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Insight into the dynamics of the tourism and hotel industries of Portugal, Italy, Greece and Spain

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BUSINESS INTELLIGENCE

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Introduction

Since 2008, the economies of southern European countries, including Portugal, Italy, Greece and Spain, have suffered as a result of the global downturn. Swollen public sectors, toxic debts and the property bubble intensified their pain and ultimately resulted in recession and high unemployment rates.

While the countries' tourism and hospitality sectors did not escape the effects of the downturn, they did not suffer to the same degree. In fact, they bolstered their respective economies through the recessionary cycle, softening the impact on employment and, in some areas, even outperforming the general real-estate market. Now that the hotel trading outlook is improving, we believe these markets have reached the turning point and are likely to become a focus of investment activity in the next couple of years.

This publication explores the trends affecting the tourism industry and hotel markets in Portugal, Italy, Greece and Spain, highlighting the characteristics that differentiate them from each other.

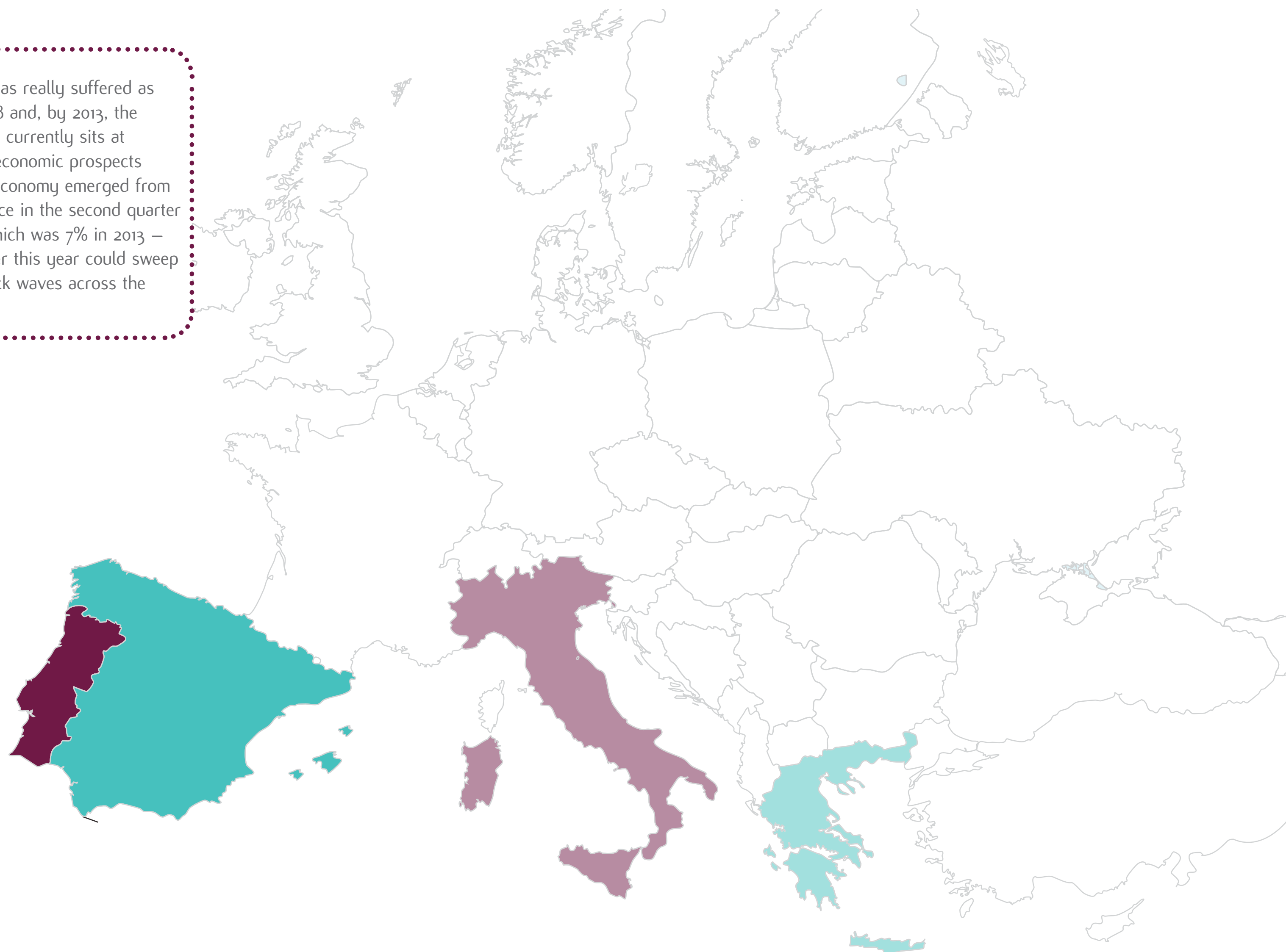
The economies of southern Europe have gone through turbulent times since the start of the recession in 2008. Despite signs of recovery over the last twelve months – Spain, for example, is likely to record strong GDP growth – major concerns remain. High levels of government debt, delayed structural reforms and risks associated with geopolitical uncertainty in eastern Europe persist.

