

Principal Real Estate

# 2025 European hotel market outlook

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**JANUARY 2025**

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## MACROECONOMIC OVERVIEW

# Investors should price in sustained growth in 2025

**The global economy is showing remarkable stability, supported by disinflationary trends, easing monetary policy, and a record number of working people in the world.**

- Our base-case outlook projects a healthy yet more moderate pace of global growth in 2025, as central bank policy pivots are expected to provide support to risk assets.
- Indeed, the gradual tide of disinflation has given central banks sufficient justification to pivot toward more accommodative monetary policies.
- On balance, the global economy remains resilient. The U.S. and Asia have experienced a modest acceleration in activity over the past 12 months, reinforcing our view that a recession is unlikely in the near term. However, European economies have shown mixed performance, with Germany, Italy, and France facing a slower growth outlook.
- Elections in Europe and the U.S. have raised concerns about increasing nationalism, which could create headwinds to stronger growth and a low-inflation environment. It remains too early in the transition process to draw definitive conclusions.
- While short-term policy rates have eased, we anticipate a higher normalized long-term interest rate environment. Investors should prepare for this potential shift.

Market	GDP growth, %			
	2023	2024-E	2025-F	
N. America		2.9	2.7	2.1
		1.5	1.1	1.8
Europe		0.4	0.9	1.5
		-0.3	-0.1	0.7
		0.9	1.1	0.9
Asia Pacific		1.5	-0.2	1.2
		2.1	1.2	2.0
		5.2	4.8	4.5

Source: Bloomberg, Principal Real Estate, December 2024. E = Estimate, F = Forecast

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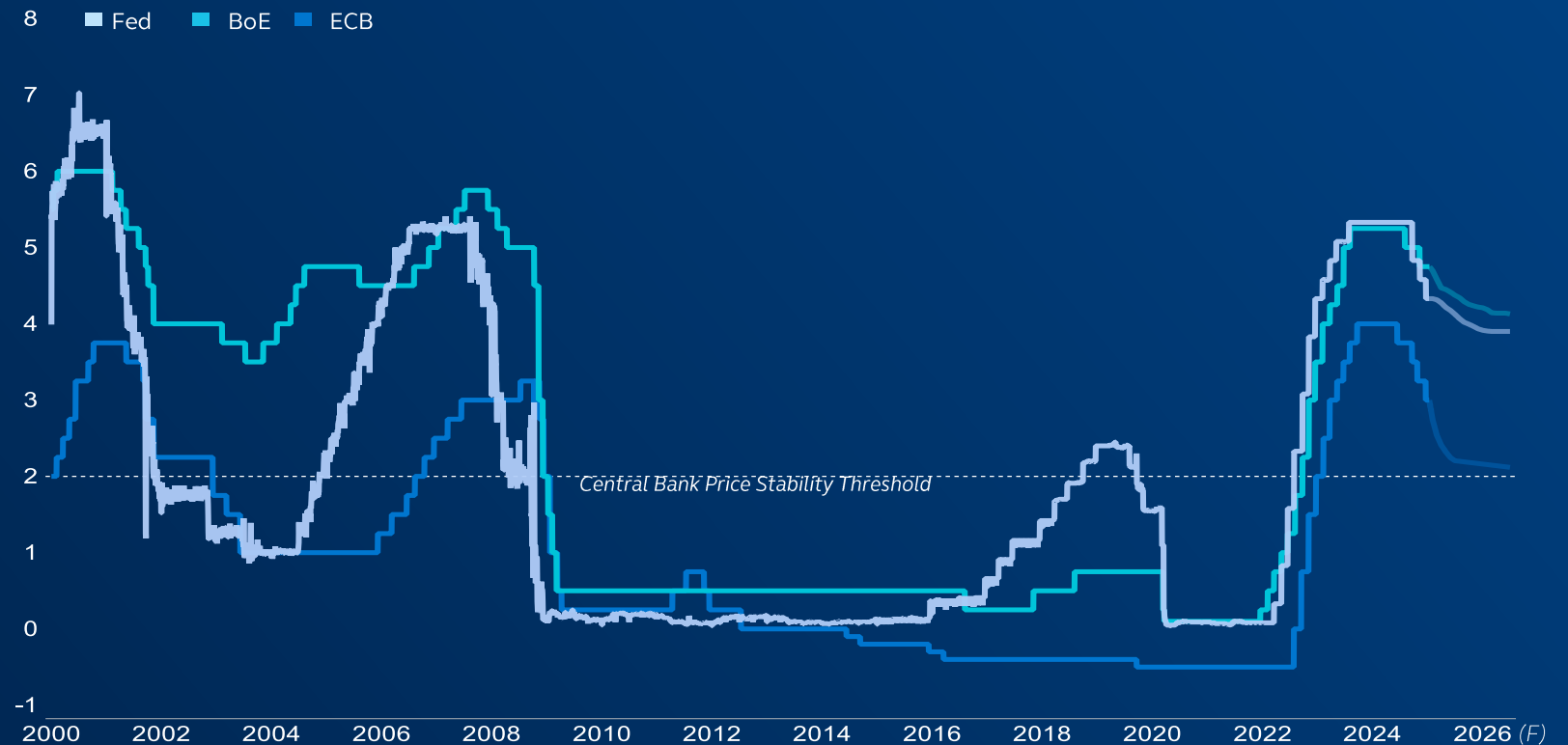
## MACROECONOMIC OVERVIEW

