MARCH 2017

2017 EUROPEAN
HOTEL VALUATION INDEX

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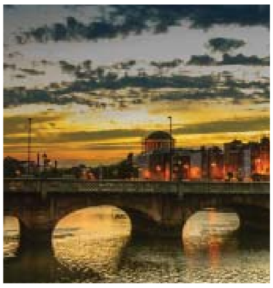

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Highlights

Consolidation

Marriott, AccorHotels, HNA… many companies were kept busy with merger and acquisition activity in 2016. So much so that about one-third of full-service branded hotels were involved in a transaction during the year. With increased scale seen as the way forward for growth, and also partly as a solution to challenges such as sharing platforms or OTAs, more changes in ownership are likely to continue to take place in 2017.

Tourism Dynamics

Despite many upheavals in Europe, including terrorism and safety and security issues, tourist arrivals increased, albeit at lower levels than in a more stable year. By the third quarter of 2016, most destinations across the region recorded growth, with some destinations such as Spain and Portugal even enjoying double-figure rises. France remained the most visited country in the world in 2016, despite some tumultuous events.

Hotel Performance

RevPAR growth remained strong across most European markets, with a few exceptions such as Paris, Milan, Brussels and, to a lesser extent, London. Given the European hotel pipeline, which is subdued at around 3% (compared to the double-figure pipelines of other continents), and continuing increases in demand for Europe, we forecast improvement in performances to continue in 2017, albeit potentially at a slower pace for a number of markets.

Disruptors

Technology continued to shake up the hotel industry over the past year, and enforced regulations on Airbnb in various markets (Dublin, Paris, Barcelona, London, Amsterdam and others) might affect the ever-changing rules of the game. Parallel to this, hotel companies have been launching campaigns to lure customers to book with them directly, with unclear long-term effects on rate.

Transaction Volume

In 2016, total European hotel transaction volume was €17.8 billion, a 25% fall on the record volume achieved in 2015 – but still the second-largest volume since pre-crisis levels in 2006/07. Germany eclipsed the UK, owing to the sale of an impressive €2.5 billion worth of portfolio assets – an increase of almost 30% compared to a fall in UK portfolio transactions of around 83% (in euro, reflecting the year-on-year ca. 10% loss in value of the pound sterling). London was still the leading European hotel transaction market, with a total volume of around €1.8 billion, ahead of Paris's €1.1 billion, although there are sound reasons for the French capital being somewhat out of favour at the moment. Finally, 83% of total volume was acquired by European players, with a large fall in North American, Middle Eastern and Asian investment. Please refer to our sister publication *2016 European Hotel Transactions* for more details.

Capitalisation Rates

Investor appetite continued to put pressure on capitalisation rates across a number of markets, as improving performance and limited pipeline allowed for income growth to be built into valuations.

Hotel Values

European average values per room are still 10% lower on average than those recorded in the peak of 2006/07. Although the German markets, for example, have all risen well above the peak values (close to 30% higher on average), Eastern European markets need to gain a further 20% to reach their former peak.

The European Hotel Valuation Index

2016 was a mixed bag. Some markets performed exceptionally well and others less so. This resulted in almost no change in the European average. In 2016, values in Dublin, Barcelona, Lisbon and Stockholm overtook previous peaks and some of these cities are among the top performers this year, in terms of percentage growth. Overall, the leaders in the index remain unchanged, but some cities were able to move up in the ranking. Looking at the bottom of the index, Sofia remains in the lowest position, even after an excellent performance in 2016, followed by Birmingham, which was penalised by the depreciation of the pound. Bratislava, St Petersburg and Athens complete the bottom five, yet all three achieved substantial value growth in 2016.

Winners and Losers

We have shortlisted the winners and losers in terms of percentage change in value in 2016 into a top and bottom chart (see pages 6 and 7). Currency dynamics in 2016 seem to have had a stronger impact than usual, mainly due to the British markets, so we also present the top and bottom markets in terms of local currency value change.

CHANGES IN VALUE

Strong Performers

2016 shows the return of Eastern Europe, with an impressive average of 11% growth in hotel values. While Budapest and Prague pioneered this trend, other markets (including Russia) have now followed suit. Bratislava, Sofia and Bucharest all grew values from a low base and this affordability may be key in developing a stronger demand base; holidays in the Eurozone for UK citizens, for example, have just become considerably more expensive, giving them a reason to seek new destinations.