Spain As the fifth largest economy in the European Union, Spain has really suffered as a result of the global recession. GDP has declined by 12% since 2008 and, by 2013, the unemployment rate had increased to 26%. The country's public debt currently sits at c. €1 trillion, which is almost 100% of its GDP. Nonetheless, Spain's economic prospects look bright. Following the implementation of structural reforms, its economy emerged from recession in the second half of 2013 and expanded at its quickest pace in the second quarter of 2014. The government is on target to reduce its budget deficit, which was 7% in 2013 – down from a high of 9% in 2011. Parliamentary elections in November this year could sweep the anti-austerity Podemos party into power, which would send shock waves across the financial markets.

GDP Growth – 1.3% in 2014 and 2% in 2015 (Forecast)
Unemployment Rate – 23.7% (Dec 2014)
Government Debt – 93.9% of GDP (2013)

Portugal's economy – the 46th largest in the world – shrank significantly during the financial crisis. GDP has declined every year for the last three years and the unemployment rate has risen to more than 15% since 2008. Through unpopular austerity measures the government has managed to balance its deficit, which is forecast to fall below 5%. Other fiscal achievements and growing exports have allowed the country to exit its €78 billion three-year bailout programme. GDP is projected to grow by 0.8% in 2014 and by a further 1.3% in 2015.

GDP Growth – 0.8% (2014) and 1.3% in 2015 (Forecast)
Unemployment Rate – 14% (Aug 2014)
Government Debt – 129% of GDP (2013)