# Policy makers have adopted a more accommodative stance

### Central bankers have shifted their stance and are now in rate normalization mode.

- After more than two years of rising debt costs from most of the world's largest central banking institutions, The European Central Bank (ECB), Bank of England (BoE), and The Federal Reserve (Fed) in the U.S. have finally started to cut rates signaling renewed optimism for global real estate investors.
- We believe that policy interest rate cuts will continue, but at a measured pace, as policymakers keep a cautious eye for data suggesting any reacceleration of inflation.
- However, investors will need to adjust valuation expectations in a new era of higher interest rates compared to last decade.

Central bank policy rates  
Percentage, historical and forecasts



Source: Fed, ECB, BoE, Euribor futures, Sonia futures, Fed funds futures, Bloomberg, Principal Real Estate, December 2024. These are the current views and opinions of Principal Real Estate and is not intended to be, nor should it be relied upon in any way as a forecast or guarantee of future events regarding particular investments or the markets in general.

# What does macro foretell for real estate?

## 2025 will be an attractive vintage for real estate investors

- A clearer inflation and interest rates environment sets the basis for private equity real estate bid-ask spreads to narrow, capital values to stabilize, and deal flow to accelerate.
- Thus, we expect the turn of the year to mark a gradual transition from contraction to recovery. While some headwinds remain, they are easing.
- We believe sectors with positive structural drivers, markets with supply demand imbalance, and quality assets will be the hallmark of successful portfolio construction.