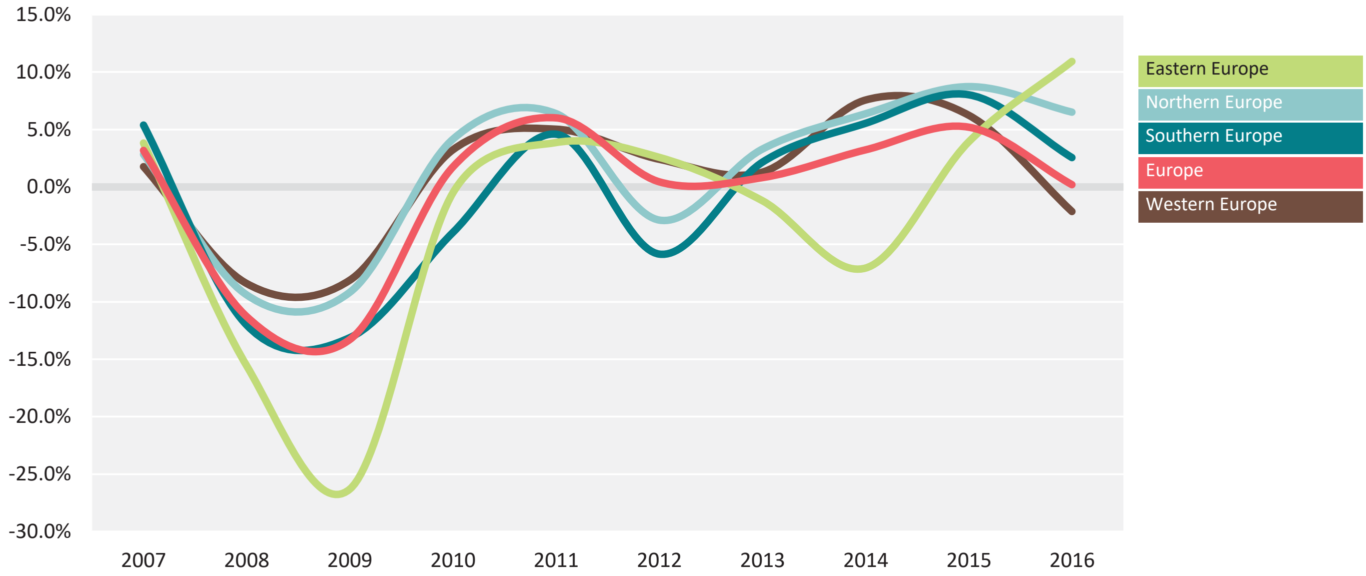
Many Eastern European markets are benefitting from the misfortunes of Western Europe.

Many Eastern European cities, especially **Sofia**, are benefitting from the misfortunes of Western Europe. Russian visitation to Sofia has increased significantly after several fall-outs between Turkey and Russia. The fact that prices in the city are still cheap is the main demand driver, but Bulgaria as a whole has now started to put together a comprehensive tourism strategy to effectively promote its many offerings to visitors.

Slovakia's capital, **Bratislava**, a more established destination with excellent connectivity through both its own airport and Vienna International airport, was able to

Year-on-Year Change

IN VALUES PER ROOM BY REGION 2007-16



Source: HVS – London Office

Note: Based on euro calculations

Hotel Values

PERCENTAGE CHANGE IN HOTEL VALUES IN EURO

		2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	CAGR[1] 2007-16
1	Bratislava	3.0	-15.2	-18.8	-15.9	4.0	-6.2	0.0	-6.3	10.7	**18.9**	-3.9%
2	Sofia	12.4	-16.0	-27.1	0.5	-9.2	0.3	-6.8	7.1	7.5	**16.0**	-3.9%
3	Dublin	-2.5	-18.6	-20.2	-5.4	6.1	5.5	6.6	13.2	13.4	**15.5**	0.9%
4	Bucharest	8.1	-21.4	-22.9	-8.0	4.6	-6.6	0.4	5.9	9.3	**14.6**	-3.5%
5	Barcelona	5.5	-19.4	-15.0	3.3	2.4	1.3	5.0	6.3	10.9	**13.8**	0.4%
6	Madrid	2.0	-16.8	-18.2	-7.4	2.6	-6.8	-5.6	14.3	14.2	**11.0**	-2.1%
7	Athens	4.7	-2.5	-14.0	-29.3	5.9	-23.8	7.6	5.9	12.6	**10.6**	-4.2%
8	Lisbon	11.9	-11.8	-14.0	-2.7	11.1	-10.0	6.0	10.3	11.1	**10.2**	0.6%
9	Warsaw	10.2	-4.0	-18.2	5.1	8.7	5.7	-6.4	-7.0	2.4	**10.1**	-0.8%
10	Budapest	-1.2	-17.1	-16.8	-0.8	4.0	-0.5	2.5	7.5	8.0	**9.9**	-0.8%
11	Prague	-5.4	-21.0	-20.3	1.6	3.7	4.7	0.0	5.7	9.4	**9.9**	-1.4%
12	Hamburg	-6.3	-3.2	-2.5	4.4	6.3	-0.3	2.2	6.7	5.3	**7.8**	2.9%
13	Copenhagen	1.0	-6.4	-2.2	-0.9	4.1	-0.5	4.9	9.1	8.9	**7.8**	2.6%
14	Amsterdam	-0.8	-14.9	-16.0	10.4	6.4	-2.8	4.8	8.6	8.6	**6.7**	0.8%
15	Moscow	2.1	-4.8	-38.8	4.2	3.8	11.6	-4.2	-37.9	-13.2	**5.5**	-10.1%
16	Stockholm	8.3	-6.9	-9.4	3.0	8.7	-5.4	0.2	1.5	8.7	**5.0**	0.4%
17	Vienna	6.5	-5.2	-18.4	-1.7	3.0	2.6	-4.8	7.3	5.3	**4.3**	-1.1%
18	St Petersburg	1.3	-25.0	-47.6	9.2	11.3	11.5	4.9	-31.6	-2.6	**2.6**	-10.1%
19	Florence	16.8	-25.3	-12.5	9.1	3.3	-1.1	9.3	8.0	9.7	**1.8**	-0.4%
20	Berlin	-0.7	0.2	-0.8	4.4	-2.6	2.6	-0.4	6.3	8.1	**1.7**	2.1%
21	Rome	-4.3	-17.6	-10.2	1.9	6.0	-2.4	2.3	3.7	4.5	**0.5**	-1.6%
	EUROPE	**3.2**	**-11.3**	**-13.3**	**1.8**	**6.0**	**0.4**	**0.8**	**3.2**	**5.2**	**0.2**	**-1.0%**
22	Munich	3.4	-7.0	-10.2	14.7	4.6	8.3	6.7	7.8	3.7	**-1.1**	2.8%
23	Frankfurt	-6.4	-7.9	-0.1	19.4	6.9	2.4	4.7	2.2	8.6	**-2.0**	3.6%
24	Milan	-1.7	-13.6	-13.0	-12.4	3.9	-4.1	3.6	5.7	10.1	**-3.7**	-3.0%
25	Manchester	-1.2	-21.9	-12.2	-4.4	0.2	3.8	0.2	13.5	11.6	**-3.9**	-2.0%
26	Geneva	5.4	17.3	-9.6	-1.4	13.1	-3.5	-5.4	6.5	0.9	**-4.0**	1.2%
27	Zürich	7.6	5.6	-4.5	12.1	11.1	-5.1	1.9	6.6	0.9	**-6.2**	2.3%
28	Brussels	6.1	1.7	-11.8	0.1	3.7	-1.5	1.5	4.0	3.5	**-6.7**	-0.7%
29	Edinburgh	1.7	-27.1	-7.6	2.8	1.7	4.5	2.5	7.3	10.7	**-6.7**	-2.0%
30	Birmingham	-0.5	-22.7	-13.1	-12.0	-6.7	3.3	0.6	11.0	12.9	**-6.8**	-4.4%
31	Paris	6.0	-5.9	-3.6	4.2	10.9	4.6	1.7	4.9	-0.5	**-8.1**	0.8%
32	London	5.5	-23.1	0.9	8.4	12.0	6.5	0.0	8.5	2.9	**-13.9**	-0.4%
33	Istanbul	8.2	10.8	-8.0	5.8	1.6	0.3	-11.0	-9.9	-8.9	**-23.7**	-5.3%

