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IN FOCUS:

LUXEMBOURG CITY

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It is surprising that a European capital is not part of most travel itineraries and can avoid massive groups of hot and sweaty tourists, pushing their way through the ancient inner-city walls. Despite its beauty and charm, Luxembourg City has managed to somehow escape this type of traveller, making it a wonderful destination for both business and leisure visitors. Luxembourg, like Geneva, is often associated with the banking industry and it is true that the city is popular with big spenders. However, the city has much more to offer than banks and suits. The city is perched overlooking gorges, valleys and forests and is composed of an intellectual and multi-lingual population, engrossed in history. Size certainly is not everything with this small European gem. This article provides an overview of the city's hotel sector and touches on the hotel investment environment.

Overview

Luxembourg is a landlocked country in western Europe, bordered by Belgium, France and Germany. It is one of the least populated countries in Europe with a population of approximately 524,000, around one third of which are foreigners. Covering an area of 2,586 km², Luxembourg is one of the smallest countries in Europe. Despite its size, Luxembourg is one of the world's most developed countries, with an advanced economy and the world's second highest GDP per capita, according to the IMF (2013).

The country was initially dominated by the industrial sector, particularly by steel manufacturing. However, with the decline of this industry, Luxembourg has

Did you know?...

- Luxembourg has the highest minimum salary in Europe and the second highest in the world after Australia. In 2013, the minimum salary was approximately €1,870 per month;
- The RTL Group (Radio Télévision Luxembourg) was founded in Luxembourg and is Europe's largest television, radio and production company. It has approximately 34 television channels and 33 radio stations in 12 countries;
- Skype, Amazon and PayPal all have their European headquarters in Luxembourg;
- Luxembourg has won the European Song Contest five times (in 1961, 1965, 1972, 1973 and 1983), an achievement only surpassed by Ireland.

become known as one of Europe's most powerful investment management centres, given its bank secrecy laws. The banking secrecy, however, led to tax evasion and fraud, which has prompted Luxembourg to sign an agreement to implement internationally agreed standards. The financial sector in the country currently accounts for almost 30% of GDP.

Aside from being a hub of a significant part of Europe's financial industry, Luxembourg is also home to many EU organisations, such as the European Court of Justice, the European Court of Auditors and the European Investment Bank, making the city both an international and an important political centre of Europe.

Unlike in other European countries where people boast about speaking two foreign languages, in Luxembourg, most people speak four, including Luxembourgish (a Franconian dialect of High German), French, German and English. French remains the official language in which business is carried out. However, German is the first language taught in schools and is used in the media.

A VIEW ONTO LUXEMBOURG CITY



Setting the Scene

The city of Luxembourg, with its population of just over 104,000, lies in the heart of Western Europe, conveniently situated 213 km from Brussels, 372 km from Paris and 209 km from Cologne.

The old centre of the city, which has been declared a UNESCO World Heritage Site, can trace its history to the tenth century, when Siegfried, Count of the Ardennes, built a castle on a rock above the River Alzette. He named the castle Lucilinburhuc. Over the centuries the castle and the surrounding town were strengthened with so many fortifications, walls and gates that the town became known as the 'Gibraltar of the North'. Today, the various components of the fortress are the city's chief tourist attraction. There are some other interesting sights in the city too, including the Luxembourg City History Museum, the Villa Vauban (Luxembourg City Art Museum), the City Palace, the *Philharmonie* and the MUDAM (Museum of Modern Art).

Hotel Supply

Not surprisingly, when compared to the country as a whole, Luxembourg City has the highest concentration of both hotels and bed capacity. Overall, hotels in Luxembourg are relatively small, with most hotels averaging fewer than 100 rooms.