Source: Principal Real Estate, December 2024

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## INVESTMENT STRATEGY

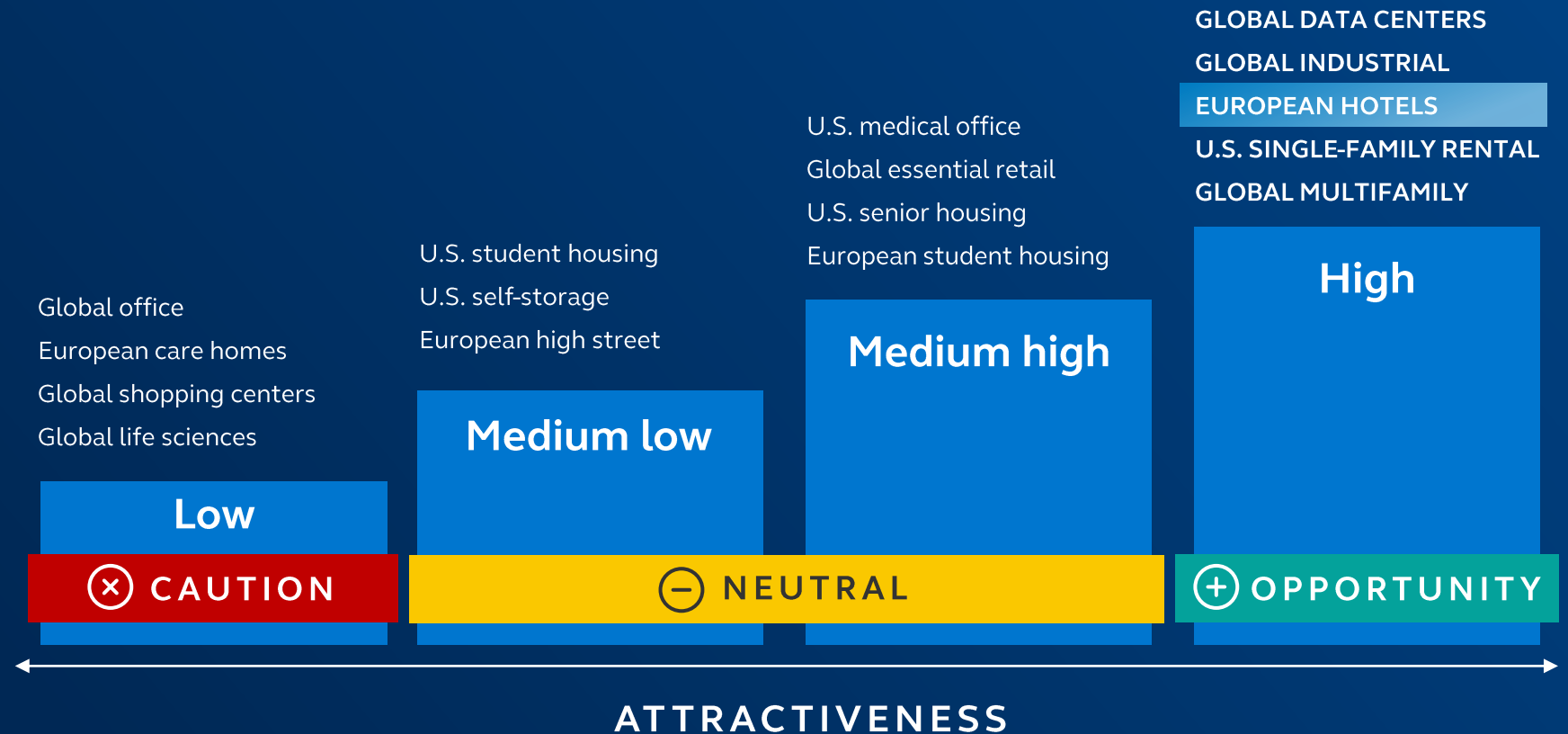
# European hotels are one of our five highest conviction ideas for 2025

### Maintain focus on fundamentals to identify sectors with positive outlook

- We believe investors should prioritize resilient property sectors benefiting from strong structural and demographic demand drivers to propel growth.
- We are optimistic about five sectors. For three of these we are geography agnostic, namely data centers, multifamily, and logistics. For the remaining two we are region specific. These are U.S. single-family rentals and European hotels.
- We believe these property sectors benefit from enduring growth trends and represent compelling opportunities for investors, offering the potential for attractive risk-adjusted returns and long-term portfolio diversification.

### Property sector fundamentals tracker

Based on rental growth, value trends, supply demand imbalance and structural drivers (key themes)



Source: Principal Real Estate, December 2024. The recommendations above reflect our views on relative opportunities over a 12-month horizon. It is not intended to be, nor should it be relied upon in any way as a forecast or guarantee of future events regarding particular investments or the markets in general.

