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TIPPING THE SCALES

ECONOMY VS LUXURY IN THE GERMAN HOTEL MARKET

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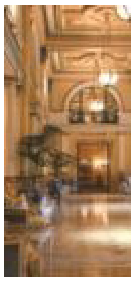
Data provided by Fairmas







Germany's Main Hotel Markets

HVS has undertaken a comprehensive hotel performance analysis of the four main German cities: Berlin, Frankfurt, Hamburg and Munich. This article is a follow up to our previous report 'After the storm: Germany in the spotlight' (October 2011).

The article focuses specifically on comparing the economy and the luxury hotel segments in the four main markets. The historical performance data was contributed by Fairmas Germany, a strategic partner of STR Global. The article shows how both segments have evolved over the years and what market factors influenced hotel performance. We have highlighted which demand segments are present in each market and how the four markets differ in this regard.

Highlights

Hypothesis: "The economy sector achieves higher occupancies than the luxury sector, albeit at significantly lower rates."

Our analysis revealed the following.

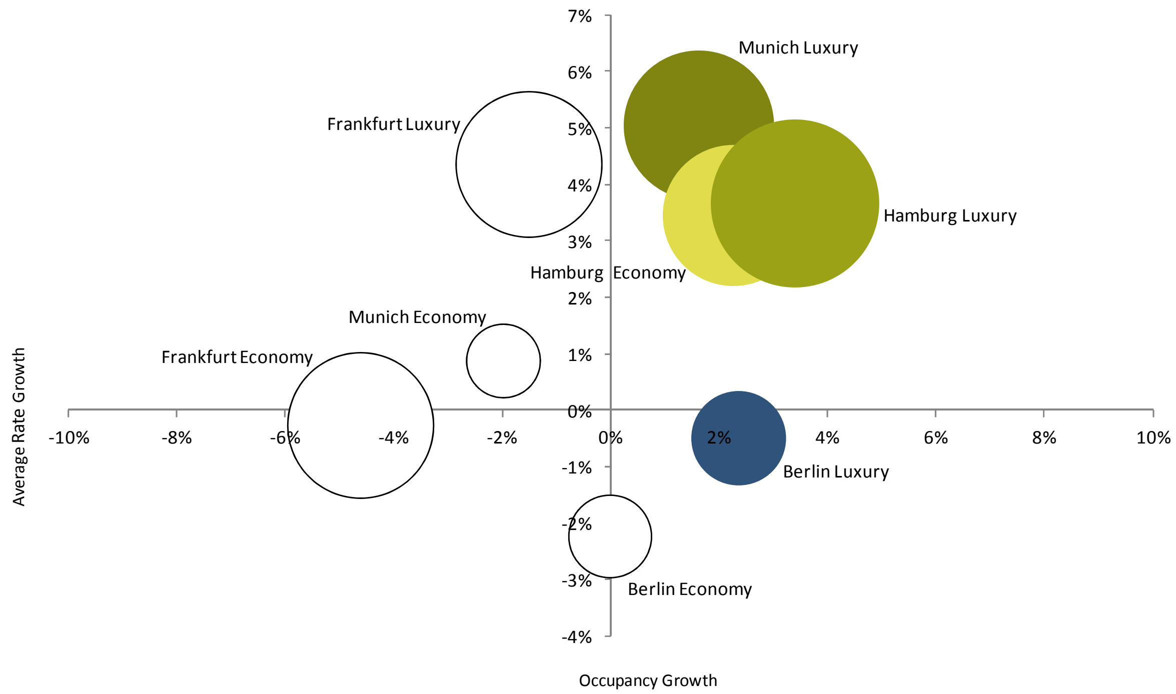
Berlin: similar occupancy levels between the two segments (around 70%), average rate premium of about €80 to €90 comparing the luxury and economy sectors.

Frankfurt: economy sector achieves higher occupancies at lower average rates, albeit, the differences have been decreasing over the last few years.

Hamburg: economy sector achieves a notably higher occupancy (low 80s) at lower rates (rate difference about €70).

Munich: economy sector achieves lower occupancy than the luxury sector at lower rates.

