EUROPEAN HOTELS
INVESTOR INTENTIONS SURVEY 2018

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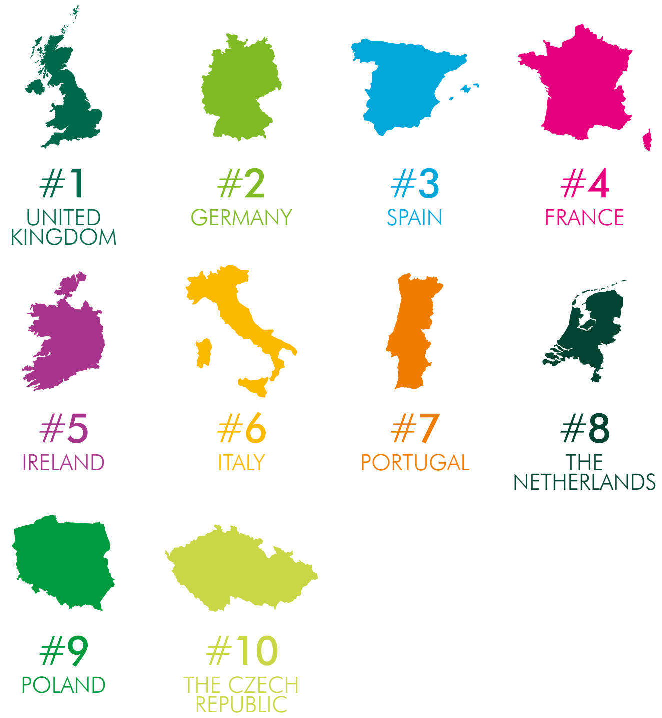
Executive summary

With Europe undergoing a period of prolonged economic and political uncertainty, the CBRE Hotels European Investor Intentions Survey aims to give hotel property stakeholders useful insight into the capital deployment plans of investors in hotel real estate. In doing so, we hope to provide a clearer picture of the future shape of the regional hotel investment market.

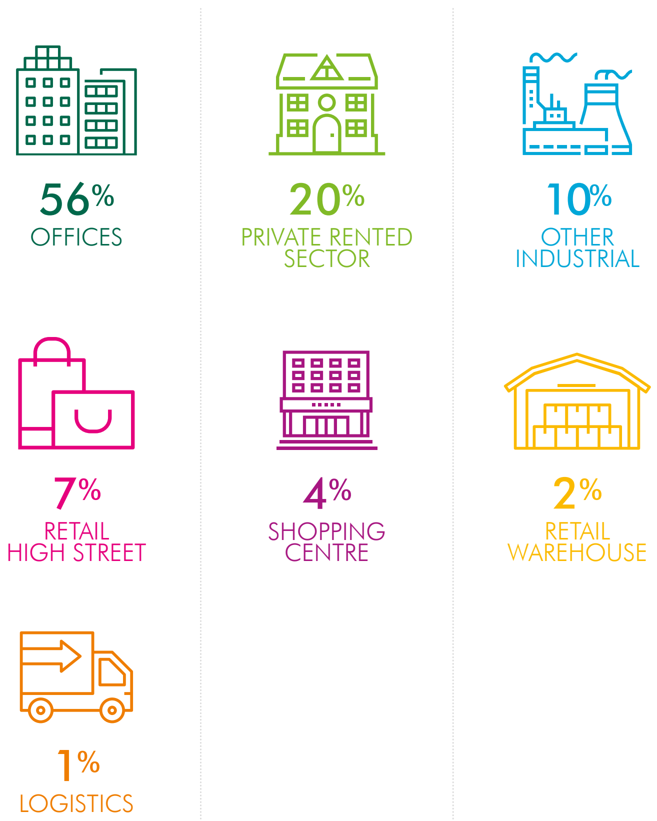
The results reflect the intentions of the surveyed investors, taking account of current and future geopolitical events that include, but are not limited to, Britain's withdrawal from the European Union, Irish and Italian elections and the Catalan independence movement.

We were encouraged to find that an overwhelming majority of survey respondents intend to invest either the same or more capital into hotel real estate in 2018, compared with 2017. This statistic points to the growing attractiveness of hotels relative to other real estate asset classes, at a time when markets are becoming increasingly unpredictable. Such findings are underscored by transactional evidence, notably the successful sales of several major hotel portfolios and operating platforms across the region in 2017. With all indicators pointing to another strong year for European hotel investment in 2018, we seek to answer the key question: which European hotspots will come to the fore? This year's European Investor Intentions Survey was answered by 336 real estate investors, all of whom have a significant interest in the hotel asset class. We would like to thank all our respondents, whose engagement has given us a solid and credible base on which to draw our conclusions.

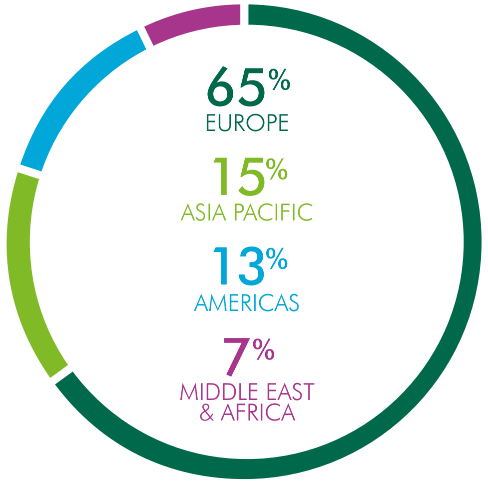
Most attractive countries for hotel investment in Europe in 2018



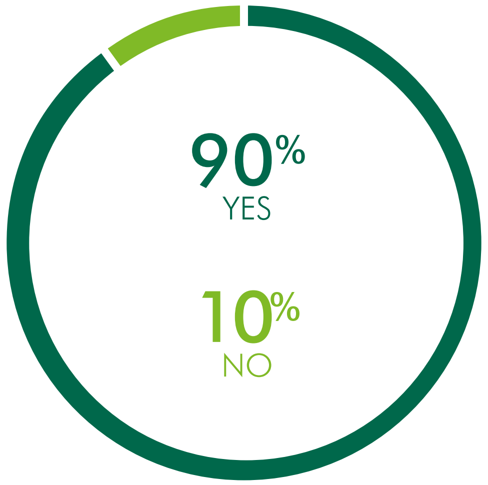
Already invested in other sectors?



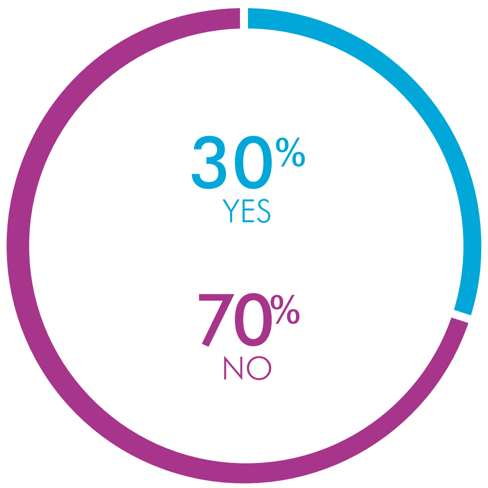
Investor capital originates from



Do you plan to invest in hotels in 2018?



