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GERMANY – THE INVESTOR'S DARLING?

A SNAPSHOT OF SELECTED CITIES

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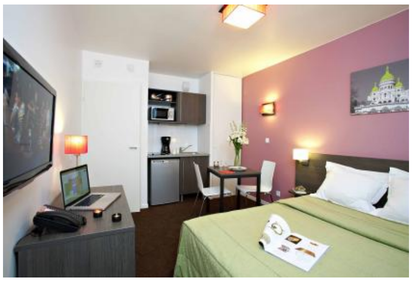


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Introduction

Compared to the vast majority of European countries, Germany's economy has boasted a strong performance over the past two to three years, both on an economic level and on a hotel performance level. Economic output has been showing above-average growth, despite the ongoing Eurozone debt crisis, which has led to a fundamental change in Germany's economic positioning within Europe over the past ten years. While the Federal Republic is today regarded as a supporting pillar and engine of growth for the Eurozone, it was still characterised as the 'sick man of Europe' a few years ago, owing to its low macroeconomic growth, which was considered to be a risk to those countries in the Eurozone.

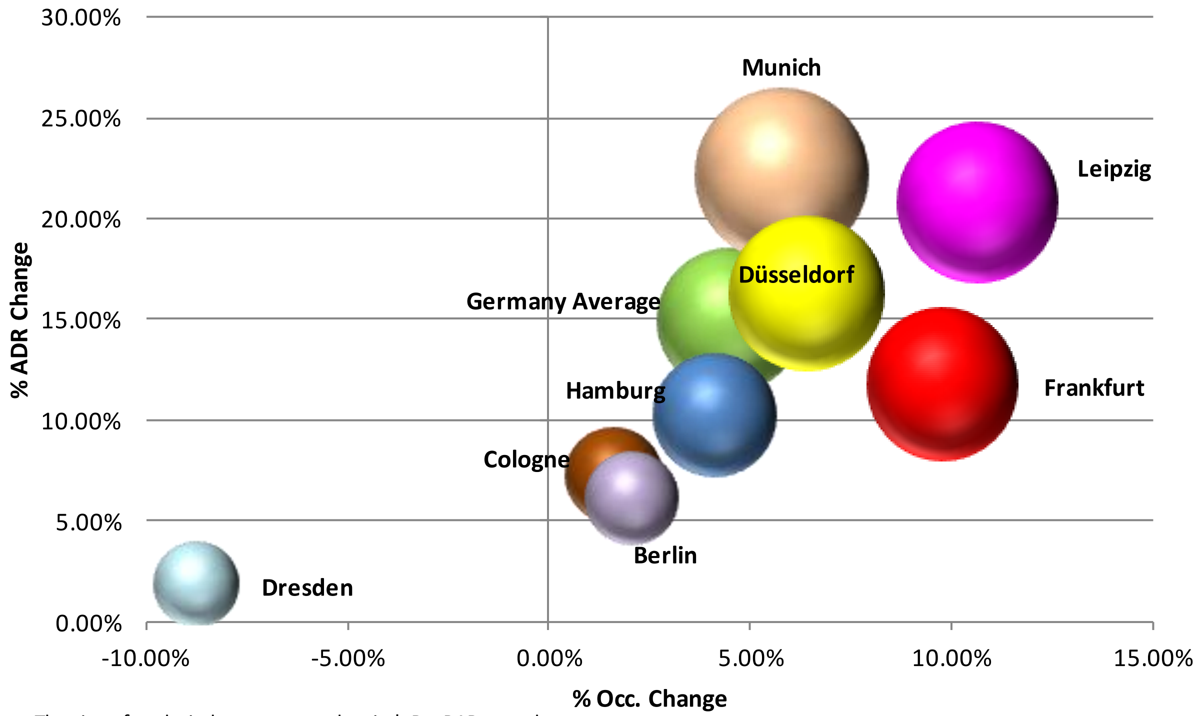
Given this strong performance, it is not surprising that Germany continues to be everybody's darling. This article gives an overview of the latest hotel real estate trends in Germany by focusing on the top four performers since the onset of the crisis, touches on the booming hotel investment market and lastly gives an indication of the movement of hotel values.