FIGURE 1: REVPAR GROWTH IN THE LUXURY AND ECONOMY SEGMENTS 2010-11



Note: the size of each circle represents that city's RevPAR growth

Introduction

Since the publication of our last article, Germany's economy developed in a slightly different direction, with the economy contracting in the last quarter of 2011; however, by year-end GDP had grown by 3.1%. The first two quarters of 2012 saw growth of 0.5% and 0.3%, respectively, according to Eurostat. The slowdown is mainly due to the continued Eurozone crisis; however, Germany still benefits from relatively low unemployment, a low inflation rate and exports outside the Eurozone.

2011 and year-to-date 2012 witnessed increases in overnight stays from international and domestic visitors alike in all four major markets, despite the slightly bleak outlook towards the end of 2011. Although the number of international overnights increased in 2011, the domestic market still accounts for the biggest share; however, this trend also highlights the increasing popularity of Germany as a tourism/corporate travel destination.

In terms of hotel performance the luxury segment achieved RevPAR growth in all four cities for 2011 and year-to-June 2012.

In contrast, in the economy segment by year-end 2011 only Hamburg registered a positive RevPAR growth. Year-to-June 2012 data shows positive year-on-year growth, especially in Munich and Frankfurt. A more detailed look at each city will follow later in the article.

As mentioned in last year's report, the 'Bettensteuer' or 'Citytax', a sort of cultural tax, continues to be a subject of great debate throughout Germany. In July this year the 'Bundesverwaltungsgericht' (federal administrative court) ruled that the tax can be charged to leisure guests but not to business travellers. Some municipalities of the affected towns now fear that the tax will not survive under these very bureaucratic circumstances, while others have taken this approach from the outset and not introduced the tax. The Bettensteuer has not been introduced in the four markets under review.

Berlin

With its many attractions, Berlin continued to be a popular leisure destination in 2011, and it maintains its status as a trendy location and global city. International overnights increased by 8.8% in 2011, reaching a total of 9.25 million. Domestic overnights increased to 13.1 million (+6.6%).

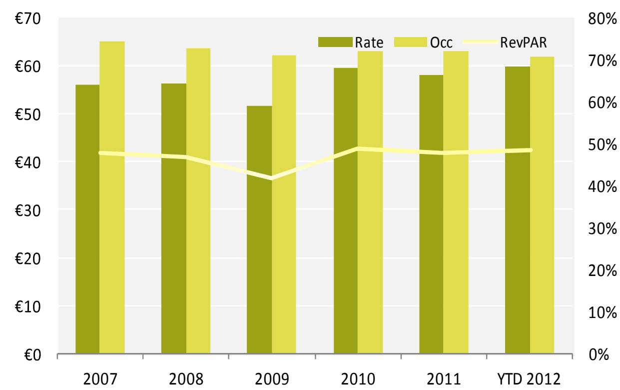
One of the biggest infrastructure developments in Berlin is Berlin Brandenburg International Airport (BBI). However, technical difficulties with fire safety regulations delayed the opening from 3 June 2012 to 27 October 2013. This is a huge setback for the region and it is having a major financial impact on the airport and airlines. Furthermore, it has caused political and public uproar in Germany. When the airport finally opens next year, we expect international travel and overall demand to benefit, further establishing Berlin as a business destination.

The opening of Berlin Brandenburg International Aiport has been delayed to 2013

According to HVS's research, the city's stock as of mid-2012 is some 60,000 rooms, with some 1,500 rooms being added over the last year. One of the new openings was the 505-room Motel One Berlin Hauptbahnhof, which accounts for a staggering one-third of the new rooms added to the market. Additionally, more than 2,000 rooms are currently under construction or in the final phases of planning. High profile openings in the near future include the Waldorf Astoria and new hotel developments around the new Hauptbahnhof and near BBI airport. According to our research, between the time of our writing this report and the end of 2013, approximately 40% of new stock will be in the economy segment and only 6% in the luxury segment, showing the significant increase in pressure on the already burgeoning economy segment in Berlin.