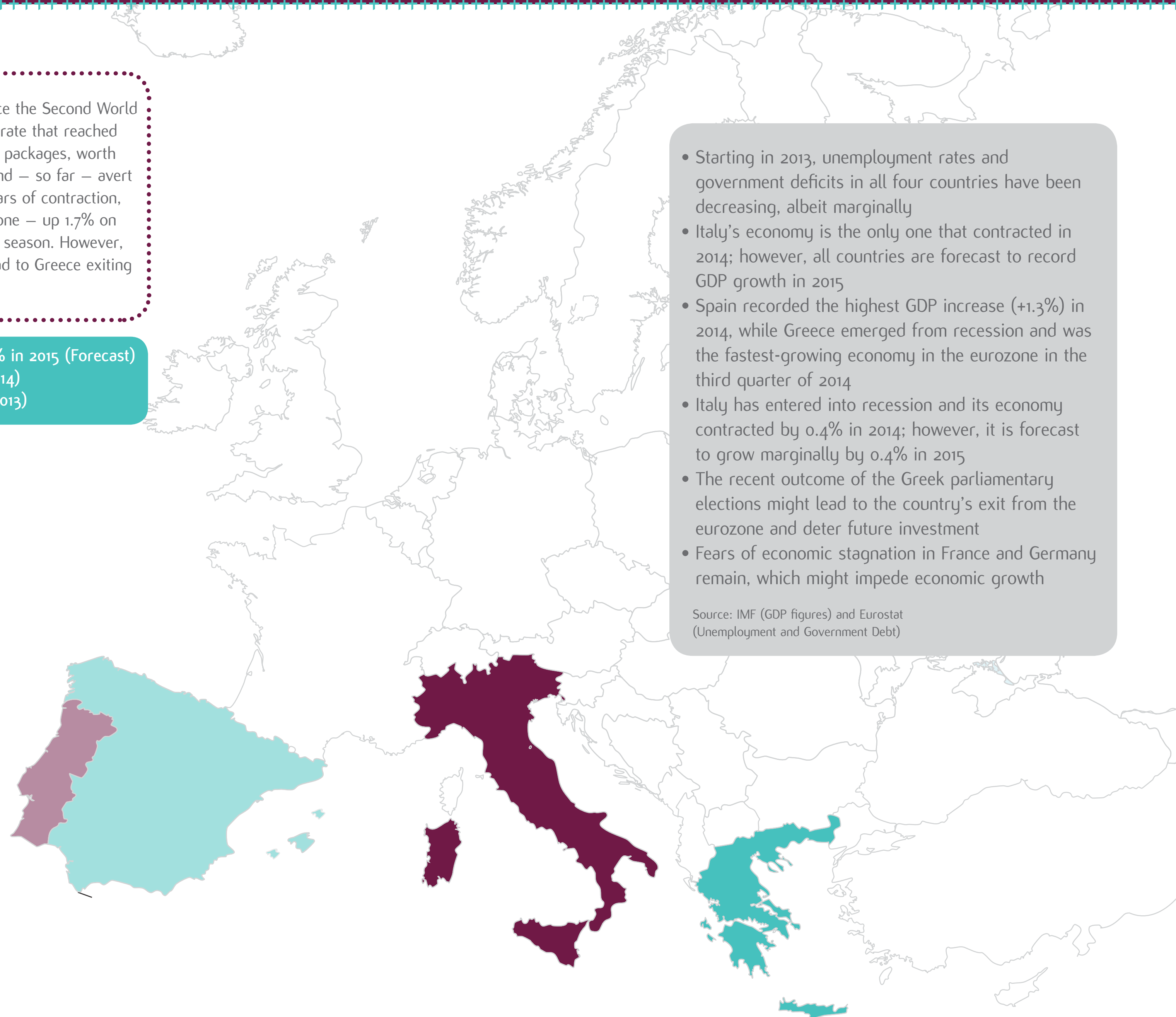


Greece Greece has experienced its longest recession since the Second World War. Amid cuts to the public sector, and an unemployment rate that reached 27%, the country had to request two unprecedented rescue packages, worth €240 billion. These have helped keep the economy afloat and – so far – avert the risk of default. In the third quarter of 2014, after six years of contraction, Greece recorded the highest economic growth in the eurozone – up 1.7% on the same period in 2013, thanks to a record summer tourist season. However, the outcome of the recent parliamentary elections might lead to Greece exiting the eurozone and deter investors.

GDP Growth – 0.8% in 2014 and 2.3% in 2015 (Forecast)
Unemployment Rate – 23.7% (Dec 2014)
Government Debt – 175.1% of GDP (2013)

Italy One of Europe's powerhouses and the fourth largest economy in the EU, Italy has experienced consecutive GDP decline over the last two years. According to the Bank of Italy, GDP has contracted by 9% since the start of the global financial crisis. Despite earlier optimistic projections, the Italian economy contracted by 0.4% in 2014 and is forecast to record only marginal growth of 0.2% in 2015. In contrast to the other countries detailed here, economic reforms in Italy have been limited, and this is reflected in the growth rates being projected.

GDP Growth – -0.4% (2014) and 0.4% in 2015 (Forecast)
Unemployment Rate – 13.4% (Dec 2014)
Government Debt – 132.6% of GDP (2013)



- Starting in 2013, unemployment rates and government deficits in all four countries have been decreasing, albeit marginally
- Italy's economy is the only one that contracted in 2014; however, all countries are forecast to record GDP growth in 2015
- Spain recorded the highest GDP increase (+1.3%) in 2014, while Greece emerged from recession and was the fastest-growing economy in the eurozone in the third quarter of 2014
- Italy has entered into recession and its economy contracted by 0.4% in 2014; however, it is forecast to grow marginally by 0.4% in 2015
- The recent outcome of the Greek parliamentary elections might lead to the country's exit from the eurozone and deter future investment
- Fears of economic stagnation in France and Germany remain, which might impede economic growth

Source: IMF (GDP figures) and Eurostat (Unemployment and Government Debt)

Tourism is an important sector for all of these economies. In 2014, it is expected to account for up to 10% of GDP and a growing share of international contribution. Historically, the hospitality sector in all four countries has been fuelled primarily by domestic demand, accounting for approximately 50-70% of overnight stays.

Consequently, as the economic crisis spread across southern Europe, slashing household incomes and impeding domestic consumer spending, this key market experienced a significant decline. Decreasing tourist numbers from key feeder markets in northern Europe, including the UK and Germany, added to the sector's woes. However, the rebound of the northern European economies, and the displacement of tourists from other popular tourist destinations, such as Tunisia and Egypt, because of political turbulence, have led to a speedier recovery. For instance, while Egypt saw a 33% decline in the number of international arrivals in 2011, Spain and Italy recorded an uplift of 10% and 8%, respectively.

Since 2008, the international inbound market has grown from 10% to 36% of total arrivals. This has helped offset the decline in domestic arrivals and soften the impact of the economic downturn. International tourism has also led to an expenditure increase of more than 24%, bolstering a marginal 0.7% growth in domestic spending since 2009.

According to the World Travel and Tourism Council, by 2024 foreign travellers are projected to spend more than €165 billion in these countries, representing a 47% increase. Russia has become the fastest-growing international market, albeit from a low base, recording an increase of more than 2.5 million visitors since 2008. However, the deteriorating Russian economy and political uncertainty in the country may slow down this trend. There is also a growing number of tourists arriving from emerging markets, including China and Brazil.

A possible threat to the future growth of the tourism trade lies in the potential European economic slowdown. This would hinder growth in key markets, including Germany and France, which contracted in the second quarter of the year. However, stronger growth in the US and the UK economies will partly offset the risks for the travel industry. Last but not least, tourism is likely to benefit from the fall in oil prices and potential reduction in airfares, making travel more affordable for more people.