Do you plan to divest of hotels in 2018?



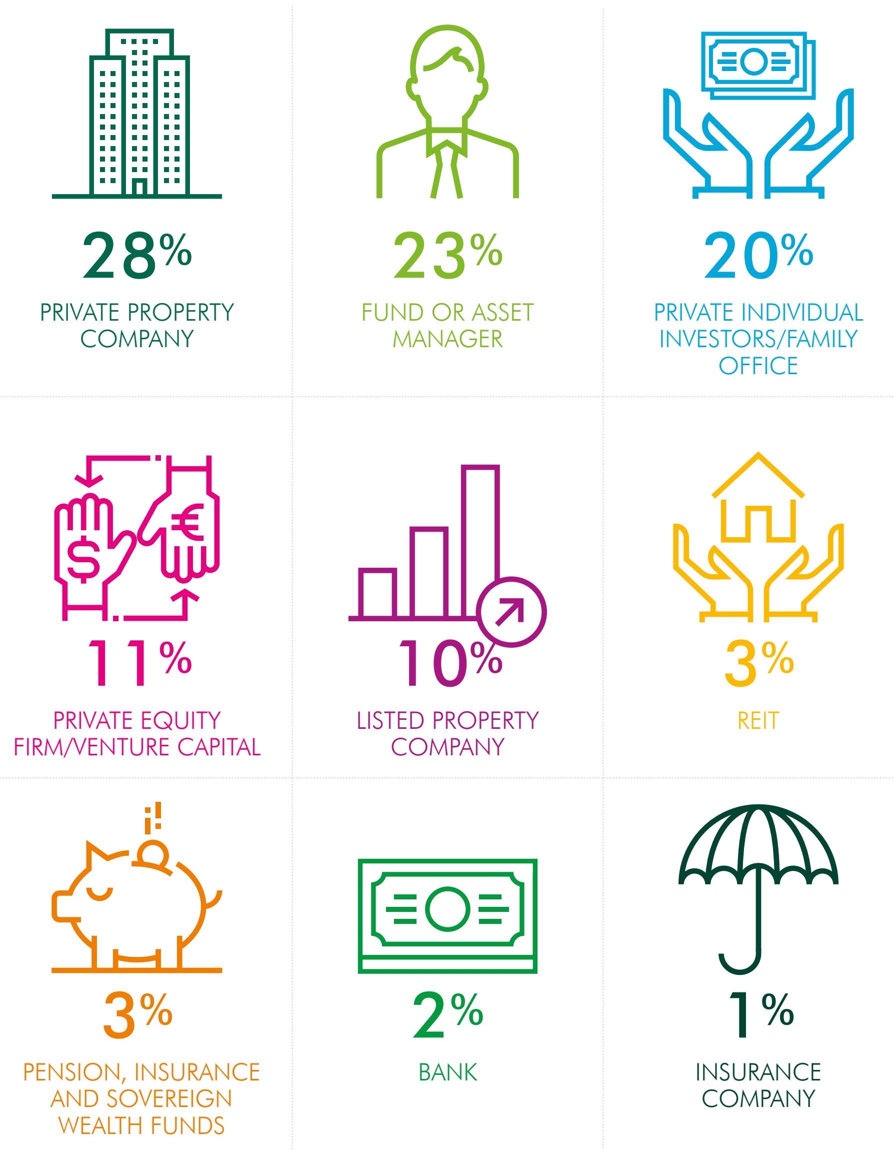
Which business sector best describes your organisation's main activity?

Hotel investors cannot be grouped into one homogenous whole. Capital originates from a variety of sources, which is reflected in our survey sample. Figure 1 provides a breakdown of the different investor groups that responded to the survey.

As with our 2017 survey, a small share of the overall sample is represented by pension funds and insurance companies. Such institutions typically prefer fixed-income real estate. The majority of respondents can be grouped under private equity funds, asset managers and private investors. These types of investors tend to have a much greater appetite for the operational exposure provided by hotel assets, where they see the opportunity to drive returns through enhanced trading income alongside capital value appreciation.

In terms of investment preference, the largest proportion (48%) of respondents opt to invest directly, while partnerships and joint ventures remain popular for portfolio transactions and for investment into hotel platforms, as seen in 2017.

Figure 1



Source: CBRE Research 2018

HOTELS European Investor Intentions Survey 2018

Where does your capital originate from?

We asked investors to tell us where their investible capital originates. The results (figure 2) largely mirror the volume breakdown we have witnessed across the European hotel investment market in 2017.

The most notable year-on-year change is the surge in prominence of European capital within the market. Investors responsible for deploying European funds represent by far the biggest percentage (65%) of the whole sample. This is 23 percentage points up on findings in our 2017 survey. Europe's growth has been gained at the expense of all three other regions, with Asia Pacific down from 18% to 15%, the Americas falling from 18% to 13% and the Middle East and Africa dropping from 11% to 7%. This is due to wider-European economic growth and the homogeneous nature of the investment market, which provides investors with optionality.

We expect capital from Hong Kong, Singapore and other Southeast Asian countries to increasingly dominate flows from Asia Pacific, following a slowdown in Chinese investment due to the imposition of outbound capital restrictions. From the Americas, we expect North American private equity funds to be increasingly active in Southern and Eastern Europe, given the potential for higher rates of return. Among Middle Eastern and African investors, much of the capital will continue to emanate from the Gulf Cooperation Council (GCC) nations despite the relatively low price of oil.