Even though hotel supply has decreased slightly in Luxembourg City from 2006 to 2013, bed capacity has increased over the same period to approximately 3,300 beds in 2013. This illustrates a trend that larger branded hotels have entered the market over the past few years, leaving smaller, unbranded properties to close. Recently opened hotels include the 161-room Meliá Hotel (mid-2009), the 28-room Hotel Place D'Arme (April 2010), the 110-room Suite Novotel (June 2010) and the 99-room Park Inn by Radisson Luxembourg (July 2011).

Given the increasing competition in the market from the entrance of new hotels, existing hotels, such as the DoubleTree by Hilton (previously Hilton), have undergone significant refurbishments. After being rebranded as a DoubleTree in June 2011, the property underwent complete refurbishment and now boasts modern rooms and public areas. The room count was decreased from 342 rooms to 235, as the hotel now

A ROOM AT HOTEL PLACE D'ARME



only consists of two wings rather than three. (The third wing will soon be converted into apartments.)

The NH Luxembourg, previously a Sheraton Hotel, located by the airport, has also begun a rooms renovation, whereby the top floors have recently been completed. We also understand that the owners of the Hotel Royal are planning a €15 million renovation of the public areas on the ground floor. These plans have been in the pipeline for a number of years and have yet to materialise.

There are currently no new hotel projects in the pipeline for Luxembourg City. We understand that several international management companies who are not currently present in the market have shown interest. Even though there are possibilities to construct or convert buildings outside of the Old Town, reflagging existing, independent hotels should also not be disregarded.

Demand

Despite being a UNESCO World Heritage Site, Luxembourg is not well-known as a tourist destination and therefore welcomes primarily business related visitors. Given the country's stable and favourable tax environment, it is the home and often the headquarters of many international companies, including, Amazon, DHL, eBay, Kuehne + Nagel, Microsoft, PayPal, Siemens, Skype and the list goes on. Additionally, Luxembourg's commercial success can be attributed to its strategic position within Europe, its

neutrality, skilled and multilingual workforce, and excellent infrastructure.

Luxembourg City houses the country's only international airport, which underwent a huge expansion in 2008, when a new terminal was opened, increasing the capacity to 3 million passengers. The airport has achieved a steady compound annual growth of 4.6% from 2006 to 2013 and passenger arrival numbers currently exceed pre-crisis levels, which is not the case throughout Europe. In 2013, passenger arrivals increased by more than 12%, as British Airways and Luxair grew their number of passengers by 19% and 10% respectively on their services to London, and TAP Portugal and KLM also recorded positive growth. In 2012, the airport managers produced a 15-year master plan aimed at expanding the existing services, shops and infrastructure at the airport, thereby hoping to secure strong demand in the future.

More or less mirroring the arrivals trend at the airport, visitation to Luxembourg has exceeded pre-crisis levels, achieving slightly slower growth of 1.2% from 2006 to 2012. Not surprisingly, international visitors account for more than 95% of the total stays. It is notable that the main source markets for Luxembourg include Western European markets, and downturns in these economies significantly impact arrivals to Luxembourg as well as hotel occupancies. This was seen in 2008 and 2009. The main source