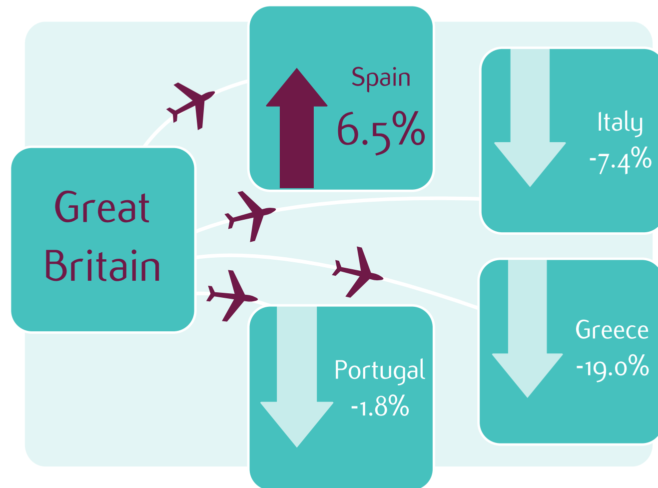
Travel & Tourism Economic Contribution

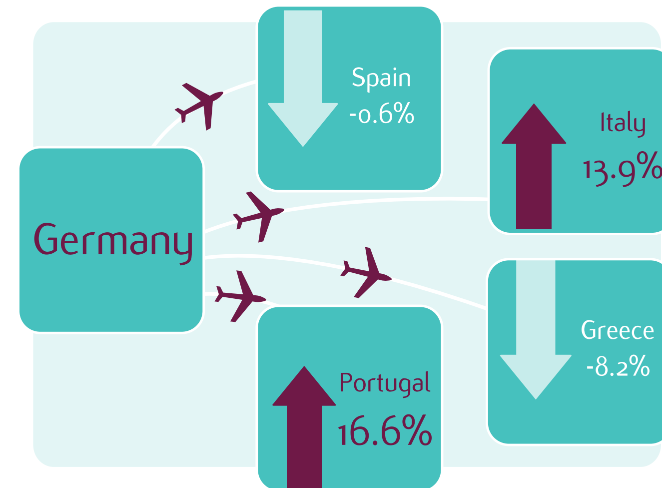
	EURbn, nominal prices	2009	% of GDP	2014*	% of GDP	2024F	Growth 2009/2014
Portugal	International	8.8	4.6%	12.6	7.1%	17.7	43%
	Domestic	6.5	3.4%	6.0	3.4%	8.1	-8%
Italy	International	29.0	1.0%	34.9	1.9%	48.5	20%
	Domestic	82.3	2.9%	88.3	4.7%	134.3	7%
Greece	International	10.2	3.8%	12	6.2%	22.5	18%
	Domestic	10.8	4.0%	7.9	4.1%	11.0	-27%
Spain	International	42.0	3.3%	52.7	4.8%	77.2	25%
	Domestic	63.8	5.0%	62.4	5.7%	82.6	-2%