Source: HVS – London Office

[1]*Compound Annual Growth Rate*

Local Hotel Values

PERCENTAGE CHANGE IN HOTEL VALUE IN LOCAL CURRENCY

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	CAGR[1] 2007-16
Birmingham	-0.1	-10.3	-2.5	-15.3	-5.4	-2.6	4.0	5.6	1.7	**5.1**	-2.4
Bucharest	2.4	-13.3	-11.2	-8.6	7.2	-3.8	-0.5	6.6	9.3	**15.9**	-0.3
Budapest	-5.5	-17.1	-7.2	-2.7	12.3	-3.1	6.7	10.0	9.5	**9.5**	1.5
Copenhagen	1.0	-6.4	-2.1	-0.9	4.0	-0.3	4.9	9.1	8.9	**7.7**	2.6
Edinburgh	1.7	-15.3	3.6	-1.0	3.1	-1.5	6.0	2.1	-0.3	**5.3**	0.0
Geneva	5.4	13.2	-13.9	-9.9	-2.5	-2.1	-3.3	5.5	-12.1	**-1.8**	-3.3
Istanbul	8.2	17.7	4.7	-2.3	18.0	-0.4	-2.4	3.9	-5.8	**-15.3**	1.5
London	6.0	-10.7	13.1	4.4	13.4	0.4	3.4	3.2	-7.3	**-2.8**	1.6
Manchester	-0.8	-9.3	-1.6	-7.9	1.6	-2.2	3.6	8.0	0.5	**8.5**	-0.0
Moscow	15.7	-4.8	-14.8	-5.3	-13.5	8.3	2.1	-24.0	12.9	**16.7**	-3.4
Prague	-7.3	-29.0	-15.6	-2.7	0.8	7.2	4.4	10.9	8.3	**9.0**	-1.7
Sofia	12.2	-16.2	-27.1	0.5	-9.1	0.3	-6.8	7.1	7.5	**16.0**	-3.9
St Petersburg	14.8	-25.0	-27.1	-0.8	-7.2	8.3	11.8	-16.3	26.7	**13.5**	-3.4
Stockholm	8.2	-5.4	2.4	-7.4	2.8	-8.9	-0.7	7.1	11.9	**6.2**	0.7
Warsaw	7.1	-11.1	0.9	1.1	7.4	8.0	-6.4	-7.4	2.5	**14.7**	0.8
Zürich	12.3	2.0	-9.1	2.5	-4.2	-3.7	4.2	5.7	-12.1	**-4.1**	-2.3