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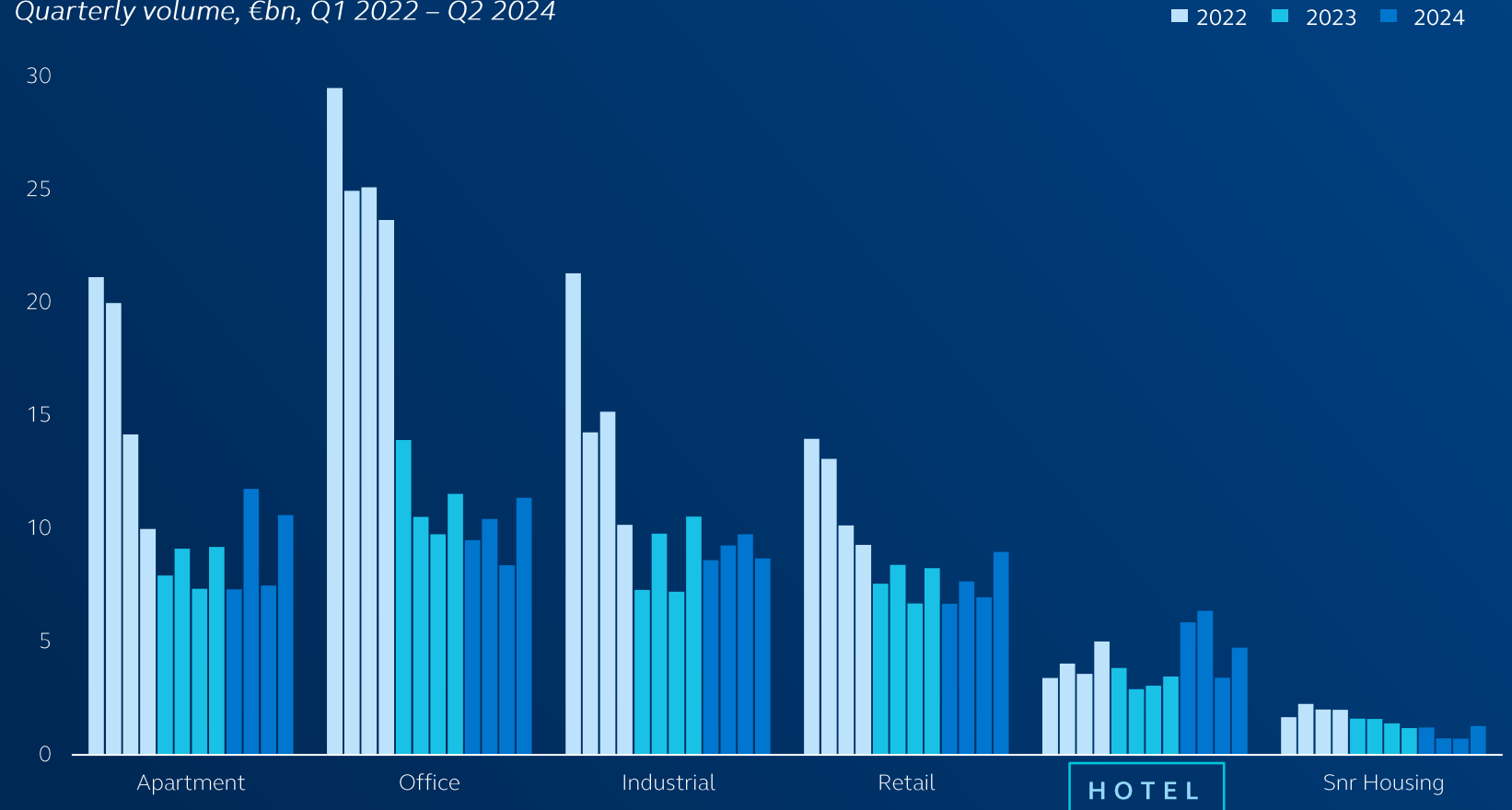
## CAPITAL MARKETS

# Hotel investment outperformed despite macroeconomic headwinds...

- Real estate transaction volume remained low in 2024 – a level which was 50% lower than the pre-crisis peak and 25% lower than the long-term average.
- However, European hotels have bucked the trend and proved more resilient than most of the other property types, driven by a resurgence in tourist numbers and above inflation operating performance.
- Indeed, European hotel capital flow in 2024 outpaced 2023, 2022, and the 10-year average.
- We expect to continue to see capital focusing on hospitality supported by solid growth in tourism and leisure demand.

### European transaction volume by sector

Quarterly volume, €bn, Q1 2022 – Q2 2024



Source: MSCI, Principal Real Estate, Q4 2024.