A Retrospective Look

The German hotel market generally differs from that of other European markets, such as the UK and France, since the average daily room rate is relatively low in comparison. The majority of European markets began to feel the impact of the financial crisis in 2008, while it was not until the first half of 2009 that the market crashed in Germany, with both arrivals and overnight stays suffering from decreases. Markets that were particularly dependent on the commercial segment, such as Frankfurt, Düsseldorf and even Munich, recorded particularly large declines.

2010, however, brought a fleeting recovery, with many markets already exceeding their 2007 peak. Germany's strong manufacturing industry and continued demand for exports helped the economy and the hotel sector recover faster than other European markets. GDP growth in 2010 actually recorded its best performance since the reunification!

FIGURE 2: OCCUPANCY, ADR AND REVPAR CHANGE FROM 2007 COMPARED TO 2013



Note: The size of each circle represents the city's RevPAR growth
Source: HVS and STR Global

Most markets have seen continuous RevPAR increases since 2010, albeit growth slowed in 2011 and 2012 owing to the ongoing Eurozone crisis. It was not until 2013, that Europe slowly began to emerge from this crisis, which was reflected in overall investor sentiment. Year-to-July 2014 data show relatively positive movements, with the average German city recording more than 2.5% RevPAR growth over the same period in 2013, primarily driven by occupancy. Going forward, we expect the outlook for hotel fundamentals in Germany to remain strong, although we note that the Ukrainian-Russian crisis has, to some degree, impacted business throughout Europe.

Zooming In

In this section, we focus on the four cities that have witnessed hotel performance growth levels above the German average since the onset of the crisis: Frankfurt, Munich, Düsseldorf and Leipzig.

Frankfurt

Frankfurt am Main has always acted as a financial and transportation hub, rather than a popular leisure destination, given that it is home to the European

FIGURE 1: MAP

FRANKFURT

Central Bank, the Frankfurt Stock Exchange and the German Federal Bank, as well as Europe's third-busiest airport. However, over the past two to three years, the city has begun to transition from being Europe's banking powerhouse to making room for a burgeoning stream of leisure travellers. With this, the city has seen a swell of lifestyle hotels entering the market, in both the lower end and luxury part of the hotel spectrum, including the opening of a second Meininger hostel at Frankfurt Airport (2012) and the opening of the Jumeirah Frankfurt (2012). The increase in leisure visitors has helped lessen the drop in seasonality on weekends and has also supported a 6% increase in the length of stay, which in 2013 hit 1.7 days.

Given Frankfurt's strong growth (even from a relatively high base), investor interest has soared. After Berlin, the city has one of the largest hotel pipelines in Germany, with a significant number of lifestyle brands, aparthotels and mid-market properties entering the market.

A 401-room Motel One Europaviertel (January 2014), a 133-room Element by Starwood Frankfurt Airport (September 2014) and a 165-room Citadines City Centre (March 2014) are among the branded hotels that recently opened this year. Marriott's new MOXY brand will also enter Frankfurt in July 2015, with 305 rooms. In total, hotel supply grew to 253 properties in 2013, reporting 8% growth from 2009, while bed supply grew by 5% to almost 42,000 units over the same period.

Despite the growth in capacity, occupancy has increased to reach the upper 60s, supported by the growth in demand from the leisure market. Full year 2013 data illustrated that average rate is the second highest in Germany, lagging just 5% behind that of Munich.

From 2007 to 2013, the city recorded a 10% occupancy increase and average rate growth of 12%, leading to an overall RevPAR rise of 23%. The year-to-July 2014 figures are almost identical to those in 2013. Despite this flat growth, Frankfurt currently has the highest average rate in Germany, above even Munich, given the southern city's weak trade fair year. Nonetheless, Munich's RevPAR remains the highest in the country.

The future of Frankfurt looks bright. Continued investment will allow the city to attract demand from all segments. In May 2014, for example, Messe Frankfurt opened its new Kap Europa Congress, which is able to accommodate congresses, conferences and other events for up to 2,400 participants. On four event levels, the Kap Europa contains a hall for 1,000 people, a divisible hall for 600, and 12 further conference rooms. Other neighbourhoods that are currently undergoing or will undergo significant revamping initiatives include Europaviertel, Bürostadt Frankfurt Niederrad and the airport district.