Source: HVS – London Office

[1]*Compound Annual Growth Rate*

Hotel Valuation Index

2007-16

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
1 Paris	3.463	3.259	3.142	3.274	3.632	3.798	3.861	4.052	4.030	**3.705**
2 London	3.588	2.760	2.786	3.018	3.380	3.599	3.599	3.904	4.018	**3.461**
3 Zürich	2.377	2.510	2.397	2.686	2.984	2.833	2.886	3.077	3.106	**2.912**
4 Geneva	2.275	2.669	2.414	2.379	2.690	2.597	2.457	2.616	2.639	**2.534**
5 Rome	2.610	2.150	1.929	1.967	2.085	2.034	2.082	2.159	2.257	**2.268**
6 Florence	2.251	1.681	1.471	1.605	1.658	1.640	1.793	1.936	2.124	**2.161**
7 Amsterdam	1.984	1.689	1.419	1.567	1.667	1.620	1.698	1.844	2.002	**2.135**
8 Barcelona	1.817	1.465	1.245	1.287	1.317	1.334	1.400	1.489	1.651	**1.880**
9 Milan	2.408	2.080	1.809	1.585	1.647	1.579	1.636	1.729	1.904	**1.833**
10 Munich	1.338	1.243	1.116	1.281	1.340	1.451	1.548	1.670	1.731	**1.712**
11 Copenhagen	1.256	1.176	1.150	1.140	1.187	1.182	1.240	1.352	1.472	**1.588**
12 Madrid	1.872	1.556	1.273	1.179	1.210	1.127	1.064	1.216	1.389	**1.542**
EUROPE	**1.682**	**1.492**	**1.294**	**1.317**	**1.396**	**1.402**	**1.414**	**1.459**	**1.535**	**1.538**
13 Dublin	1.407	1.146	0.915	0.865	0.918	0.968	1.033	1.169	1.326	**1.532**
14 Edinburgh	1.773	1.293	1.195	1.228	1.249	1.305	1.338	1.437	1.590	**1.483**
15 Stockholm	1.417	1.319	1.196	1.231	1.338	1.265	1.268	1.287	1.399	**1.469**
16 Hamburg	1.105	1.070	1.043	1.089	1.158	1.154	1.179	1.258	1.325	**1.430**
17 Frankfurt	0.969	0.892	0.892	1.064	1.138	1.165	1.220	1.247	1.355	**1.327**
18 Prague	1.437	1.135	0.904	0.919	0.953	0.997	0.997	1.054	1.153	**1.267**
19 Vienna	1.355	1.285	1.049	1.031	1.062	1.090	1.038	1.114	1.174	**1.225**
20 Berlin	1.007	1.009	1.000	1.044	1.017	1.043	1.039	1.104	1.193	**1.214**
21 Warsaw	1.202	1.154	0.944	0.993	1.079	1.141	1.069	0.994	1.017	**1.120**
22 Istanbul	1.795	1.990	1.831	1.938	1.968	1.975	1.757	1.583	1.442	**1.100**
23 Brussels	1.105	1.125	0.992	0.993	1.029	1.014	1.029	1.071	1.109	**1.035**
24 Manchester	1.244	0.971	0.853	0.815	0.817	0.847	0.850	0.964	1.076	**1.034**
25 Budapest	1.101	0.913	0.760	0.754	0.784	0.780	0.800	0.860	0.929	**1.021**
26 Lisbon	0.962	0.849	0.730	0.710	0.789	0.710	0.753	0.830	0.922	**1.016**
27 Moscow	2.525	2.403	1.471	1.533	1.591	1.775	1.701	1.057	0.917	**0.968**
28 Bucharest	1.175	0.923	0.712	0.655	0.685	0.640	0.643	0.681	0.744	**0.852**
29 Athens	1.255	1.223	1.051	0.743	0.787	0.599	0.645	0.683	0.769	**0.850**
30 St Petersburg	2.138	1.604	0.840	0.917	1.021	1.139	1.195	0.817	0.796	**0.817**
31 Bratislava	1.132	0.960	0.780	0.656	0.682	0.640	0.640	0.600	0.664	**0.789**
32 Birmingham	1.140	0.881	0.766	0.674	0.629	0.650	0.654	0.726	0.820	**0.764**
33 Sofia	1.029	0.864	0.630	0.633	0.575	0.577	0.537	0.575	0.618	**0.717**

Source: HVS – London Office *Note: Based on euro calculations*

build on a good performance in 2015. The city is now actively promoting MICE tourism, which experienced a boost in the second half of 2016 when Slovakia hosted the European Union (EU) Presidency for six months.