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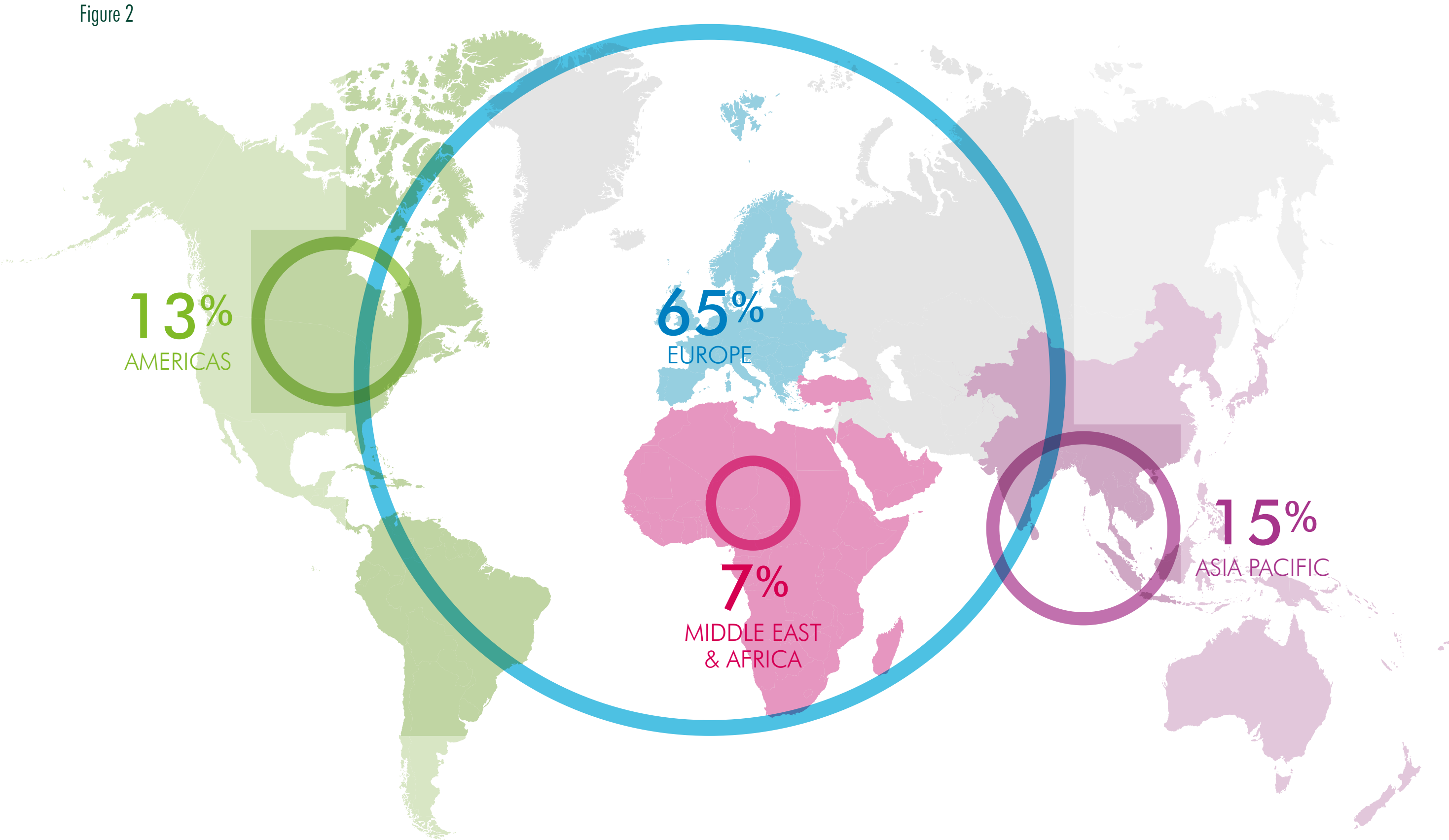
Figure 2



Source: CBRE Research 2018

In addition to hotels, which other sector do you have the greatest investment exposure to?

When it comes to hotels as an asset class, the combination of greater transparency and enhanced knowledge of the sector has brought a much broader investment community into the market. Hotels are no longer viewed as niche investments, suitable only for specialist players. Hotels are becoming increasingly attractive to institutional capital.

By asking our sample about the other real estate assets in their portfolios (figure 3), we can demonstrate the trend towards including hotels as a means of diversifying the portfolio mix. In our survey this year, some 65% of respondents said they also hold investments in the office sector, which is up from 25% in 2017. We note that institutional investors consider fixed-income hotels increasingly attractive to form part of their portfolio alongside other stable, long-dated income streams. If leased hotel stock continues to become more widely available, this trend will surely gain further momentum.

Another notable trend is the increasing enthusiasm of investors to choose hotel assets to sit alongside their investments in the private rented sector or vice-versa. This is up by 153 percentage points compared with our 2017 survey results.

Regarding portfolio allocation, the largest exposures to hotel assets can be found among private equity funds and private property companies. Many of the latter claimed to have real estate portfolios where hotels represent as much as 70% to 100% of the total. As might be expected, there is much greater diversity among institutions such as insurance companies and pension funds, as well as fund managers, who report that hotels represent anything between zero and 10% of their total real estate holdings.

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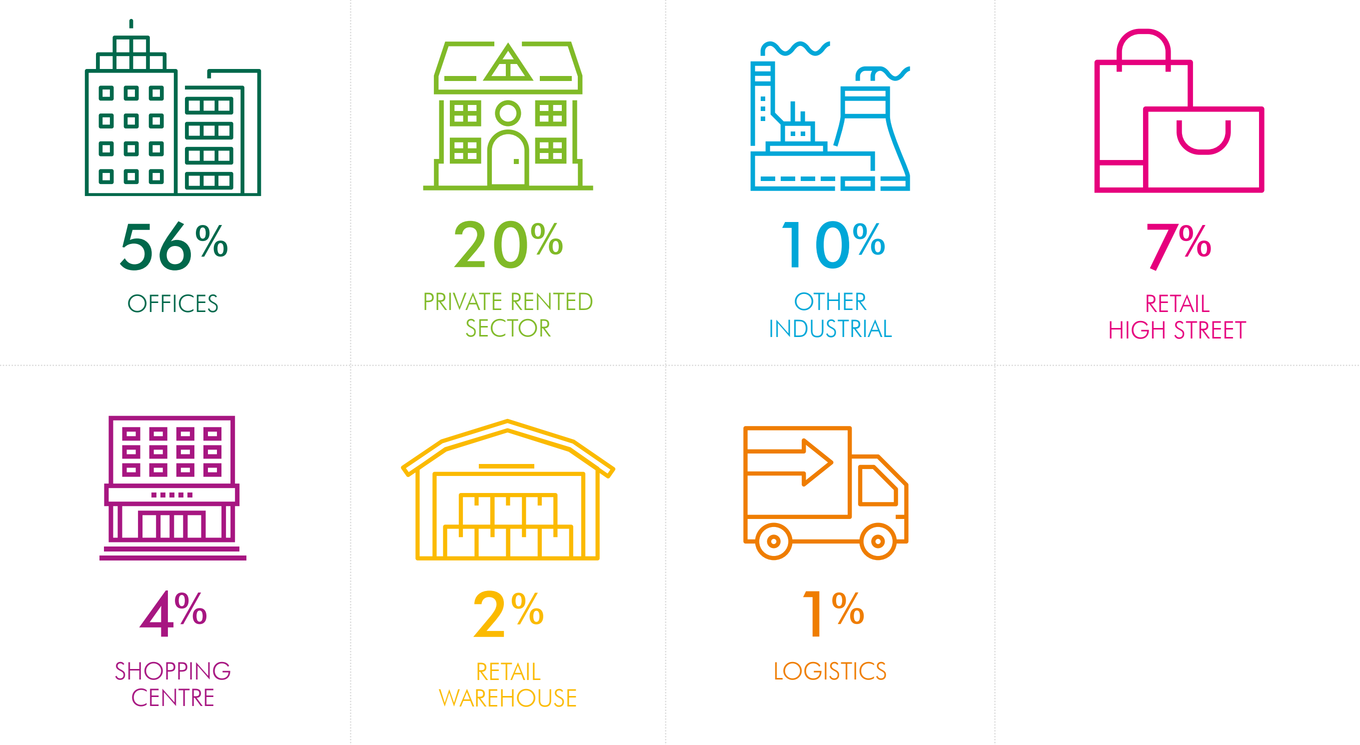
Figure 3



Source: CBRE Research 2018

HOTELS European Investor Intentions Survey 2018

"A low-yield environment and shortage of good-quality investable stock continues to present a challenge to property investors seeking opportunities to deploy capital. Throughout this cycle, we have seen a growing number of institutional investors become active in the hotel space, amid increasing transparency and a growing understanding of the sector. The majority, if not all, have gone on to benefit from relatively high risk-adjusted returns, in addition to the enhanced diversification benefits that hotels can deliver to their portfolios."