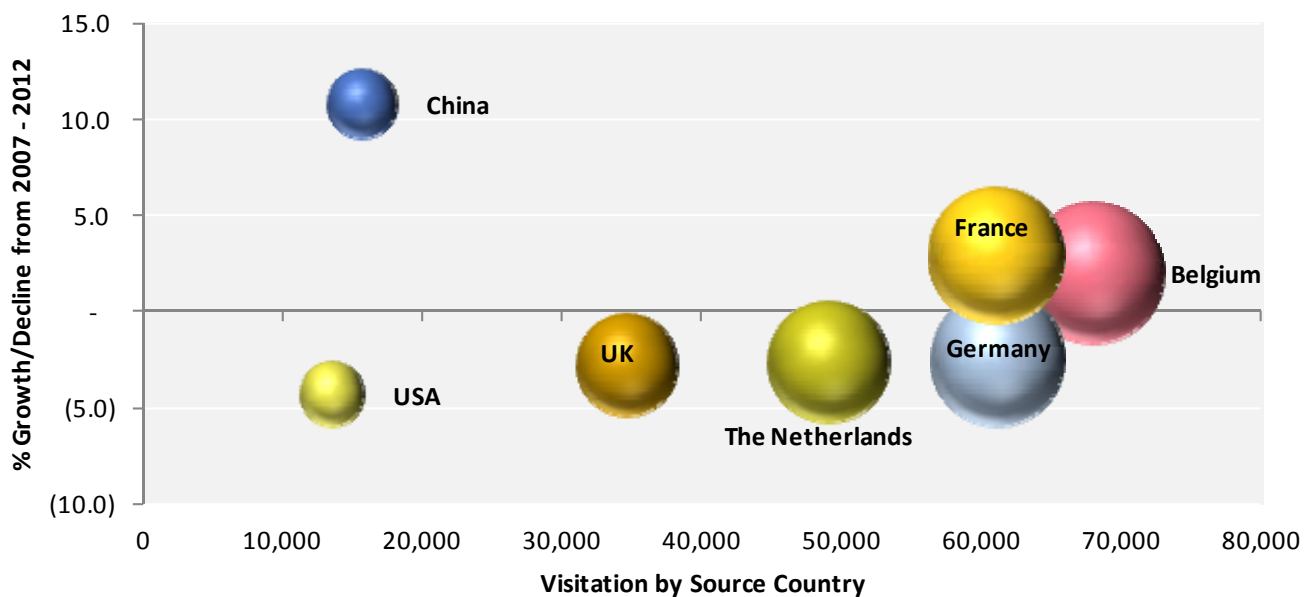
markets include Belgium, Germany, France, the Netherlands and the UK. China has also become an increasingly important source country and has shown more than 10% annual growth from 2007 to 2012, although it must be noted that it started from a low base. An uptick in travel has also been witnessed by other BRIC countries, especially Russia and Brazil. (In Chart One, the size of the bubble represents the share of total arrivals. Hence, for example, Belgium has the biggest bubble and is the largest source market.)

Hotel Performance

Given that the hotel market is particularly seasonal and dependent on the commercial segment, hotel performance suffered severely during the financial crisis when budgets were cut and business travel declined. However, the downward trend from 2007 to 2010 cannot only be explained by the harsh economic environment but also owing to the increase in hotel supply, in particular in 2009 and 2010, that put pressure on both occupancy and rate. The years 2011 and 2012 saw the return of the business traveller. However, 2007 performance levels have yet to be exceeded. In 2013, there was a strong growth in leisure demand, a pleasant surprise to most hoteliers who were able to achieve higher occupancies in the summer holiday period than previously. Hotels that were able to accommodate both parents and children in a room together fared particularly well.

CHART 1: SOURCE MARKET

Visitation by Source Country



Source: TourMIS, 2013

Going forward, the tourism and marketing efforts will continue to focus on attracting family in the low-demand periods and on weekends.

Given the lack of new hotel supply in the market, we forecast both occupancy and average rate to grow, climbing back towards 2007 levels in real terms. Occupancy is expected to stabilise around 75% and average rate should witness growth slightly above inflationary levels, from the 2013 level of around €123.