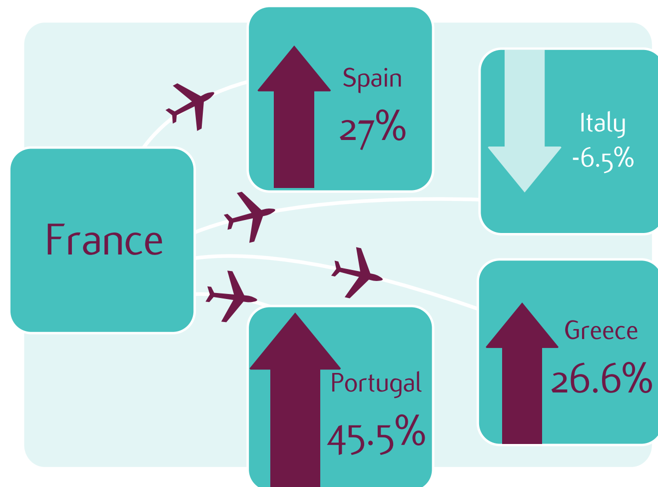
Source: World Travel & Tourism Council

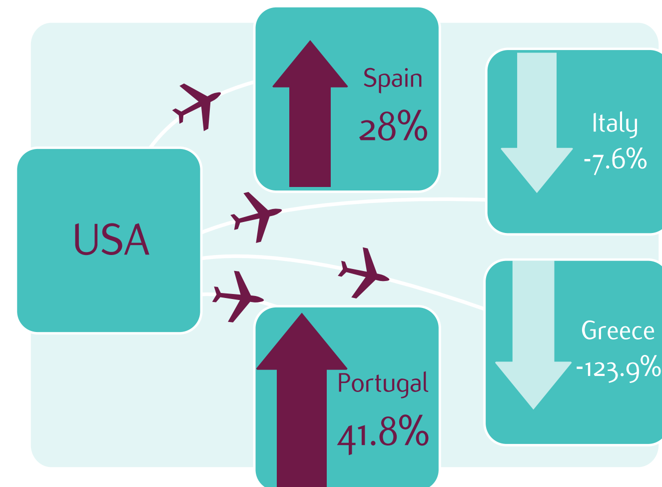
*Estimate

International tourism arrivals





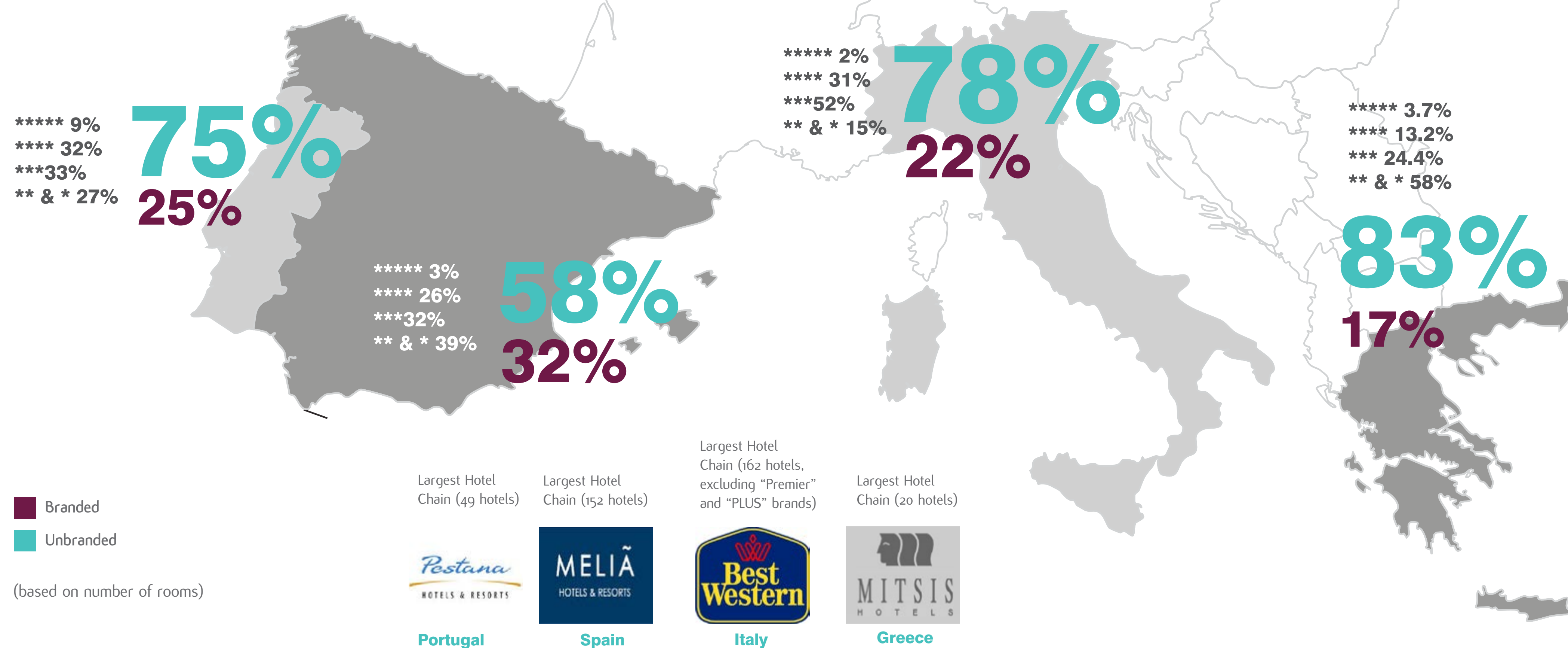




Hotel Supply Dynamics

December 2014 YTD

Hotel supply across the region is dominated by the budget sector, with 27-58% of supply. Next is the three-star segment, which represents approximately 30-35% of all hotels. Existing hotel supply across the four countries is mainly independently operated, ranging from 58% in Spain to 83% in Greece, with no major changes in recent years. Unlike the hotel market in the US and, to a lesser extent, in the UK, branding has not fully spread across southern Europe. Here, the markets are dominated mainly by independent hotels, many of which are family-owned, followed by domestic and international hotel operators. As a result, the markets tend to be highly fragmented, with assets of varying standards. This creates challenges when competing for business internationally. Furthermore, many hotels were not designed and constructed with operational efficiency in mind. The consequent need for consolidation and asset repositioning presents a significant opportunity for investors with a value-add investment strategy.



In terms of Revenue Per Available Room (RevPAR), only three markets recorded a compound annual growth rate between 2008 and 2014. The Canary and Balearic Islands benefited from a solid international inbound tourism base, and Turin recorded a marginal increase of 1%. Conversely, primarily domestic-driven markets, including Madrid, Athens and Milan, have seen the strongest drop in RevPAR. Here, austerity measures and contraction in both public and private sectors have impacted the purchasing power of both corporate and leisure guests.

In 2014, the improving, albeit constrained, economic conditions have seen the hotel trade start to recover across all four markets. Greece has recorded the strongest year-on-year RevPAR growth of 22%, followed by Spain (10%), Portugal (9%), and Italy (5%). This has made them more appealing to international investors.