Munich

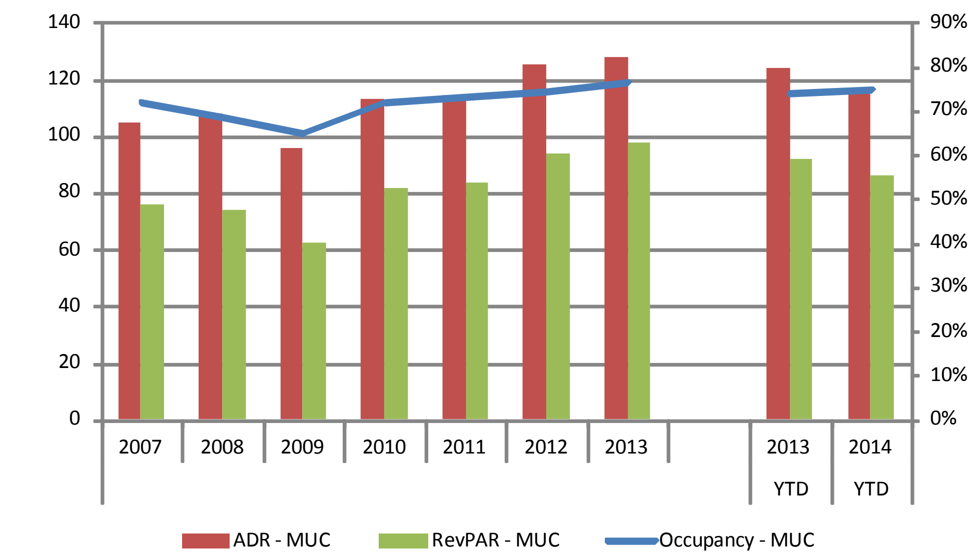
Munich remains at the forefront of everyone's mind, and demand for accommodation seems to increase perpetually. Not even the crisis could deter the 5% compound annual growth rate in overnight stays that the city has witnessed since 2007. Munich benefits from a healthy mix of leisure, business and MICE guests, which causes the seasonality to be relatively flat.

MUNICH

Despite the fact that Munich generally sees stronger performance in the odd years since the important congresses and trade fairs fall into those years, 2012 RevPAR growth was above 10%, fuelled by average rate. 2013 exceeded the new records reached in 2012, owing to a strong trade fair programme. The BAUMA (every three years), which attracts over 400,000 participants, and the Messe Bau (every two years), which attracts 235,000 visitors, both took place in 2013.

2014 has witnessed a slower start, and year-to-July RevPAR currently lies slightly below that of the previous year owing to the lack of the large conferences. The drop in year-to-July RevPAR can be explained by a 7% decrease in average rate. While Munich still boasts the highest RevPAR, current average rate levels in Frankfurt exceed those of Munich.

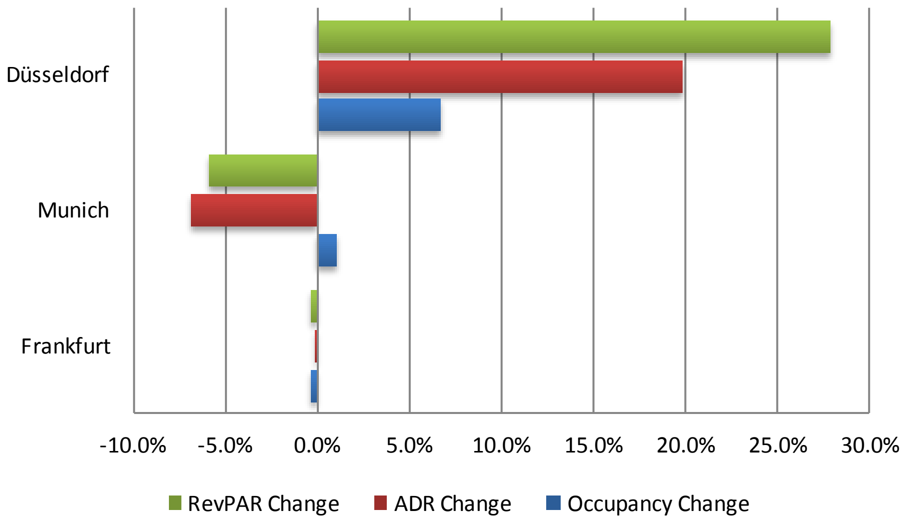
FIGURE 3: MUNICH HOTEL PERFORMANCE (€)