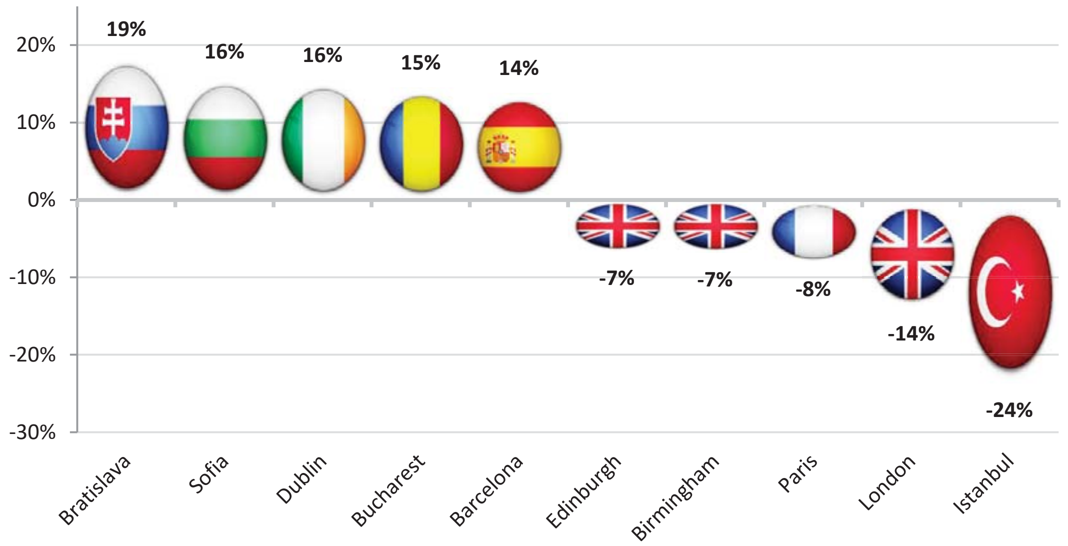
Romania is now among the fastest growing economies in the EU, driven by increased consumption through recent tax reliefs and VAT cuts. Wages are rising due to a shortage of qualified personnel. Successful businesses have helped increase spending in **Bucharest** and drive the accommodation sector. While the corporate segment remains dominant, leisure tourism is rising, supported by Danube river cruises. Significant potential exists in the market, as occupancies are high (>70%) and rates are still well below those of hotels in neighbouring cities Prague and Budapest, possibly also due to a smaller luxury market. The future looks bright, but the country lacks professionals to promote the city, as well as a modern MICE venue to attract larger conferences. An underdeveloped infrastructure and the extreme shortage of qualified hotel staff will be some of the challenges to overcome for this market.

Dublin, again in the top five, was able to build on a very successful 2015 and has repeatedly reported double-figure RevPAR growth. Limited supply growth in the city has allowed hoteliers to grow occupancy levels and leverage average rates, resulting in a growth in values in 2016. The outlook for Dublin for 2017 appears very positive; new supply is somewhat limited with most of the pipeline entering the market in 2018. Similarly, the city is among the contenders to take up jobs from

Dublin is among the contenders to take up jobs from financial institutions in London post-Brexit.

Top and Bottom Five

PERCENTAGE CHANGE IN HOTEL VALUES IN EURO



Source: HVS – London Office

financial institutions in London post-Brexit and is currently building a second runway at its airport. Although investment volume in 2016 was considerably below that of 2015, hotels transacted a higher price per room, showing the continued interest from investors.

Unsurprisingly, **Barcelona** experienced another record year. On the back of strong rate growth, values per room increased by 14% in 2016. This is great news for those who are there now – as the regulations on new hotel development continue to be very strict and barriers to entry are high. The few projects that have planning permission will enter the market in 2017, and the future for new hotels thereafter remains highly uncertain. Similarly, illegal tourism rental apartments will soon face heavy fines or closure, which will further decrease the accommodation capacity of the city. Tourism arrivals have been growing at a steady pace over the past few years (11% increase in airport arrivals in 2016), but tourism might also soon face a cap as Barcelona is flooded every summer by day trippers from nearby beach destinations or cruise ships. Going forward, 2017 and 2018 are expected to be busy years for the conference segment, giving hoteliers a further opportunity to leverage rates.

Lastly, if we compare value growth on a local currency basis, **Moscow** is back among the top five. Apart from the political turmoil, the second half of 2016 was very positive for Russia: a strengthening rouble together with a slow recovery in oil prices allowed the economy to come out of recession. In Moscow, values per room rose by 17% in local currency. The pipeline for Moscow is strong; more than 6,000 rooms are expected to enter the market within the next 18 months, in time for the FIFA World Cup in 2018.

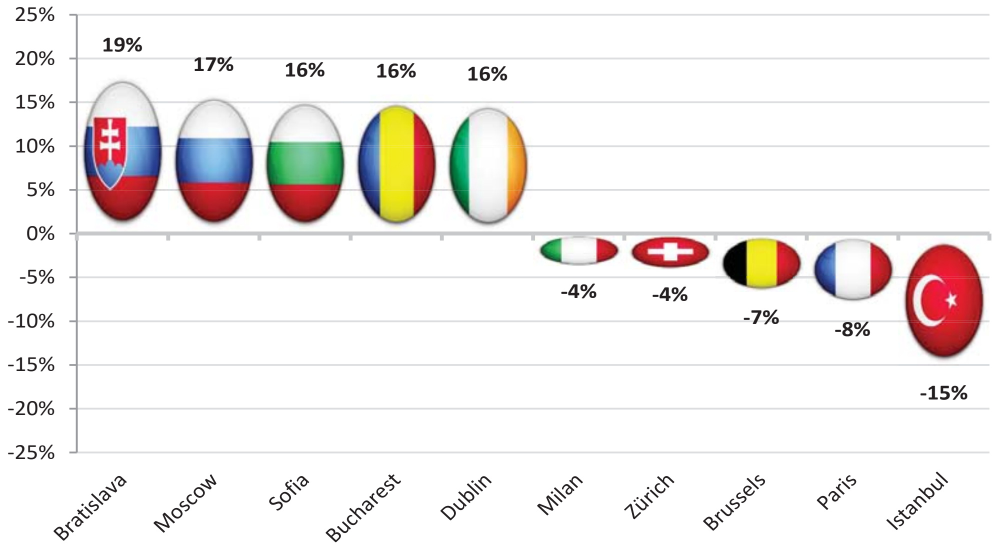
Challenged Markets

Terrorist attacks, Brexit, an unknown future for the Eurozone and increasingly protectionist political movements led to a decrease in values per room in euro of around 2.1% in Western Europe. The British cities only appear at the bottom of the list because of the currency dynamics – in a local currency analysis, Zürich, Milan and Brussels complete the list of the bottom five markets instead of London, Edinburgh and Birmingham.