In 2011, Berlin's economy segment experienced a 2.2% decrease in rate while occupancy remained

FIGURE 2: BERLIN ECONOMY HOTEL PERFORMANCE

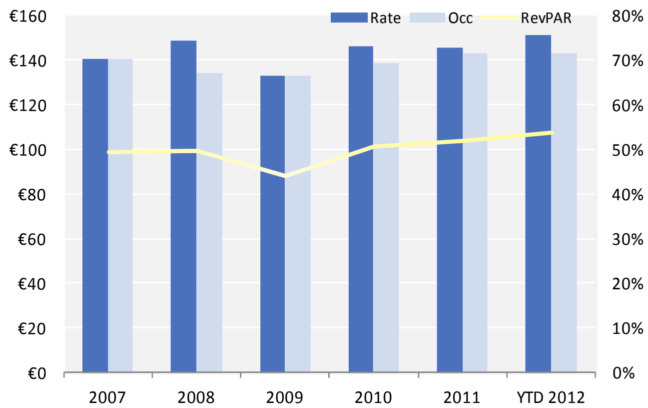


stable. However, year-to-June 2012 data shows an increase in occupancy to 70.6%, while rate remained more or less stagnant at €60 (0.7%), leading to a RevPAR increase of 4.7% to €42. This trend highlights the continued pressure on rate and the price pressure currently experienced in Berlin's economy segment, mainly due to the vast new supply that has entered the market over the past few years. Compound annual growth rate (CAGR) between 2007 and 2011 was flat for both average rate and occupancy, with just over 1% growth in rate and a slight decline in occupancy. However, on a positive note all this new supply has not had a tremendous impact on the economy's sector performance showing that this market segment has very well absorbed additional room nights. In the past few years, eight Motel One hotels have opened in Berlin, highlighting the strong presence of the economy sector and aggressive investments from Motel One. We consider that this trend will continue in the near future, with more hotels and hostels currently under development in Germany's capital city.

In 2011, the luxury segment saw a 2.4% growth in occupancy, while rate declined by 0.5%, resulting in a rise in RevPAR to €104. Year-to-June 2012 data shows growth in both rate and occupancy, with a RevPAR rise of 5.3% to €108. The luxury segment only recorded a minor decline in performance in 2009. The CAGR between 2007 and 2011 was 2.2% in occupancy while rate decreased by 0.7%.

Berlin has a vast supply of luxury hotels, with more than 6,000 rooms, and it has proven to be a very competitive market. The 233-room Waldorf Astoria, set to open in 2013, is the most prominent new hotel coming to Berlin. Additionally, the Steigenberger Hauptbahnhof will enter the market in 2014.

FIGURE 3: BERLIN LUXURY HOTEL PERFORMANCE



Somewhat surprisingly, occupancy levels for the economy and luxury segments in Berlin are relatively similar, with both achieving historical levels of around 70%; most other markets in Europe have historically tended to record higher occupancies in the economy segment. In terms of rate, the luxury segment had a rate premium on the economy segment of approximately €81 to €92 between 2007 and 2011. The main problem lies when comparing Berlin's luxury segment to other capital cities in Europe and luxury hotel performance in those markets. The rates achieved in the luxury segment in Berlin are nowhere close to those in for example Amsterdam; this means that the Economy segment has a much tougher task of achieving higher rates, which are somewhat 'capped'. This trend can also be seen in the other three markets under review, as detailed later in this article.

Frankfurt

Frankfurt am Main, also dubbed as 'Mainhattan', is the financial and economic centre of Germany. Frankfurt continues to be a destination primarily visited by corporate and trade fair guests. In 2011, total visitation rose for the second year in a row, with an increase of 5.1% to 3.8 million visitors, of which 2.2 million were domestic, indicating the importance of the domestic market for this location.