Source: HVS and STR Global

Despite the mediocre year-to-date performance, hotels should see healthy demand in August, September and October owing to an increase in leisure travel, the Oktoberfest and two large congresses, namely the DGN Congress (15-19 September) and the Expo Real (October 6-8). Hoteliers have also seen a pickup in meeting and incentive demand over recent months, compared to 2013.

FIGURE 4: PERCENTAGE CHANGE IN OCCUPANCY, ADR AND REVPAR – YEAR-TO-JULY 2013/14



Source: HVS and STR Global

Düsseldorf

Over the past seven years, much has happened in **Düsseldorf**, allowing it to record strong occupancy and average rate growth from 2007 to 2013. Like Frankfurt, Düsseldorf saw a 40% increase in bednights over the period under review, which is primarily attributable to the growth in MICE business. Currently more than 50 international trade fairs are held in the city, with more than half considered to be 'leading trade fairs' or 'Leitmessen' in their respective field, such as Drupa, K, interpack, Medi, Boot Düsseldorf, Wire and Tube, and Rehacare. Not all of the above-mentioned congresses are annual, leading to particularly strong trade fair years every six years (the last occurred in 2012).

Generally, the Düsseldorf hotel market is very dependent on commercial and MICE guests, which together make up more than 70% of demand, leading to significant decreases in occupancy on the weekends, and therein lies the potential to launch initiatives to attract leisure demand in the future.

In terms of performance, Düsseldorf has exceeded both pre-crisis occupancy and average rate levels (taking into account inflation) with these figures ending 2013 at around 65% and €107, respectively. Year-to-date, Düsseldorf has shown extraordinary growth, reaching almost the same year-to-July average rate levels as Munich at around €115. This equates to almost 20% growth year-on-year.

The outlook for Düsseldorf remains relatively encouraging. Although 2015 will be a slightly slower year owing to a weaker trade fair calendar, 2016 should show strong growth, followed by another record year in 2018, when all of the larger trade fairs fall in the same year. This gives hotel developers something to work towards.

DÜSSELDORF

Source: http://cph-hotels.com/en/

Leipzig

We have included **Leipzig** in our analysis, although it can be seen as the 'odd man out' when compared to the larger primary cities previously covered. The city, however, provides a good example of renewed investor interest in Germany's secondary and tertiary cities, some of which show an interesting supply and demand pattern that fosters hotel performance growth. Although average rate lies significantly below that of the previously mentioned cities (approximately €30-€50 lower), Leipzig recorded strong growth in occupancy, average rate and RevPAR over the period under review, thereby attracting investor interest from those willing to accept slightly more risk in order to achieve a higher return.

In real terms, average rate generally lies at pre-crisis levels, while occupancy has surpassed its previous 2007 peak. Leipzig has made remarkable economic progress. The motor vehicle industry is extremely important, with both BMW and Porsche housing large plants in the city. Additionally, in 2011 and 2012, DHL moved the bulk of its European air operations from Brussels Airport to Leipzig/Halle Airport, which is generating additional demand.

Leipzig has benefited significantly from growth in MICE demand, given the expansion of its trade fair facilities in 2012. It is home to one of the oldest trade fair grounds in the world. Leisure tourism has also grown, as the city offers a long tradition of music and culture, and is the home town of Johann Sebastian Bach. The USA, Switzerland and Austria have become key source markets and, overall, international arrivals now account for around 15-16% of total arrivals, but are expected to make up around 20% over the next five years. Leipzig is focusing on further developing leisure tourism attractions and scored big with the events surrounding Richard Wagner's 200th birthday in 2013 and the reopening of the Gondwanalandes exhibit at the Zoo in 2012.