It is the second year that **Istanbul** has featured in our 'losers' list, for much the same reasons, but with more intensity. The political stability of Turkey is no longer certain, and an attempted coup d'état in July along with six terrorist attacks (152 casualties) have helped seal the fate for Istanbul as a tourism destination, at least in the short term. Russia, the strongest source market for Turkey, placed a ban on Russian charter flights to Turkey between November

Top and Bottom Five

PERCENTAGE CHANGE IN HOTEL VALUES IN LOCAL CURRENCY



Source: HVS – London Office

2015 and August 2016 over military disputes and the continued involvement in the Syria conflict. Overall, these are certainly not the prerequisites wished for in terms of foreign investment in hotels, although the pipeline for 2017 is still substantial (it remains to be seen how much of the pipeline will become operational). The Turkish lira continued its depreciation against the euro in 2016.

After sterling depreciated significantly against the euro in 2016, three UK cities made the bottom-five list, experiencing large drops in euro values per room. But only **London** showed a softening of values in local currency. The UK capital experienced a slow start in 2016 and hotels only recorded performance growth in November and December, despite large events like the biennial Farnborough Airshow, as the expected boom in visitation from a cheaper currency did not materialise immediately. A substantial influx of new supply further hindered occupancy growth, and luxury hotels experienced drops in spending in the aftermath of the Paris, Nice and Brussels terrorist attacks. Nevertheless, investment did not come to a halt. After some uncertainty in the first half of the year, activity returned in the second half, and it should be noted that prices for foreign capital are now substantially discounted (albeit, as are earnings). Additionally, planned supply for London will not dry up any time soon, as the next three years will see more than 11,000 new hotel rooms enter the market.

Edinburgh, on the other hand, is on a roll. After very good performance growth in 2014 and 2015, the city has again recorded some 7% RevPAR growth on the back of a strong (group) leisure segment and supported by the expanding airport infrastructure (11% growth in passenger figures). Apart from the continued popularity of the various summer festivals, the city has become very much a year-round destination with annual occupancy levels over 80% – stronger than London in 2016. There is a considerable pipeline for the next two years, of predominantly internationally branded hotels.

BRASTISLAVA: THE NEXT PRAGUE?

Similarly, **Birmingham** remains a winner, although it lost some value in euro terms. The city managed to build on its increased exposure through the Rugby World Cup in 2016, and the percentage of visitors that stay overnight doubled in three years to 45%. The increase in visitation is driven by the leisure segment, attracted by the growing cultural offer. The fuller event calendar, improved connectivity (14% increase in airport passengers, and the much talked about HS2 railway project on the horizon) and very modest pipeline bode well for the continued development of the city's hotel performance (in local currency).

After a complicated year in 2015, 2016 was certainly depressing for **Paris**. Further terrorist attacks in Brussels (February) and Nice (July) solidified fears among the leisure segment (especially group travel) in visiting the city. Heavy flooding in June and several air-traffic-staff strikes made matters worse, and not even the UEFA Euro 2016 championship could counterbalance these dynamics. With an overall RevPAR decrease of 13%, hotels' top lines were heavily impacted, but profitability also suffered as strict labour laws in France prevented hoteliers from being more flexible on staffing levels. The luxury hotels (heavily geared towards the leisure segment) as well as non-city centre hotels (usually benefitting from overspill demand) suffered most from recent events. Nevertheless, it is our opinion that this is a short-term situation; investor interest has not shown any sign of slowing, which is reflected in the strong pipeline – especially in the luxury segment – and the still substantial transaction volume in 2016. However, the city has another hurdle to face: presidential elections, which will take place in May 2017, and the race is still very much open at the time of writing.

Investor interest in Paris has not shown any sign of slowing, but could be affected by the outcome of the presidential elections in May 2017.

ISTANBUL: ANOTHER DIFFICULT YEAR FOR THE GATEWAY CITY BETWEEN ASIA AND EUROPE

Much like Paris, **Brussels** has experienced one of its worst years, owing to terrorism. The downturn in demand started in November 2015 when the government issued a security alert that was extended with the attacks in the city in February 2016. The leisure segment took the biggest hit, but Brussels also saw a considerable decline in the MICE segment, as organisers hesitated to choose the city for an event. Hoteliers were able to maintain rates somewhat, but remain cautious until at least the second half of 2017. While the outlook might not appear to be the best, the city still has a stable base of corporate demand, linked to the EU, and the virtual lack of new supply until the Corinthia (Astoria) property enters the market in 2020 should help the city's hotels to recover occupancy levels.