Joe Stather, Associate Director, Investment Advisory, EMEA

Compared to 2017, what do you expect your investment activity in 2018 to be?

An overwhelming majority (94%) of investors are intending to either invest the same or more capital into the market in 2018.

Gauging the level of investor appetite provides a key indicator of the future vitality of the European hotel investment market. An overwhelming majority (94%) of investors are intending to either invest the same or more capital into the market in 2018 than they did in 2017 (figure 4). This is up on the 90% figure recorded last year.

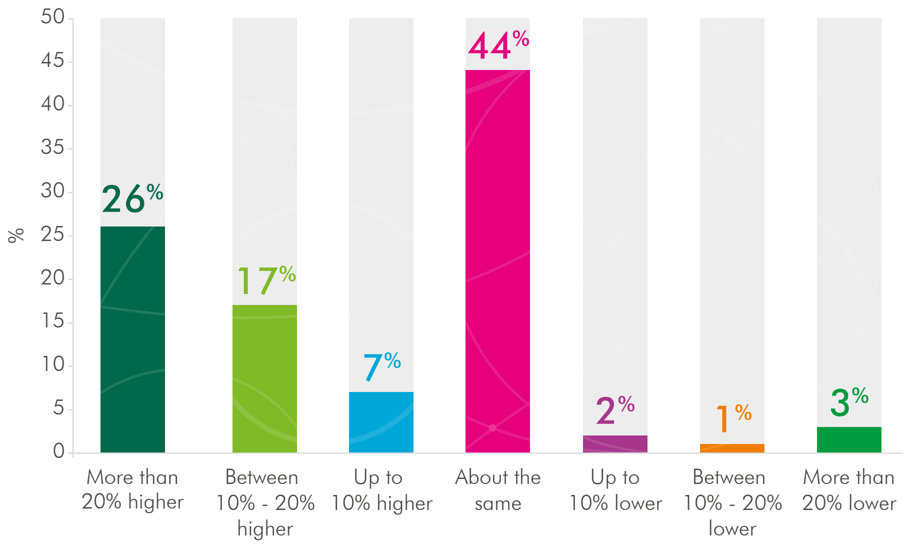
The biggest mover in percentage terms is the proportion of investors seeking to invest between 10% and 20% more capital in 2018. This has risen from 10% to 17% year-on-year; an indication of growing satisfaction with investment performance.

The potential issue for the market is that investor appetite may be unsated by a shortage of investible stock in 2018.

Of the investors surveyed, only 30% said they would consider divesting hotel assets in the coming year. We saw something similar in our 2017 survey and it would be safe to conclude that this ongoing imbalance between supply and demand may well drive further inflation in hotel asset prices across Europe.

There are few surprises in the potential sources of future hotel stock, with the typically active and opportunistic private equity firms and private property companies saying they would be most likely to consider asset sales.

Figure 4



Source: CBRE Research 2018

How long do you typically plan to hold your hotel real estate investments?

The 'sweet spot' for retaining hotel assets (figure 5) appears to alight around the five to ten-year mark, with very few investors opting for very short-term holdings. This year's findings underline the shift away from a holding period of less than five years that was more prevalent in the immediate aftermath of the global financial downturn.

Almost a quarter (24%) of surveyed investors are looking to hold for more than ten years, while a further 16% – the so-called 'generational purchasers' – say they intend to keep their hotel assets indefinitely.

That said, we note a small but perceptible movement towards shorter holding periods when comparing this year's figures with 2017's. Last year, 24% of investors said they intended to hold their investment for between two and five years, while 26% gave that answer this year.

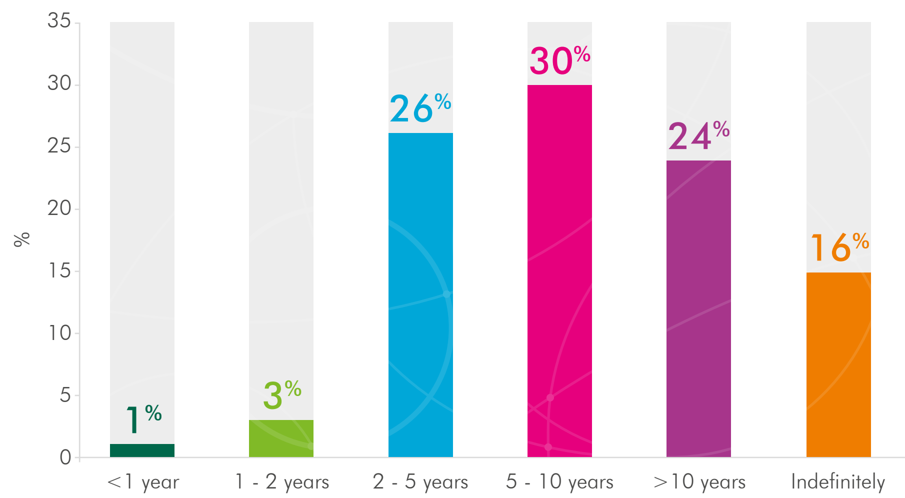
Why do investors choose to invest in hotel real estate? The prime motivation (38%) cited by respondents is an expectation of capital value growth – a figure similar to 2017's survey. This was followed by 16% of respondents who report being motivated by a need for portfolio diversification – an increase on the 2017 survey results and an indicator of continued strong appetite among investors who are new to the hotel sector. Other somewhat less prominent answers included the attractive yields generated by hotels relative to other asset classes; also, yields relative to the cost of debt.

Yields for hotel assets are at ten-year lows across most European markets at present; a further indicator of the strength of investment appetite, but also a sign of asset price inflation, given that cash flows have also grown.

We additionally asked investors to estimate the amount of capital they were looking to deploy in 2018. This year, the most popular bracket (30% of responses) was €100m-€500m, followed by €10m-€50m (28%) and €50m-€100m (23%). Though the differences are quite small, this does represent a change from 2017 results, when the €10m-€50m range was most popular.

At the top end, only 7% of respondents claimed they would be investing more than €500m, reflecting the limited number of players with the scale to invest at that rarefied level of the market. However, some private equity firms told us they are considering deploying as much as €500m to €1bn in the year ahead, which suggests a continued demand for the wider portfolio and platform acquisitions that were a feature of 2017.

Figure 5



Source: CBRE Research 2018

"There is a considerable weight of capital targeting long-term, stable cash flows. At the other end of the risk spectrum, some opportunistic investors are seeking to capitalise on this demand by converting value-add assets to core and selling as quickly as possible, thereby minimising their market exposure and maximising their IRR."