Although many hotel managers consider the market to be saturated given the low RevPAR of just over €50 in 2013, hotel companies are keen to expand in this eastern European metropolis. In January 2014, the Nordic Hotel Group from Kiel took over the three-star Hotel Vivaldi and rebranded it as a Nordic Hotel, and Meliá Hotels is looking to begin construction on a 153-room Innside by Meliá in the Kosmoshaus across from the Thomaskirche, which should open in late 2015. Additionally, a new hotel project is in the pipeline at the 100-year old former airport. It is expected to become a four-star hotel with 200 rooms and potentially 100 serviced apartments.

Leipzig boasts further good news, as Leipzig Tourism has been commissioned to manage the entire tourism marketing for the region, which will help to create tourism synergies in Sachsen. Additionally, a new city tunnel was completed in December 2013, which should facilitate access to the city and to the region.

Hotel Investment Market

Hotel investment volumes in Germany remain very strong and only seem to go in one direction – and that is up. Our initial analysis illustrates that over the first seven months of 2014, German hotel transactions have reached new records, with the volume surpassing €1.5 billion, compared to just over €800 million over the same period last year, translating into an increase of approximately 100% year-to-date.

Two major portfolio transactions have dominated the market so far this year, with the largest being the 86-hotel Accor portfolio, of which 67 properties were in Germany. The total portfolio transacted for €722 million and was sold to Accor by two Moor Park funds, in a reverse of Accor's sale-and-leaseback of substantially the same portfolio to Moor Park in 2007. This year's buy-back reflects Accor's return to 'asset right' rather than 'asset light'.

A second large portfolio of 18 European hotels, of which 11 were in Germany, was sold by Ivanhoé Cambridge to a fund affiliated with Apollo Global for €425 million.

Additionally, two-hotel portfolios have also been popular. The Courtyard by Marriott and the adjoining Residence Inn Munich City East transacted jointly for approximately €65 million. The Le Méridien Munich and Le Méridien Parkhotel Frankfurt are also currently on the market.

Interesting to note as well is that the hotel market has mirrored the wider commercial real estate market in that higher-yielding opportunities in secondary markets are becoming more sought after, thereby substituting more secure investments in primary cities that were initially targeted after the crisis. There are also notably more transactions occurring in eastern Germany, with both Dresden and Leipzig on the radar.

Budget hotels are transacting more frequently as room yield growth forecasts are strong and investment opportunities remain large.

We have also seen debt liquidity returning to pre-crisis levels. Debt remains relatively cheap, which is encouraging for investors and is underpinning the German property boom. We opine that more risk-enthusiastic investors, such as private equity funds, may even see the current climate in Germany as a perfect time to exit this market and begin to look for higher returns elsewhere in Europe.

In summary, the outlook for the German hotel industry remains strong, with the possibility that transactions volume may exceed €2 billion in 2014, despite the relative shortage of suitable products on the market at present compared to the strong levels of demand from investors. Germany remains one of Europe's most sought-after hotel investment markets.

Hotel Valuation Index

From our valuation experience and knowledge of the investment market, we have been able to give an indication of values per room for the four cities described above, using the income capitalisation approach, as explained in our Hotel Valuation Index, released annually in March. The methodology employed in producing the HVI is based upon actual operating data from a representative sample of four- and five-star hotels.