Zürich is among the bottom five markets in local currency terms. In contrast to the UK, Zürich's hotels are affected by a strengthening Swiss franc, making an already expensive Switzerland even pricier. The city remains dominated by family-operated businesses, with an illiquid transaction market, making barriers to entry even higher. An influx of new supply around the airport has increased pressure on rates and this is expected to continue in the short term, as Motel One will make its debut in the city with some 400 rooms, one of the largest hotels in the country. Zürich remains attractive for the corporate segment; however, repeated controversial initiatives might decrease the city's attractiveness for international headquarters.

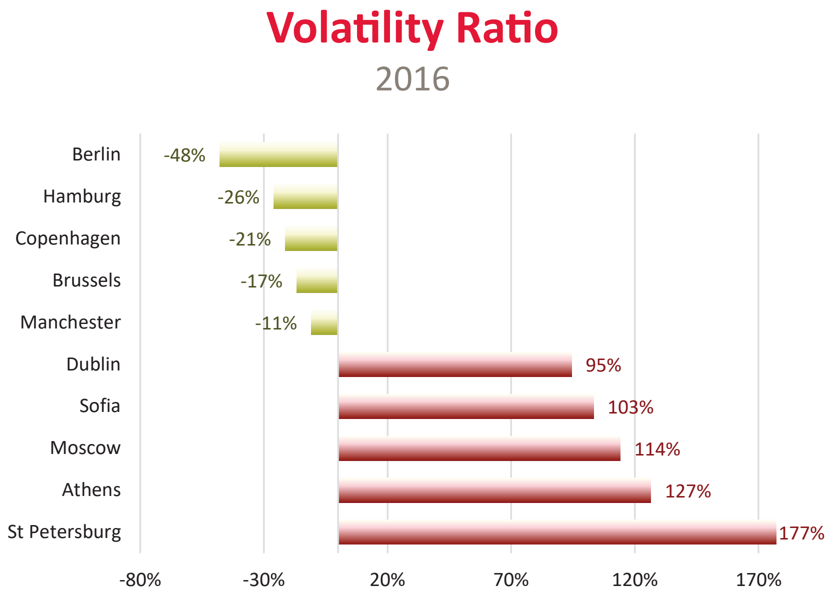
A drop in performance was to be expected for **Milan**, following the very successful Expo year in 2015, but the city's hotels still performed better than in 2014. Large supply increases in time for the Expo and a number of rumoured projects, especially in the luxury segment, will keep up the pressure on hoteliers going forward. While the future seems relatively bright for the city and its hotels, Italy as a whole remains not without structural challenges. A much-needed reform on how the country is governed was rejected by a people's vote in December and the amount of bad debt present in Italian banks lies heavy on the balance sheets.

Most and Least Volatile Cities

The volatility ratio is a tool to assess (to a certain extent) the fluctuation in value and the overall risk associated with a hotel investment. Hotels are not only a capital-intensive type of asset, but they are also affected by external factors such as micro and macro market issues (oversupply, recessions, natural disasters, terrorism and so forth). Any of these factors could have an impact on the profitability of the business; thus, it is critical to be able to quantify the overall level of risk associated with a hotel investment. A good indicator of investment risk is volatility, which provides a measure for variation in asset prices over time. Higher volatility implies higher risk. We have therefore again included a volatility ratio, which calculates the standard deviation of the annual capital appreciation/ depreciation in value divided by the average value (Europe) over the same period. For example, Dublin has a volatility ratio of 95%, which means that hotel values are 95% more volatile than the value of a typical hotel in Europe. A higher level of volatility would be more acceptable in cases where the returns are also high. A city with the highest negative volatility would in fact be the most stable market, as it would change even less than the average (Europe).

The volatility ratio shows the five most and five least volatile European cities in 2016 in local currency (to remove the impact of currency fluctuation), with Europe as a whole set at 0%.

The most volatile markets mainly remain the same as presented in the 2016 HVI except that Moscow replaces Prague as the third most volatile. In terms of the least volatile, Brussels has moved to fourth position and Manchester came in fifth, just before Paris.



Note: volatility is expressed in relation to the overall European average

Source: HVS – London Office

Outlook

The many political surprises that 2016 had in store for us will doubtless be followed by others, as France, Germany and the Netherlands hold key elections in 2017. Investment activity should somewhat intensify as these events take place and remove (or otherwise!) some element of uncertainty.

In addition to some potential bombshells on the political front, it is likely that we might have other surprises, as established hotel companies continue to explore new partnerships with disruptor companies, in an effort to capture part of the new business these newcomers have created. Companies diversifying their demand base, if not re-inventing themselves, is one of the newest trends that should continue to be the focus in 2017.

Regardless of political situations, hotel values in Europe still have some room for growth, as markets, such as in some of the 'PIGS' countries, for example, continue to climb the value ladder to their rightful positions. The prospect of rising inflation in the UK, as a result of Brexit, indicates that the time for an upward movement in interest rates might be coming nearer. An increase in capitalisation rates for the UK is therefore likely, whilst for Europe a number of markets would still be expected to experience a tightening of yields (potentially Germany, or Spain again).

As previously indicated, a subdued pipeline, decent demand growth and room for rises in value compared to ten years ago all bode well for Europe in 2017, although with moderation.

The US Federal Reserve's gradual interest rate increases have started reversing the long downward trend in the cost of debt. Europe is not about to replicate this move in the immediate future, but change is looming for 2017 and beyond (particularly in the UK). However, cheap debt is not going to go away overnight, so investors should expect no shocks on that front at least!

