunk to €61,200 as Milan posts a value per room of €467,000. The gap in value between third and fourth place has increased to €53,200; Zürich shows growth of 10 per cent with values at €413,800 per room.

After only one year with hotel values above the European average, Prague has once again dropped just below the European average value per room at €252,300 per room. Edinburgh (€319,600) has overtaken Rome (€311,000) with the sixth highest value per room, after Geneva (€365,800), while on the other side of the table Athens (€135,600) and Frankfurt (€165,600) have both dropped in the rankings.

HOTEL ACQUISITIONS AND DISPOSALS

As shown in Figure 3, in 2006 HVS International recorded a total of 134 single asset hotel transactions, each of more than €7.5m, the minimum amount set for a transaction to qualify for inclusion in our survey. Although the number of transactions has stayed virtually the same (the figure was 133 in 2005), the average transaction price per room has risen by 18 per cent, to €246,000, compared to €208,000 in 2005. This increase can be explained by the phenomenal price of trophy assets in 2006. In 2005, luxury hotels in top locations, such as The Savoy in London and the Danieli in Venice (which achieved prices per room of €1.2m and €760,000, respectively), and properties such as the InterContinental in Paris drove up the average price. In 2006, the Four Seasons Hotel Milan alone achieved an astronomic €1.7m for each of the luxury property's 118 bedrooms. The Marriott Park Lane Hotel and the Hotel Arts Barcelona achieved prices per room of €964,000 and €863,000, respectively.

Figure 3: European single asset transactions 1996–2006¹

Once again, the strongest driver of total investment volume in Europe has been portfolio transactions, which in 2006 amounted to €14bn. This total surpassed even the considerable investment volume of 2005 (€9.8bn), which in turn exceeded the record levels of 2001 of approximately €8.8bn.

FUNDING AND DEVELOPMENT

European hotel assets attract investors from all over the globe. Cross-border deals continue to be facilitated by the euro, as it has allowed greater transparency and increased the pool of potential lenders and investors seeking to invest in European markets.

In 2006, investor profiles again changed significantly and, surprisingly, hotel operators appeared at top of the list with a share of 34 per cent of the total transaction activity. This is, however, less of a surprise when one considers that the reason for this is largely the Hilton International/Hilton Hotels Corporation (HHC) transaction, which made up 33 per cent of the total portfolio activity and a remarkable 24 per cent of the total investment volume in Europe in 2006. As HHC is a hotel owner-operator, this also influenced greatly the proportion of hotel operators as an investor type. Hotel operators acquired assets worth €6.9bn in 2006, compared to €1.76bn in the previous year.

Despite the large proportion of hotel operators acquiring assets (as a result of the Hilton transaction) in 2006, it is important to appreciate the general trend followed by hotel operators — that of reducing their asset intensity by separating the ‘bricks’ aspect of the business from the actual operation (the ‘brains’). By divesting themselves of hotel assets in return for management (or franchise) contracts, hotel operators gain a considerable sum of capital that can be put towards refurbishment, or used to fund acquisition and development activity in new markets and brands. Alternatively, capital can be returned to shareholders. Asset divestment reduces hotel operators’ exposure to the risks associated with asset ownership. We expect the current trend — the acquisition of hotels by private equity firms and institutional investors — to continue, as more of these deals take place.

When we consider portfolio transactions, the dominance of two principal investor types — hotel operators and private equity companies — becomes apparent; together they accounted for more than 50 per cent of the portfolio values traded in 2006.

CONCLUSIONS AND OUTLOOK

The year 2006 saw an overall increase in total investment value from roughly €15bn in 2005 to more than €20bn, which represents a surge in transaction values of 28 per cent. The main trends in 2006 were a higher proportion of portfolio transactions (now 71 per cent of the total investment value) and an increasing number of investors acquiring properties abroad (foreign capital invested in 2006 was 60 per cent greater than it was in 2005!). Major capital sources are global funds, Middle Eastern investors and US buyers. When considering total investment values, dominating buyer types are private equity companies and real estate investors, both attempting to diversify their portfolios with

the inclusion of hospitality assets (although 2006 was somewhat distorted by hotel companies, in particular the Hilton 'remarriage'). Generally, the structure of hotel ownership is shifting towards companies with a real-estate background and away from pure hospitality companies.

The average European values per hotel room in 2006 have reached the highest levels in history. Propelled by the extremely strong values per room in London, Paris, Milan, Zürich and Geneva, it was also the first year since 2000 in which none of the 28 markets covered in our survey experienced a decrease in value per room. Not only have the debt markets remained competitive, but investors have increased their typical geographic investment boundaries and pushed up activity in areas such as Eastern Europe over the last few years. From next year HVS will introduce more Central and Eastern European markets to the HVI. Initial calculations show that the average value of hotels in Central in Eastern European cities is in the order of €160,000 per room. While this is below the European average, it exceeds the performances of Lisbon, Athens and Warsaw. Growth in hotel values in 2006 in Central and Eastern European capital cities was 6 per cent compared to 12 per cent in the previous year.

The concern of increased availability of debt financing and resulting growth causing oversupply did not quite pan out as thought in early 2006, but the same concern remains for the coming year as markets show no signs of drastic decline.

In 2007 we expect that a lot of the markets will continue the upward trend in hotel values for a further year, albeit perhaps not at the same rate as 2006 or indeed 2005. Lending terms are in all likelihood at their most competitive which would probably not enable there to be further yield compression. Nevertheless, investors' appetite for the hospitality industry in view of recent performance is very likely to push yields slightly further down as many investors compete for each opportunity. Terrorist-led events in recent years have caused a temporary blip and have been followed by generally short periods of recovery, demonstrating the resilience of the hotel guest throughout Europe to such shocks. Unless there is something on a much larger scale, it is reasonable to assume (as most investors do) that terrorism should not have an adverse effect on the main hotel markets in Europe in 2007. In line with last year at this stage (March), the year ahead is promising to be very active in terms of hotel real estate transactions. In the last two years, many large portfolios have been sold and speculators question what else is left to come to the market. Therefore, we expect a greater number of smaller portfolios to be sold and an increase in single asset sales. Some of the owners of recently acquired hotels and portfolios will no doubt seek to maximise the value of their investments by taking advantage of the currently 'hot' trading markets in European hotels.

References

1. Geieregger, E. & Smith, K. (2006). *HVS International's European Hotel Transactions 2006*, HVS International, London.
2. Bader, E. & Bourdais, D. (2007). *HVS International's European Hotel Valuation Index 2007*, HVS International, London.