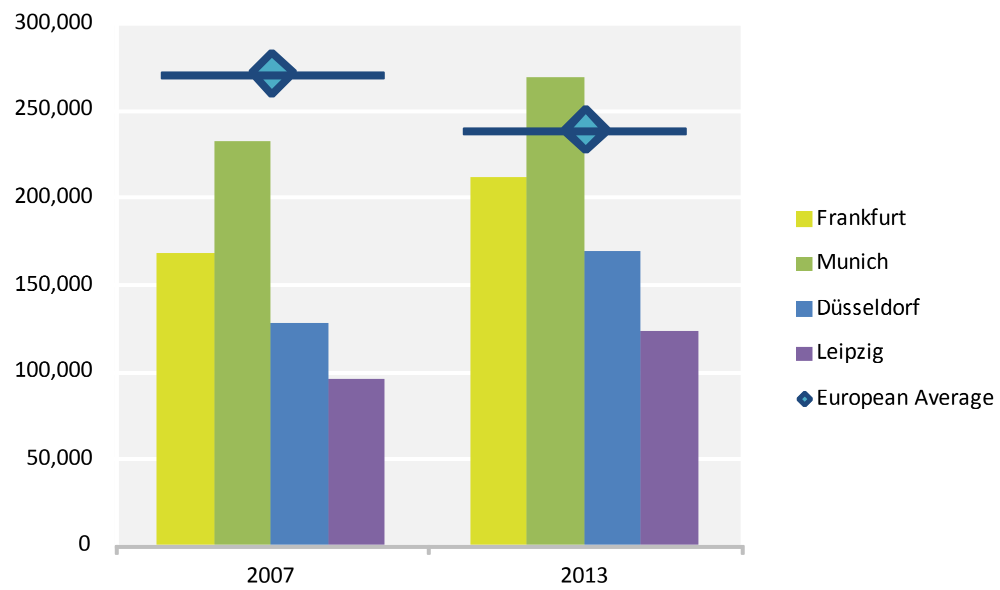
Not surprisingly, Munich has always reported the highest values in Germany, given the strong trading fundamentals of hotels in the city. Although growth in hotel values has slowed over the past four years, investor interest remains high, and in 2013 the average price per room reached an all-time record of €269,000, 15% higher than its 2007 levels. Munich is the only city in Germany that is able to achieve hotel values above the European average, as indicated in Figure 5. Although year-to-date performance in Munich has been lagging behind last year's given the weaker trade fair year, we envisage investor interest to remain high and for the market to bounce back in 2015. Capitalisation rates remain low in Munich and new hotel developments are limited given the high barriers to entry, allowing investors to continue to feel optimistic about the city's trading prospects.

Hotel values in Frankfurt have shown very healthy growth of more than 25% when compared to pre-crisis levels, the highest growth of the four cities that we looked at in this publication. The rise in leisure demand and ongoing investment in the city, which is very visible in the new Europaviertel, has made the city increasingly attractive to investors. With the strong rise in year-to-date hotel performance, we envisage investor interest to remain high, although the relatively large new supply pipeline may put a small damper on hotel trading fundamentals. In 2013, hotel values in Frankfurt reached €212,000 per room.

Düsseldorf hotel values currently lie at €173,000 on a per room basis, more than 20% higher than the peak 2007 levels. Although hotel performance suffered in 2009 as in the majority of German cities, the strong growth in the conference market and healthy hotel fundamentals has attracted investor interest. The market was particularly active in 2013, as many budget and mid-market hotels were sold as part of larger portfolios.

Leipzig has shown hotel values increase by more than 20% since 2007, reaching

FIGURE 5: HVI



Source: HVS - London Office

€130,000 in 2013, although they are still the lowest in absolute terms out of those included in this article. As yields are forced down by a new enthusiasm for real estate in Germany's primary cities, investors are looking for higher returns in secondary cities, including those in eastern Germany. Hotel transactions in Leipzig have almost doubled in 2014 when compared to last year and recent sales include the 96-room B&B Hotel Leipzig, the 115-room Tryp by Wyndham Leipzig North and the Mercure Hotel in Leipzig. We envisage investor interest to remain strong in the eastern part of Germany.

Conclusion

The outlook for hotel fundamentals in Germany remains strong, although we have seen some grey clouds forming on the horizon owing to the Ukranian-Russian crisis, which has begun to impact business throughout Europe, due in part to the sanctions on Russia. Although Germany's economic outlook has recently been downgraded from a 2014 GDP forecast of 2.0% to 1.5%, output is 105% higher than before the 2008/09 financial crisis, far ahead of many other European economies

Frankfurt, Munich, Düsseldorf and Leipzig mirror Germany's healthy performance trends. Although Düsseldorf and Leipzig do not reflect the highest RevPARs in Germany, the cities have shown extraordinary growth since the onset of the crisis, which is not expected to slow over the next year.

Germany is evidently still a strong focus for investors, as hotel transactions have surpassed €1.5 billion in the first seven months, more than 100% growth on the transaction volumes in the same period last year. The willingness to take on more risk in exchange for higher returns seems particularly prevalent, with an increase in transactions in B and C locations, a trend that we expect to continue in the future.

Low interest rates and debt liquidity returning to pre-crisis levels has helped fuel this hotel property boom and many consider that hotel transactions will surpass €2 billion by the end of the year.

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