As we indicated last year, holding horizons continue to be short, and the appetite to sell is magnified by the prospect of most markets potentially reaching the end of the investment cycle over the next 12-24 months. Uncertainty has, however, made operating leases all the more attractive to investors… alas, not so much yet for operators.

Generally, 2017 could be another solid year for foreign investment in Europe. As the price of oil might start slowly to recover, this could have positive repercussions for Middle Eastern investment. Also, whilst capital controls imposed by China for 'non-core' business investment might pose some challenges, European returns remain attractive to Chinese investors, with a weaker renminbi, whose interest for trophy assets in key gateway cities is expected to remain solid going forward. Another action-packed year has just started – if you must blink, do it now!

– HVS –

Understanding the HVI

The HVI is a hotel valuation benchmark developed by HVS. It monitors annual percentage changes in the values of typically four-star and five-star hotels in 33 major European cities. Additionally, our index allows us to rank each market relative to a European average. All data presented are in euro, unless otherwise stated.

The methodology employed in producing the HVI is based upon actual operating data from a representative sample of four-star and five-star hotels. Operating data from STR were used to supplement our sample of hotels in some of the markets. The data are then aggregated to produce a pro forma for a typical 200-room hotel in each city. Using our experience of real-life hotel financing structures gained from valuing hundreds of hotels each year, we have determined valuation parameters for each market that reflect both short-term and longer-term sustainable financing models (loan to value ratios, debt coverage ratios, real interest rates and equity return expectations). These market-specific valuation and capitalisation parameters are applied to the EBITDA less FF&E Reserve for a typical upscale hotel in each city. In determining the valuation parameters relevant to each of the 33 cities included in the European HVI, we have also taken into account evidence of actual hotel transactions and the expectations of investors with regard to future changes in supply, market performance and return requirements. Investor appetite for each city at the end of 2016 is therefore reflected in the capitalisation rates used and investment yields assumed.

The HVI assumes a date of value of 31 December 2016. Values are based on recent market performance, but the capitalisation rates reflect the expected future trends in performance, competitive environment, cost of debt and cost of equity. As our opinion of value remains an opinion of Market Value, we have attempted to remove all aspects of distress when analysing transactions and assessing the opinions of value. The parameters adopted assume a reasonable level of debt and investor sentiment. Conversely, the values reported may not therefore bear comparison with actual transactions completed in the marketplace. However, this is the best approach to retain the integrity of the HVI as a rolling annual index.

The HVI allows comparisons of values across markets and over time by using the 1993 average European value of €173,737 per available room (PAR) as a base (1993=1.000). Each city's PAR value is then indexed relative to this base. For example, if the index for Paris was 4.000 (€694,948/€173,737), the value of a hotel in Paris would be four times higher than the European average in 1993.

INDEX RANKING | PERCENTAGE CHANGE IN VALUE (€)

About HVS

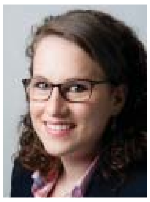
HVS, the world's leading consulting and services organization focused on the hotel, mixed-use, shared ownership, gaming, and leisure industries, celebrated its 35th anniversary last year. Established in 1980, the company performs 4,500+ assignments each year for hotel and real estate owners, operators, and developers worldwide. HVS principals are regarded as the leading experts in their respective regions of the globe. Through a network of more than 40 offices and more than 350 professionals, HVS provides an unparalleled range of complementary services for the hospitality industry. HVS.com

Superior Results through Unrivalled Hospitality Intelligence. *Everywhere*.

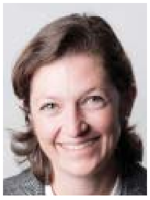
With offices in London since 1990, HVS London serves clients with interests in the UK, Europe, the Middle East and Africa (EMEA). We have appraised some 4,000 hotels or projects in more than 50 countries in all major markets within the EMEA region for leading hotel companies, hotel owners and developers, investment groups and banks. Known as one of the foremost providers of hotel valuations and feasibility studies, and for our ability, experience and relationships throughout Europe, HVS London is on the valuation panels of numerous top international banks which finance hotels and portfolios.

For further information about the services of the London office, please contact Sophie Perret, director, on +44 20 7878 7722 or sperret@hvs.com.

About the Authors



Nicole Perreten is a senior associate with the HVS London office. Before joining HVS in 2015, she gained valuable operational experience in various establishments in France and Switzerland, and worked with STR and Cushman & Wakefield in London. Nicole holds a BSc (Hons) in International Hospitality Management from Ecole hôtelière de Lausanne with a specialisation in real estate, market and corporate finance. Recent assignments at HVS include hostel and hotel valuations and feasibility studies and hotel market overviews for several European cities.



Sophie Perret is a director at the HVS London office. She joined HVS in 2003, following ten years' operational experience in the hospitality industry in South America and Europe. Originally from Buenos Aires, Argentina, Sophie holds a degree in Hotel Management from Ateneo de Estudios Terciarios, and an MBA from IMHI (Essec Business School, France and Cornell University, USA). Since joining HVS, she has advised on hotel valuations and investment projects and related assignments throughout the EMEA region, and is responsible for the development of HVS's business in France and the French-speaking countries. Sophie completed an MSc in Real Estate Investment and Finance at Reading University in 2014.