Kristen Kozlowski, Senior Director, Head of Investment Properties, EMEA

At what level do you intend to leverage your hotel acquisitions in 2018?

How are investors looking to fund their hotel acquisitions in 2018? Almost 10% of the market will opt for an all-equity purchase (compared with 12% in 2017), the rest will be seeking some degree of debt finance (figure 6), hoping to take advantage of the current low interest rate environment across Europe.

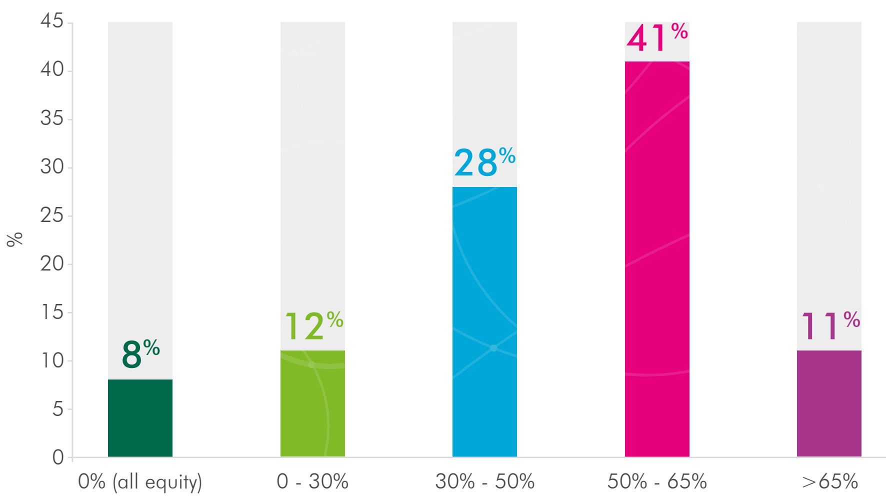
With a 41% weighting, the most popular loan-to-value (LTV) ratio is between 50% and 65%, while a further 11% of respondents, mostly private equity, say they will be looking to borrow at above 65% LTV. This latter figure is up from 9% in our 2017 survey, suggesting that there is increasing demand for the generally more expensive mezzanine finance in addition to senior lending. It will be interesting to see whether this quite aggressive stance begins to soften if European interest rates start to rise.

When further analysing the responses by investor type, we found that higher levels of leverage are most popular among private property companies, private equity firms and individual/family investors. By contrast, REITs plan to leverage their acquisitions at an average LTV of between 30% and 50%, while pension funds and institutional investors intend to use the lowest levels of leverage.

"Continuing the trend initiated about 18 months ago, alternative lenders continued to increase their market share in the hospitality sector. This has ultimately kept pressure on lending margins and worked in favour of the investment community. It must also be noted that all lenders are becoming more comfortable with the sector and increasingly see it as an opportunity to grow and diversify their loan books. Despite the prospect of rising interest rates across Europe, we expect debt finance to continue to be an accretive strategy for hotel investors and a liquid market to be prevailing throughout 2018."

Georgia Contogoulas, Senior Director, Hotel Debt & Structured Finance, EMEA

Figure 6



Source: CBRE Research 2018

In Europe, what location type are you predominantly targeting for investment purchases in 2018?

This question produced a notable change at the top, with gateway cities now on-par with capital cities in terms of demand for hotel assets (figure 7). To find a reason for this, we need to look no further than the twin effects of a shortage of investible stock in major European capital cities, alongside the relatively low yield environment across prime cities.

We see opportunistic hotel investors starting to look further afield in their search for yield. Meanwhile, institutional funds will continue to restrict their activities to the more stable capital and gateway cities, where growth in hotel operating performance tends – in relative terms – to be considered more secure.

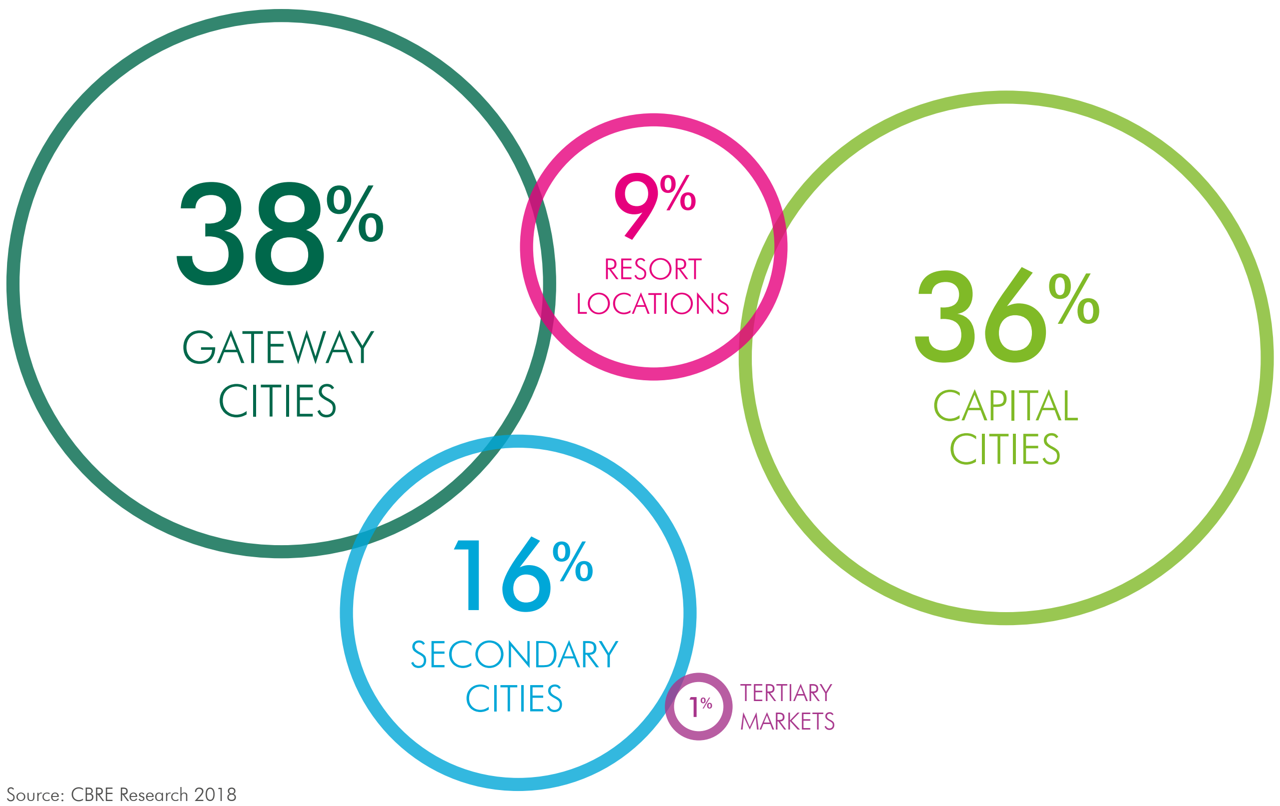
Although interest in secondary cities was slightly down in year-on-year terms (19% to 16%), this is not necessarily the case. In fact, we expect demand for secondary locations (16%) and resorts (9%) to strengthen moving forward, due to a shortage of stock in highly sought-after gateway cities. Of the respondents who showed an interest in resort properties, the overwhelming majority (84%) are seeking beach/seaside locations.