Frankfurt has experienced strong new hotel supply in recent years, with the total number of rooms reaching just over 15,000 in mid-2012. Some of the most prominent openings during the last year were the Jumeirah Frankfurt (218 rooms), the Hilton (249 rooms) and Hilton Garden Inn at Frankfurt Airport (334 rooms) and the Meininger Hotel Frankfurt (168 rooms). In the next two years, new hotels such as the

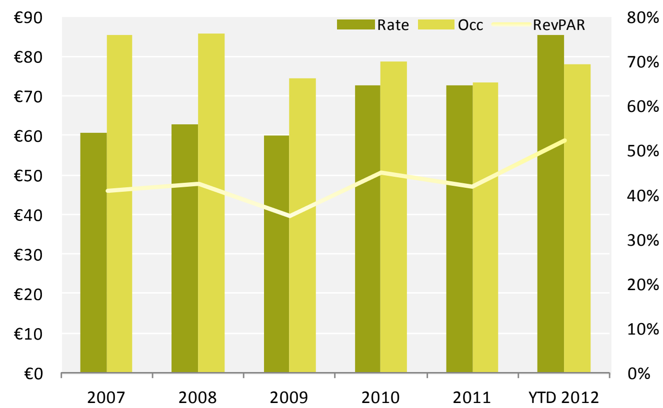
Frankfurt's Hotel Market has seen a strong increase in new supply

Motel One Europaviertel (401 rooms) and the Citadines (165 rooms) are set to enter the market.

The Messe Frankfurt is a very cyclical trade fair with visitor-intensive events taking place in uneven years. The IAA (Internationale Automobil Austellung) and the Book Fair (Frankfurter Buchmesse) are the most prominent exhibitions at Messe Frankfurt. There are plans for the centre to be expanded to accommodate an additional 2,000 delegates. This expansion is part of the Skyline project in the Europaviertel district, an area which is currently under development (between the fairground and the train station). The trade fair market continued to be one of the most important demand drivers in 2011. The number of fairs in 2011 increased by 2.8% to 37, while number of visitors increased by a staggering 56.6% to 2.3 million, which is a pattern repeated over recent years, with uneven years being the better trade fair years.

As shown in Figure 4, occupancy in Frankfurt's economy segment has declined since 2007, while rate has gone from strength to strength. In 2011, occupancy decreased by 4.6%, while rate remained stagnant, leading to a fall in RevPAR of 6.8% to €47. Year-to-June 2012 figures show increases of 5.3% and 6.4% in rate and occupancy, respectively, which resulted in a rise in RevPAR to €59.

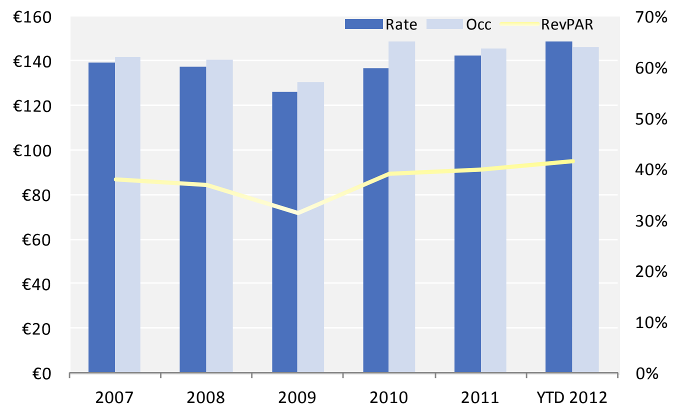
FIGURE 4: FRANKFURT ECONOMY HOTEL PERFORMANCE



While the economy segment has taken a hit in terms of occupancy, with increased supply in the city, the luxury segment has remained stable with a CAGR of 0.6% in both rate and occupancy between 2007 and 2011. In 2011, occupancy decreased by 1.5% while rate increased by 4.4%, resulting in a RevPAR of €91 (+2%). Year-to-June 2012 data shows flat occupancy with a 3.6% rate increase, leading to a RevPAR of €95 (+ 3.1% year on year).

Rate difference between both segments range from approximately €63 to €78 between 2007 and 2011. Higher rate differences were recorded before the economic crisis in 2007 and 2008. Since 2007, the occupancy levels for both segments have become more similar, albeit the economy sector still achieves higher occupancy levels than the luxury segment overall. While the luxury segment's occupancy rates remained stable, occupancies in the economy segment fell from approximately 76% to 65% between 2007 and 2011. We assume that this trend is due to the increase in new supply in the economy segment and the reliance on less price-sensitive corporate guests, which tend not to use economy hotels as often as leisure guests.