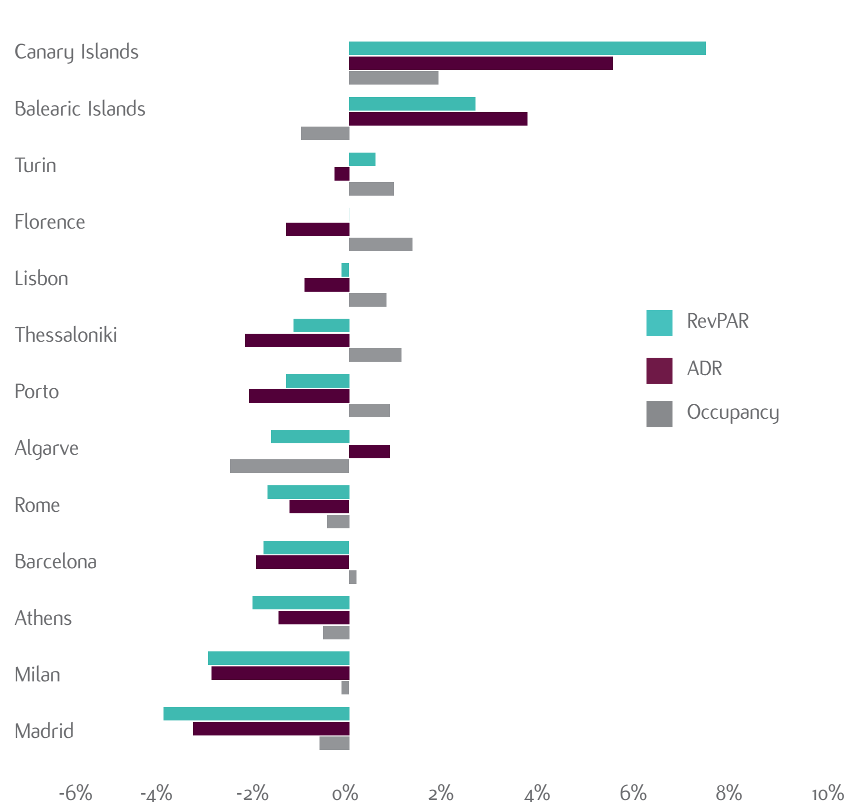
Athens recorded a remarkable upturn in RevPAR of 29%. This, alongside growth in international passenger numbers, has resulted in a year-on-year increase of approximately 21% for the Greek capital. According to STR Global, Athens is expected to experience a further 6.7% growth in RevPAR, driven by an increase in Average Daily Rate.

Hotel demand has outpaced supply growth in Spain and Italy, which explains why most key markets in these countries have recorded an occupancy-rate increase. Italy has the largest pipeline, with more than 4,000 rooms. This is mainly driven by Milan, which is a host city of Expo 2015. Spain, on the other hand, has currently the lowest projected supply growth (0.8%), despite a growth in demand.

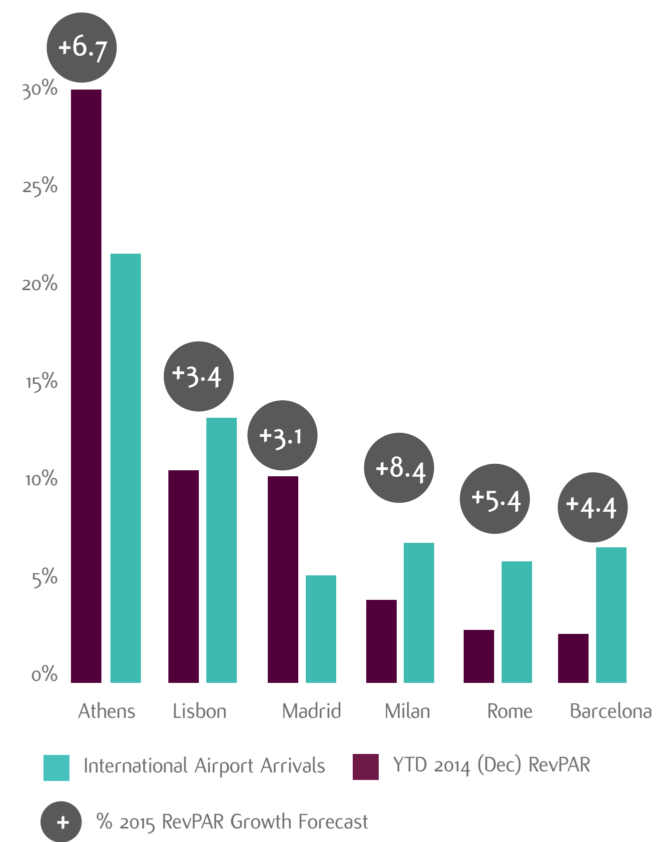
RevPAR Growth Rate - 2008 - 2014

	2008	2014	Growth Rate
Canary Islands	50.2	76.7	52.8%
Balearic Islands	51.3	76.7	49.5%
Florence	85.8	107.5	25.2%
Lisbon	57.1	61.3	7.3%
Porto	39.4	42.8	8.5%
Rome	100.6	99.7	-0.9%
Barcelona	88.6	87.6	-1.2%
Turin	52.8	49.0	-7.2%
Milan	91.5	83.2	-9.0%
Algarve	50.5	47.4	-6.2%
Thessaloniki	50.4	41.8	-17.0%
Madrid	71.0	56.2	-20.9%
Athens	81.5	69.7	-14.5%

KPIs CAGR (2008 - 2014)