Looking ahead, we expect appetite for 'alternative' investments, including hostels, to continue to gain momentum – a view supported by the major pan-European portfolio and single asset deals in 2017.

"Interest in Mediterranean resorts accelerated in 2017 with multiple transactions occurring, increasingly involving institutional capital. The more opportunistic investors continued their pursuit of yield in resort markets to fulfil their higher rate of return objectives."

Jorge Ruiz, Senior Director, Head of Hotels Spain

Figure 7



Source: CBRE Research 2018

Which countries are you targeting for investment in 2018?

“The UK is attracting a wide spectrum of international investors who are seeking opportunities in key cities, London, Edinburgh and Manchester in particular, but who are also prepared to consider other less obvious regional locations.”

Paul Collins, Senior Director, Head of Investment Properties, UK & Ireland

As was the case last year, the top three destinations for hotel investment in 2018 (figure 8) are the UK, Germany and Spain. The big difference year-on-year is how top-heavy the graph has become, with the leading three countries now accounting for 69% of total responses, compared with just 41% in 2017. The UK has surged ahead, with an increase in investor appetite of 106% compared to 2017 survey. The UK remains particularly attractive for private property companies and private individual investors.

Our findings arrive on the back of a strong year for hotel investment in the UK in 2017. They also seem to contradict the gloomier predictions of industry commentators, who feel the UK’s impending withdrawal from the European Union might deter investors. In fact, the results of this year’s survey suggest that any restrictions to the growth of UK investment volumes are more the result of low supply than any reduction in demand for hotels assets as proved in 2017.

Spain, in third place, saw the highest year-on-year growth in investment volumes in 2017. A recovering economy, attractive asset pricing and stock availability have been the major factors driving this increase. Distressed hotel real estate that was acquired in the aftermath of the global financial crisis has now returned to the market, as opportunistic funds seek to crystallise their investment gains. In addition, some of the larger Spanish hotel groups are adopting an ‘asset light’ strategy; disposing of their assets by means of sale and leaseback/manage-back deals.

France comes out in fourth place – after a slowdown in recent years, investment activity is expected to pick-up again in 2018 as French institutions look for opportunities to deploy capital across asset classes. This is pertinent in the hotels space, as operating performance has begun to recover following a slow-down due to the effect of terrorism.

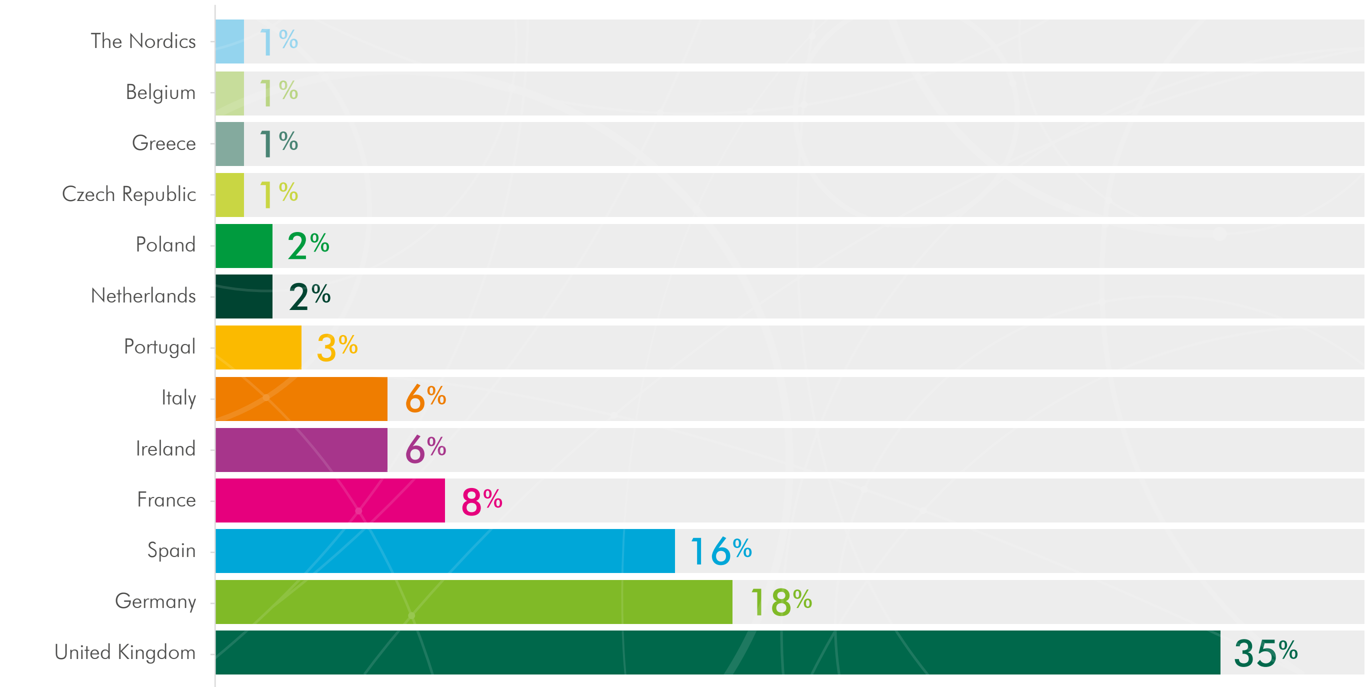
Ireland has moved into joint fifth place overall alongside Italy, followed by Portugal and the Netherlands seventh and eighth place respectively.

The strong fundamentals of the German hotel market, coupled with very favourable financing conditions, will continue to lead to high demand for hotel real estate and therefore to yield compression in 2018. Developments have become of increasing importance for investors seeking relatively large returns, accounting for 26% of the total transaction volume in 2017, up from 18% in 2016.

Olivia Kaussen, Managing Director, Head of Hotels Germany

Two Eastern European countries have made it into the top ten in this year’s survey. These are Poland, which moved up a place to number nine, and the Czech Republic, which moved from 12th to 10th. Eastern European markets are being increasingly targeted by the more opportunistic funds because of strong performance growth in recent times. North American private equity funds will continue to look for opportunities in these markets in order to achieve their typically higher rates of return requirements.

Figure 8



Source: CBRE Research 2018

“2017 was a record year both in terms of volume and number of hotel transactions in Poland. Some €350m was invested into Poland’s hotel sector last year – a growing investor appetite that we expect to continue through 2018.”

Marta Abratowska-Janiec, Senior Consultant, Advisory Services, Poland

What operating structures are you targeting in 2018?

As with 2017's survey, investors express interest across the spectrum of operating structures (figure 9). However, the favoured option for 2018 continues to be operational lease agreements, which account for 32% of responses, up from 28% in 2017.