FIGURE 5: FRANKFURT LUXURY HOTEL PERFORMANCE



We consider that Frankfurt will continue to benefit from corporate travellers and hence less price sensitivity, especially in the luxury segment. A limited amount of new supply is expected to enter the Frankfurt market this year, which will allow for the absorption of the hotels that have been added in previous years.

Hamburg

Hamburg is Germany's logistical, media and commercial centre, with more than 1.8 million inhabitants, making it Germany's second largest city. Europe's second largest port is also located in Hamburg, as well as some 120,000 enterprises.

Hamburg has always been predominantly a domestic destination. In 2011, foreign arrivals increased by 11% to just over 1 million for the first time, while domestic arrivals rose by 7.8% to approximately 4.1 million. Overall demand has constantly increased in Hamburg, even throughout the

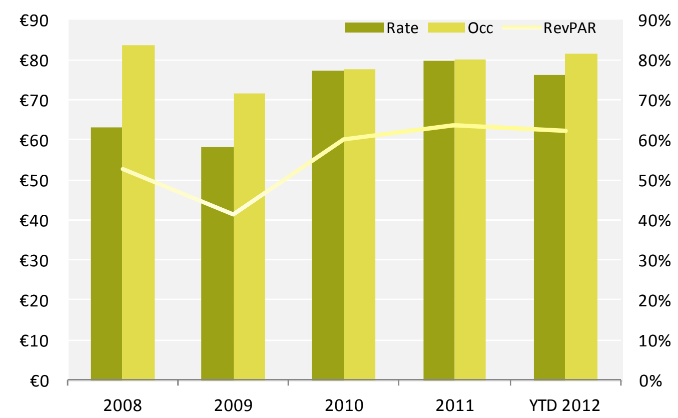
Germany's second largest city, Hamburg is predominantly a domestic destination

economic downturn. The same can be said for overnights which increased by 7.7% in 2011 to 9.5 million overnight stays.

Between July 2012 and the end of 2013, approximately 2,683 rooms will have entered the market, according to Hamburg Tourism. Further hotels are planned for 2014/15, and these will add further pressure on rates and occupancies. Historically, the city's hotels have managed to maintain their performance, as demand and supply have grown at the same pace. Hamburg is a city that is still somewhat undiscovered by the foreign leisure market, and is a perfect European weekend-break destination.

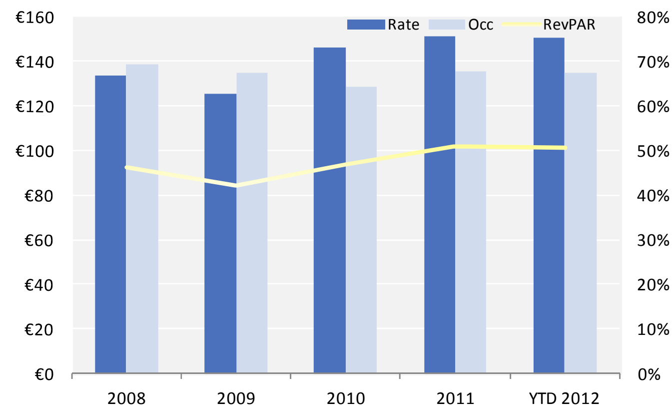
Occupancy in the city's economy segment experienced a contraction in CAGR of 1.4% between 2008 and 2011, with the biggest dip in 2009. This shows the volatility of the economy market in terms of occupancy in an economic downturn, as it is primarily a leisure destination. However, rate in this segment recorded a strong CAGR of 8.1% between 2008 and 2011, with a slight dip in 2009, a strong recovery in 2010 and a relatively flat increase in 2011 Overall, RevPAR has increased by 6.5% CAGR between 2008 to 2011, reaching €64 in 2011. As mentioned previously, Hamburg has experienced a major increase in new supply. Motel One has opened three hotels in the city and one at the airport, adding a significant number of rooms to the economy segment, and putting a strain on performance.