YTD 2014 (Dec) RevPAR vs Total Passenger Arrivals



Source: STR Global, Christie +Co Research & Analysis, PWC

Investor Landscape

There have been few hotel transactions since the start of the financial downturn. This is largely due to severely limited debt availability from banks, uncertainty as a result of politico-economic upheaval, and a decline in hotel performance levels. Furthermore, domestic banks have taken time to work through their debt exposure – indeed, some are only starting this process now – so there are more distressed hotel or NPL transactions to come. We believe these markets have now reached a turning point. Investor appetite for hotel real-estate deals in southern European markets is growing, attracted by favourable yields compared with other northern European locations. There is also potential for growth in RevPAR as the markets continue to recover. In addition, investment values can be low, meaning assets can often be acquired below build cost. There is then scope to turn performance around through branding/rebranding, capital expenditure, cost reduction (to a degree, although many of these markets have a higher fixed-cost base compared with markets like the UK), and consolidation of existing assets. Demand is primarily fuelled by private equity and real-estate funds largely emanating from the US, which have considerable capital to deploy.

However, in spite of a number of appealing investment opportunities, various issues remain. These include inflexible labour laws, red tape, inconsistent legal environments and lack of transparency, which create barriers to foreign investment. According to the 2014 Doing Business ranking, which illustrates the ease of doing business in 189 countries, none of the countries made it into the Top 20; however, we note the progress achieved since 2008.

As hotel demand has become more international, more domestic hotel owners are finding that they are losing out to global hotel operators in attracting an international clientele. Henceforth, we expect to see more international operators entering the market in the short-to-medium term – either through joint-venture agreements (e.g. Marriott – AC Hotels), or management or franchise contracts.

Portugal

Owing to the relatively small size of the hotel market, deal activity has largely focused on Lisbon and the Algarve

The last activity of any note took place in 2010, with the acquisition of the former Novotel Vermar Conference and Beach hotel in Póvoa de Varzim in northern Portugal by Axis Hotéis & Golfe

Historical transactions have typically involved hotels in distress acquired by Portuguese hotel groups, or, alternatively, well-established assets sold to international investment funds

The Tivoli Hotels & Resorts Portfolio has been on the market since summer 2014, but any progress was delayed by the collapse of Banco Spirito Santo

In January 2015, six of the 14 hotels – four in Portugal and two in Brazil – were sold to Thai company Minor International (MINT) at a reported price of over €168 million, making it one of the largest ever transactions in the Portuguese hotel sector

According to the 2014 Doing Business ranking, Portugal ranked 25th – the highest-ranked of the four countries

Italy

Deal activity to date has largely been concentrated in Rome, Milan, Florence and Venice, with investment from HNWIs primarily interested in trophy assets

Recent hotel transactions include the purchase of the St. Regis Hotel in Rome by Constellation Hotels Holding Limited for approximately €110m

The market is highly fragmented, with an approximate owners-to-hotels ratio of 1:1 and small average hotel size of around 35 bedrooms per hotel

The majority of hotels are owned not by specialist hospitality operators but by families with limited debt exposure and a reluctance to offload the assets. The second-generation hotel-owners are more willing to dispose of hotel assets

Banks are starting to offload hotel assets, but a shift to increased NPL activity is expected

Prime hotel yields in key cities vary between 5% and 7%

Italy ranked 56th according to the 2014 Doing Business ranking

Greece

Limited transactional activity has occurred since 2008

Markets with strong investment appeal include Athens, the Cyclades, Peloponnese and western Greece

There has been a growing interest in hotel real estate from China and Russia, attracted by a visa investor scheme

No NPL transactions to date. However, the banks have now largely assessed their exposure and a number of hotel assets is likely to be offloaded over the coming months

Greek banks are ready to implement a new law on non-performing loans, which is likely to facilitate and encourage investment

Red tape is regarded as the major barrier to investment, along with unstable taxation schemes

Prime hotel yields vary between 14% and 18%

Greece ranked 61st according to the 2014 Doing Business ranking

Spain

Spain has experienced the most transactions compared with Portugal, Italy and Greece, with Barcelona, Madrid and Mallorca proving most popular

Over the last 18 months, interest has increased significantly, widening to include the Balearic and Canary Islands, as well as some coastal areas

Increased activity by SAREB (created in 2012 to deal with non-performing loans) along with SOCIMIs (Spanish REITs) has encouraged investment from domestic and foreign investors

Current yield levels for trophy assets in Madrid and Barcelona are in the region of 4-5.5%, whereas for city-centre hotels, yields are in the region of 6-8%

New opportunities are expected to develop in the market as banks end the refinancing in operation since the start of the economic downturn in 2008

A big gap remains between buyers' and sellers' expectations, despite prices declining since 2008

Spain ranked 33rd according to the 2014 Doing Business ranking

This publication has identified the following trends:

From a macroeconomic perspective, growing confidence in the economic recovery of Spain and Portugal, will be bolstered by rising GDP and international tourist numbers

The strengthening US and UK economies, the recovery of domestic business, and a growing number of tourists arriving from emerging markets are all likely to support further growth of the tourism industry in these countries

The tourism industry is also likely to benefit from the weakening euro and falling oil prices