Hotel management agreements have fallen somewhat out of favour, dropping from 28% to 23%, primarily because of their perceived inflexibility. We have seen this anecdotal evidence backed by hard numbers in recent times, in the form of higher yields for such properties. We do, however, expect white label management structures to continue gaining popularity in European markets in 2018.

A further sign of investor desire for flexibility can be seen in the strong showing for franchise agreements and vacant possession structures (18% and 26% respectively). With a combined 44% of responses opting for the two it could be argued that investors still favour the more flexible end of the operating spectrum.

Can Europe's leased hotel stock keep pace with investor demand? At present, the physical supply is considerably lower than the demand indicated by our survey. Indeed, outside of Germany, the United Kingdom and the Nordic countries, assets encumbered by lease agreements represent a very small percentage of the market, mainly since most major full-service hotel brands choose to eschew them.

We increasingly see new entrants, particularly in the budget space, offering leases to appeal to a wider investor base in order to expand their European footprint, which in turn will create further opportunities for fixed-income investors.

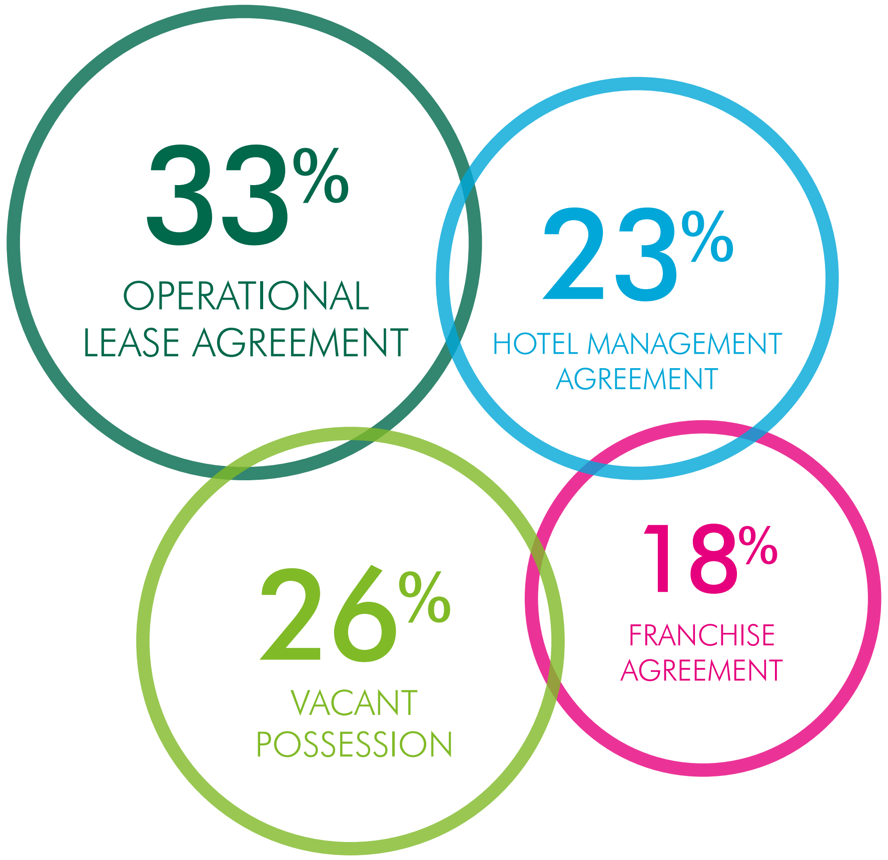
However, leases are unlikely to become the most prevalent operating model without a major shift in operator sentiment.

We also asked our respondents to select the tier of the market that they are targeting for their 2018 hotel investments. As with our survey last year, the majority selected the upscale and midscale tiers, followed by the budget and limited service tiers. Where responses differed year-on-year was a significant drop in appetite for serviced apartments/aparthotels. It will be interesting to note whether this is reflected in actual market activity throughout 2018.

"Long-term variable leases remain the predominant operating structure in the Nordics, with owners and operators keen to keep their interests aligned by sharing both the investment risks and upsides."

Phil Rist, Associate Director, Valuations, Sweden

Figure 9



Source: CBRE Research 2018

HOTELS European Investor Intentions Survey 2018

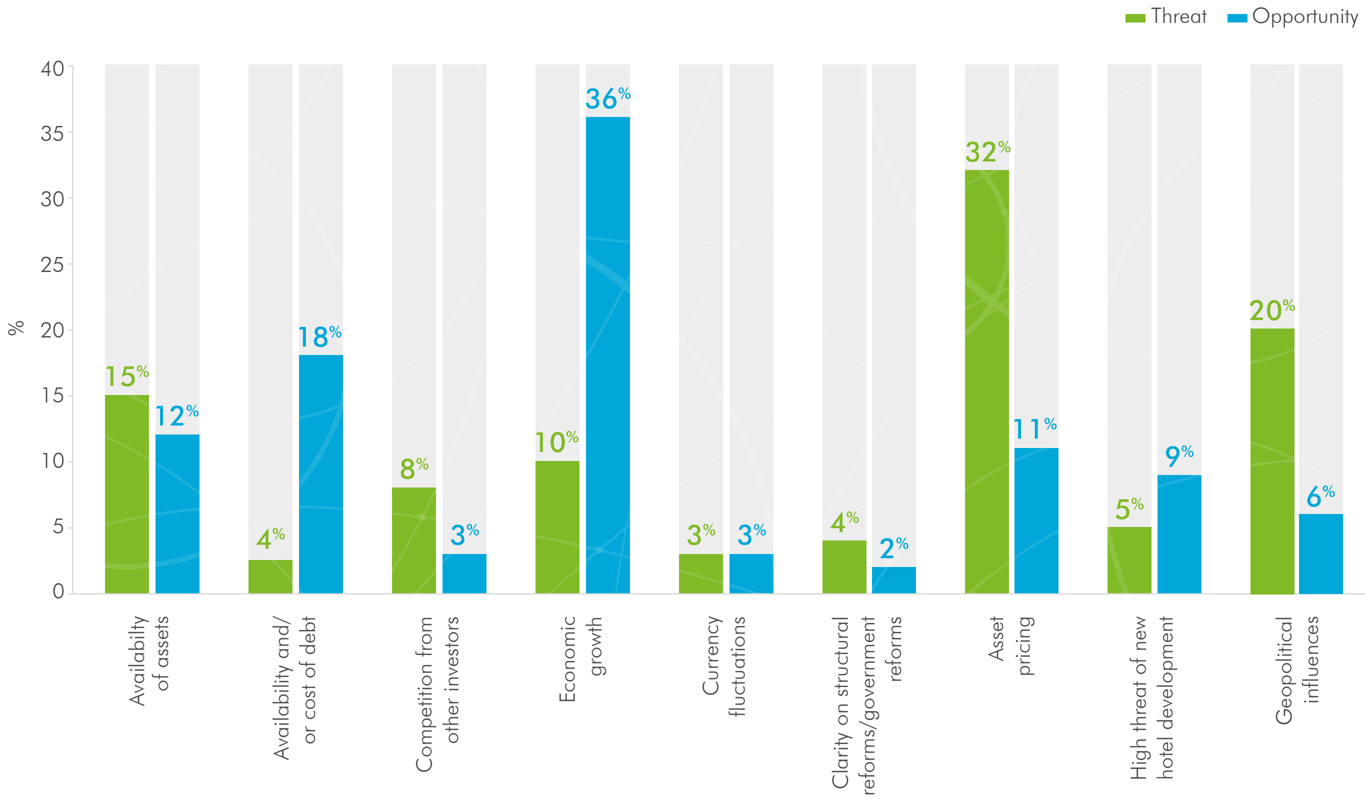
Which of the following do you believe poses the greatest opportunity/threat to European hotel investment in 2018?