FIGURE 6: HAMBURG ECONOMY HOTEL PERFORMANCE



Hamburg's luxury segment also experienced a drop in occupancy levels, with a fall in CAGR of 0.8%; thus, occupancy remained relatively flat. In terms of rate, a small dip was recorded in 2009; however, strong recovery took place from 2010. Overall, rate grew at a CAGR of 4.3% between 2008 and 2011. Some of the

FIGURE 7: HAMBURG LUXURY HOTEL PERFORMANCE



luxury hotel stock was partly out of order for refurbishment, such as the Fairmont Hotel Vier Jahreszeiten and Kempinski Hotel Atlantic. Furthermore, the Westin Hotel Elbphilarmonie is expected to enter the market in mid 2013.

Rate differences between both segments range from €67 to about €72 between 2008 and 2011, which is on a smaller spectrum compared to Berlin and Munich. In terms of occupancy, Hamburg displays a trend that is somewhat expected and is the same case for most European markets, which is the economy segment achieves much higher occupancies, of more than 10%, than the luxury segment. The exceptional year to the rule was 2009 when similar occupancies were recorded in both segments due to decreased demand.

Munich

Munich is both a business and leisure destination. Many of Germany's DAX companies have headquarters in the city. Furthermore, Munich has established itself as a MICE destination, with another strong year predicted for 2013. A main attraction for leisure guests is the annual Oktoberfest.

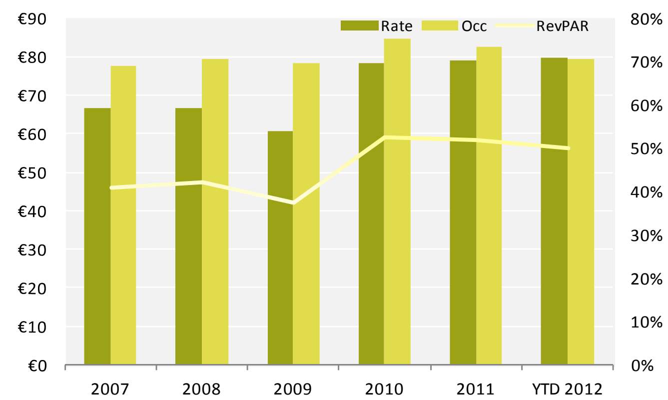
Visitation to Munich has increased since 2009, and 2011 was another year of visitor records, with an overall increase of 6.4% to 5.9 million, of which 43% was international visitors and 57% domestic. This indicates that Munich has a healthy mix of international and domestic visitors, an advantage over the other main German cities. The same trend is witnessed in overnights, which increased by 5.8% in 2011 to 11.7million, of which 46% was international and 54% domestic.

Munich experienced an increase in supply in 2011, with approximately 1,700 rooms entering the market. This supply includes two Motel One developments, a Courtyard by Marriott, a Residence Inn by Marriott and a B&B Hotel at the airport. It is worth mentioning that Munich has seen no real new supply in the luxury segment over the last few years, except for the Charles Hotel (Rocco Forte) in 2009 and The Louis in 2007, combined a total of 232 rooms.

Limited supply in Munich has entered the luxury segment over recent years

New supply in 2012 is staying at very low levels, partly due to high barriers of entry for central Munich locations. The economy segment recorded a CAGR of 1.4% in occupancy between 2007 and 2011, indicating that occupancies have remained stable. Average rate remained relatively flat in 2007/08. There was a small slump in rate in 2009, followed by an immense increase in 2010, and then rate remained relatively flat in 2011 at €79. The overall CAGR for the period under review was 5.8%. Year-to-June figures indicate further growth in average rate of 6.5%, leading to a RevPAR of €56. Whereas luxury new supply is non-existent

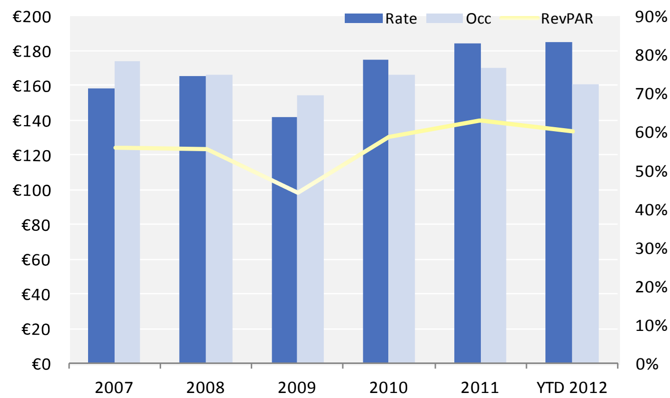
FIGURE 8: MUNICH ECONOMY HOTEL PERFORMANCE