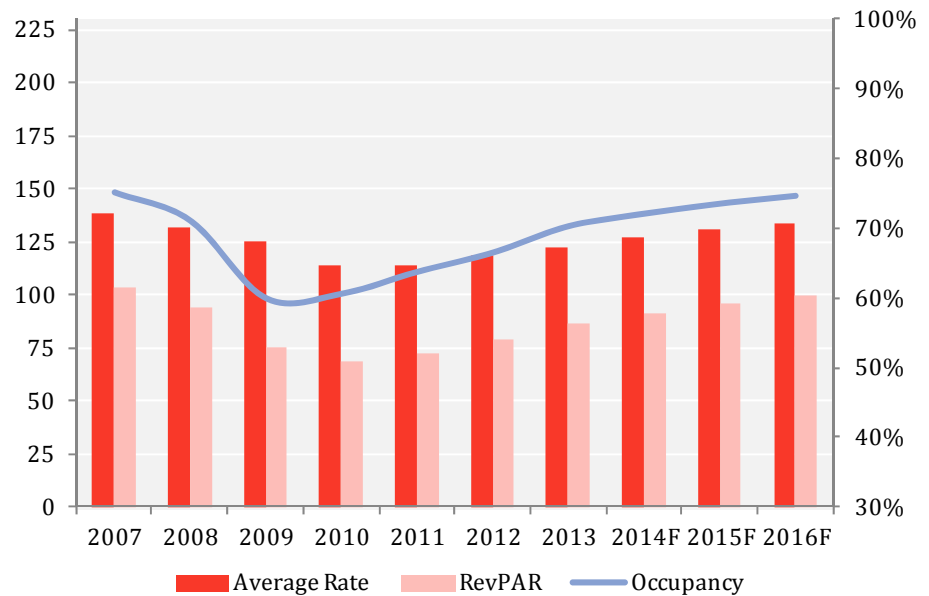
Investment Environment

Situated at the heart of Europe, Luxembourg occupies a classic gateway location. As a member of the EU, Luxembourg profits from the advantages of a huge single market with a single currency (euro), thereby eliminating transaction costs and uncertainty caused by exchange rate fluctuations. Despite these benefits, hotel transactions in Luxembourg have been practically nonexistent. From our valuation experience and knowledge of the market, we have been able to give an indication of values per room using the income capitalisation approach. Unlike other European capitals like London and Paris, which are able to achieve relatively high average rates per room, the average value per room of Luxembourg hotels averaged around €125,000 in 2012. In 2007, values stood at their peak at €169,000 per room, before witnessing a significant drop in 2008 as economic conditions worsened causing RevPAR and net operating income to fall significantly. As conditions improved, and more or less mirroring the recovery of the market, room rates began to increase in 2010. Given the stable growth expected in the market, we forecast conservative growth in average room prices over the next two years. However, it will take time to reach the 2007 peak in hotel values once again.

Conclusion

Commercial demand in Luxembourg is strong and leisure visitation is on the rise. Following the global economic crisis, airport arrivals, visitation and

CHART 2: HOTEL PERFORMANCE 2010 TO 2013 ACTUAL AND 2014 TO 2016 FORECAST



Source: HVS London

overnight stays all realised new records in 2012 and 2013, illustrating that Luxembourg is not only a wealthy financial centre but is also attractive as a tourist destination. Hopefully, 2014 figures will reveal continuing positive trends.

New hotel supply has come to a standstill, allowing hotels to push both occupancy and rate and we can expect performance to reach 2007 peaks over the next few years.

As leisure demand continues to grow, and Luxembourg City remains one of the few European capitals that has yet to be discovered by a large number of tourists, it makes a perfect weekend getaway for both families looking to explore the historic Old Town and couples seeking a romantic getaway.

Given its gateway location at the heart of Europe, stable market, and educated labour force, investors see Luxembourg City as a safe haven. Many are looking for an opportunity to enter the market, and with its high barriers to entry, especially in the Old Town and city centre, hotel values should continue to increase in the next few years.



About HVS

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About the Author



Veronica Waldthausen is an Associate with HVS London, specialising in hotel valuation, feasibility studies and consultancy. She joined HVS in 2012 after completing her Bachelor of Science in International Hospitality Management at École hôtelière de Lausanne, Switzerland. Since joining HVS, Veronica has conducted hotel appraisals and feasibility studies in Azerbaijan, Slovakia, the Czech Republic, Croatia, Denmark, France, the Netherlands, Luxembourg, Germany, Switzerland, the UK, Ghana and Kenya, and has written several market and industry related articles.

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