When asked to consider the threats and opportunities presented by the European hotel investment landscape in 2018 (figure 10), our respondents' answers have more clearly crystallised around a handful of factors.

In terms of threats, the issue of asset pricing is now far and away the number one concern, amounting to 32% of responses (against 19% in 2017), with the availability of assets also a significant cause for anxiety at 15%. This is again the result of the imbalance between investor demand and the supply of investible stock, which has been driving up asset prices in recent years. In addition, numerous events in the geopolitical arena give cause for concern among investors across Europe. This threat was cited by 20% of respondents (up from 16% in 2017). Geopolitical events can heavily influence the fundamental demand drivers behind hotel operating performance.

Among the opportunities for investors, economic growth was the prime consideration at 36% in comparison to 20% in 2017. This sentiment was displayed most strongly by investors who said they were focused on Germany, the United Kingdom, Spain and Italy as their target destinations. Investors also saw the continuing availability and/or cost of debt as giving them a freer hand in the market, while asset availability featured almost as strongly as an opportunity than it did as a threat.

Figure 10



Source: CBRE Research 2018

Investors also saw the continuing availability and/or cost of debt as giving them a freer hand in the market, while asset availability featured almost as strongly as an opportunity than it did as a threat.

In 2018, do you intend to invest outside of Europe?

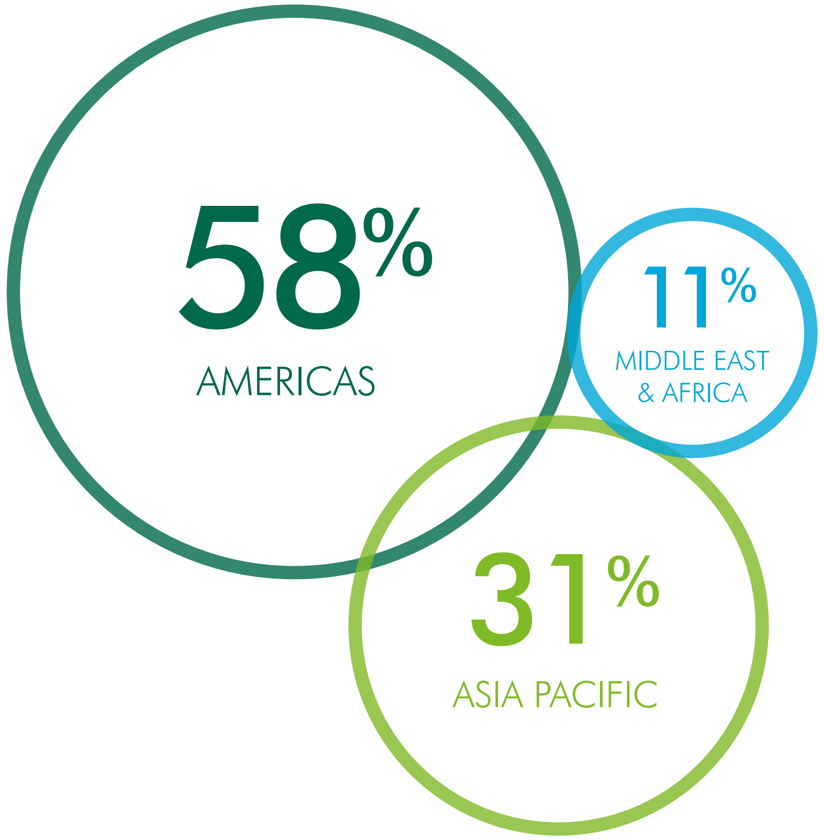
"Expectations for continued economic expansion in the US indicate another favourable year for lodging market participants. With hotel construction volumes levelling off and only a handful of US markets experiencing excess supply in the near-to-mid-term, rising consumer and business confidence will drive demand and strengthen the hand of hotel revenue managers. Revenue growth will be critical to counter increased pressure on labour costs resulting from ultra-low unemployment across most markets."

Mark Woodworth, Senior Managing Director, Head of Lodging Research, Americas

The response to this question proved remarkably consistent year-on-year. 38% of investors this year said they intended to invest outside of Europe, compared with 37% in 2017.

As with last year, the Americas were the most popular region for investment interest outside of Europe, followed by Asia Pacific. The Middle East and Africa again attracted the lowest level of interest.

Figure 11



Source: CBRE Research 2018

Conclusion

The vast majority of those investors surveyed by CBRE Hotels intends to deploy either more or the same amount of capital into hotel real estate in 2018, compared with 2017. This highlights the growing attractiveness of hotels amongst an increasingly diverse investor base. Ultimately, confirming hotels as a mainstream property sector.

Growing demand should result in increased European hotel transaction volume through 2018. However, we recognise the challenges regarding a possible shortage of investable stock and high pricing, which was noted as a key threat by survey respondents and could cause the deal volume to stall.

European economic growth gathered momentum through 2017. The survey results suggest that investors expect this momentum to continue through 2018, as many cited economic vitality as a key driver of their expected hotel returns. This sentiment was most strongly expressed by investors interested in Southern Europe.

The combination of greater transparency, increased knowledge and the closer alignment of operator and investor interests, has attracted a broader spectrum of capital. Hotels have become increasingly appealing to institutional funds given the rising availability of fixed-income opportunities across core locations. Opportunistic investors, on the other hand, have secured attractive returns in Europe's secondary markets and resorts.

Such is the growing global consumer demand for experiential travel, we see this driving an acceleration in hotel product innovation and new accommodation concepts. As a result, investors seeking to diversify their portfolios have an increasing array of hotel sector options from which to choose which should allay concerns around a shortage of available investable stock.

The UK bucks any Brexit induced uncertainty to retain top spot for 2018 hotel investor intentions. This is underpinned by record hotel performance and a generally optimistic demand outlook for overnight accommodation. However, with European investor intentions typically shaped by the geopolitical landscape, this remains volatile and hard to predict as we start 2018.

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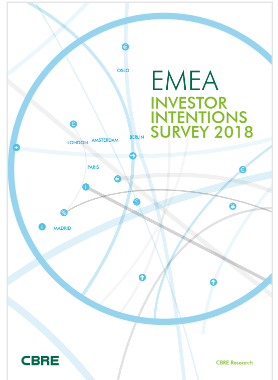
Global Investor Intentions Survey 2018



EMEA Investor Intentions Survey 2018

Americas Investor Intentions Survey 2018

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