There are concerns surrounding the state of the Italian and Greek economies, as sluggish reforms in Italy and political uncertainty in Greece could deter potential investment

Fears of economic stagnation in France and Germany, geopolitical uncertainty in Eastern Europe, and a growing Islamist militant threat might also impede future economic recovery and have a negative impact on inbound tourism

In terms of hotel KPIs, some hotel markets have reached the turning point, achieved pre-crisis levels, and are forecast to perform better in 2015

An increase in hotel performance levels in Spain has already attracted investors from private equity and real-estate funds, largely from the US, which led to a significantly higher number of hotel transactions in comparison with Portugal, Italy and Greece

We expect investment in Greece to increase, as banks are ready to implement a new law on non-performing loans, which is likely to facilitate and encourage investment

Portugal, despite its economic recovery, has a limited number of investment opportunities owing to the relatively small size of the hotel market. Therefore, we expect deal activity to focus on Lisbon, the Algarve and Porto

We have cautious expectations regarding investment opportunities in Italy, as more needs to be done to resolve the inefficient labour legislation and stimulate growth of the sluggish economy

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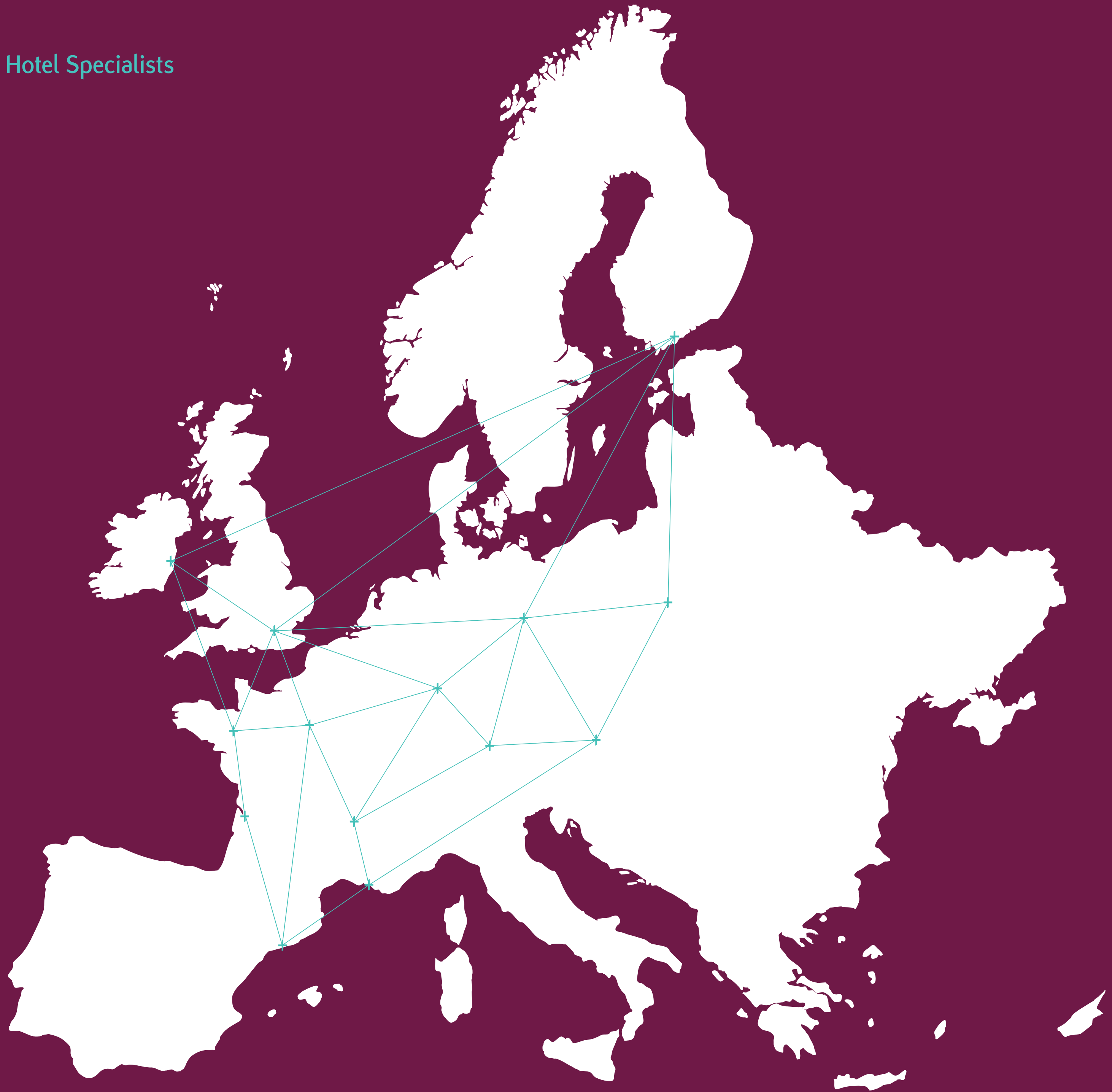

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