Munich now has a total of seven Motel One hotels, having witnessed an aggressive expansion strategy, especially since 2008. Two Motel One hotels with a total of 637 rooms were added to the market in 2011, and an indication of flat performance of the sector can be witnessed in this year, suggesting demand is growing with supply.

ADR performance in the luxury segment increased with a CAGR of 3.6% to €184, while occupancy remained relatively flat in the period under review. RevPAR reached €140, exceeding pre-recession figures. Year-to-June 2012 data shows flat occupancy and a strong increase in rate of 8.6% to approximately €185. As mentioned previously, the luxury segment has not seen any major changes to supply over recent years and little new supply is expected to enter the market in the near future. Thus, we expect this segment to continue to perform strongly.

FIGURE 9: MUNICH LUXURY HOTEL PERFORMANCE



Surprisingly, the luxury segment achieved higher occupancies than the economy segment in most of the years under review, which goes against the principal of economy hotels achieving greater occupancies at a lower rate. In terms of rate premiums achieved in the luxury segment, Munich witnessed a range of approximately €81 to €105 between 2007 and 2011. This is an indication of the strong performance and stable demand of the luxury segment in Munich.

Munich has had some incredibly successful years in terms of tourism arrivals and hotel performance. We envisage that Munich will continue to attract business visitors as well as leisure guests as a popular city destination, and continue to go from strength to strength.

CONCLUSION

Having analysed performance trends, supply and demand dynamics, and future improvements to infrastructure in all four markets, we have drawn the following conclusions. Overall, all four cities have shown stable performances throughout the financial crisis. However, during difficult economic times, economy hotels are generally more resilient, as budget cuts in the corporate sector affect the luxury market first.

Arrivals and overnights have shown positive trends in all four markets in 2011 and the first half of 2012, showing that tourism growth is stronger than ever after the economic downturn and indicating a positive trend for the future, with a continued strong MICE market and further growth of international tourism. Despite Germany still being the strongest economy in Europe, the ongoing euro crisis will affect this export-driven economy and thus domestic demand for transient accommodation.

In terms of occupancies, our hypothesis was that economy hotels maintained higher occupancies than the luxury segment, which was the case in all markets but Munich, where in fact the luxury segment excelled. This trend shows the importance of the luxury segment in Munich, which has a higher international and corporate base than the other three cities.

Overall, it is safe to say that Germany's hotel markets, and the four markets analysed in this article in particular, continue to see stable performances and have managed to absorb in some case vast amounts of new supply. The only factor that needs improvement over the coming years is the rate structures in the luxury market. As mentioned previously, the rates achievable by the economy sector are being constrained by the luxury sector's difficulties in increasing rates significantly, especially in comparison to those rates being achieved by other luxury hotels in the main European cities.

About HVS

HVS is the world's leading consulting and services organization focused on the hotel, restaurant, shared ownership, gaming, and leisure industries. Established in 1980, the company performs more than 2,000 assignments per year for virtually every major industry participant. HVS principals are regarded as the leading professionals in their respective regions of the globe. Through a worldwide network of 30 offices staffed by 400 seasoned industry professionals, HVS provides an unparalleled range of complementary services for the hospitality industry. For further information regarding our expertise and specifics about our services, please visit **www.hvs.com**.

About Fairmas

Fairmas Gesellschaft für Marktanalysen mbH was founded in 2003. The focus of its business is on software development, mainly in the areas of benchmarking, budgeting, controlling and forecasting. Fairmas is also a high-quality data provider of hotel performance data with a focus on the German-speaking market and a strategic partner of STR Global. For further information, please visit www.fairmas.com or contact Sabine Fischer at sabine.fischer@fairmas.com or +49 30 322 940 5 43

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