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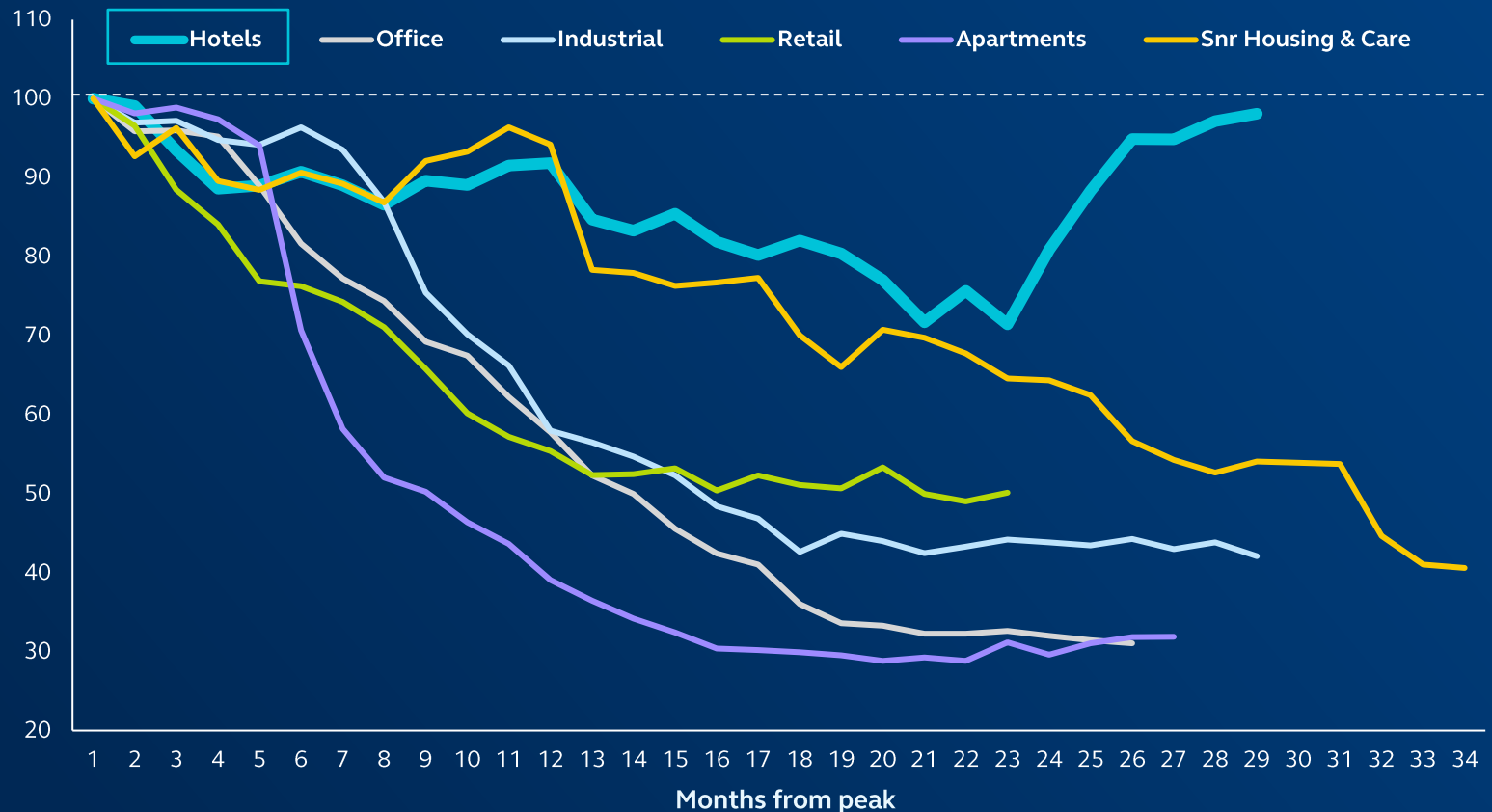
## CAPITAL MARKETS

# Hotel was the only sector that pared back losses from pre-crisis peak...

- In terms of capital flow, the European hotel sector is the only sector that closed the gap compared to its 2022 level, as investors took note of the continued spike in tourism and increasing business travel demand.
- A growing global economy and the increase in the middle class in developing markets support strong medium and long-term growth in the hotel sector, particularly for the European region which accounts for the largest share of international tourist arrivals worldwide<sup>1</sup>.
- This demand growth has been ahead of supply growth over a prolonged period underpinning sector fundamentals. Investors have clearly identified this and have been looking to re-allocate into the space.

### European transaction volume recovery by sector

Index, Europe, rolling four quarters, pre-crisis peak volume = 100



<sup>1</sup> The UN Tourism

Source: MSCI, Principal Real Estate, Q3 2024.



## CAPITAL MARKETS

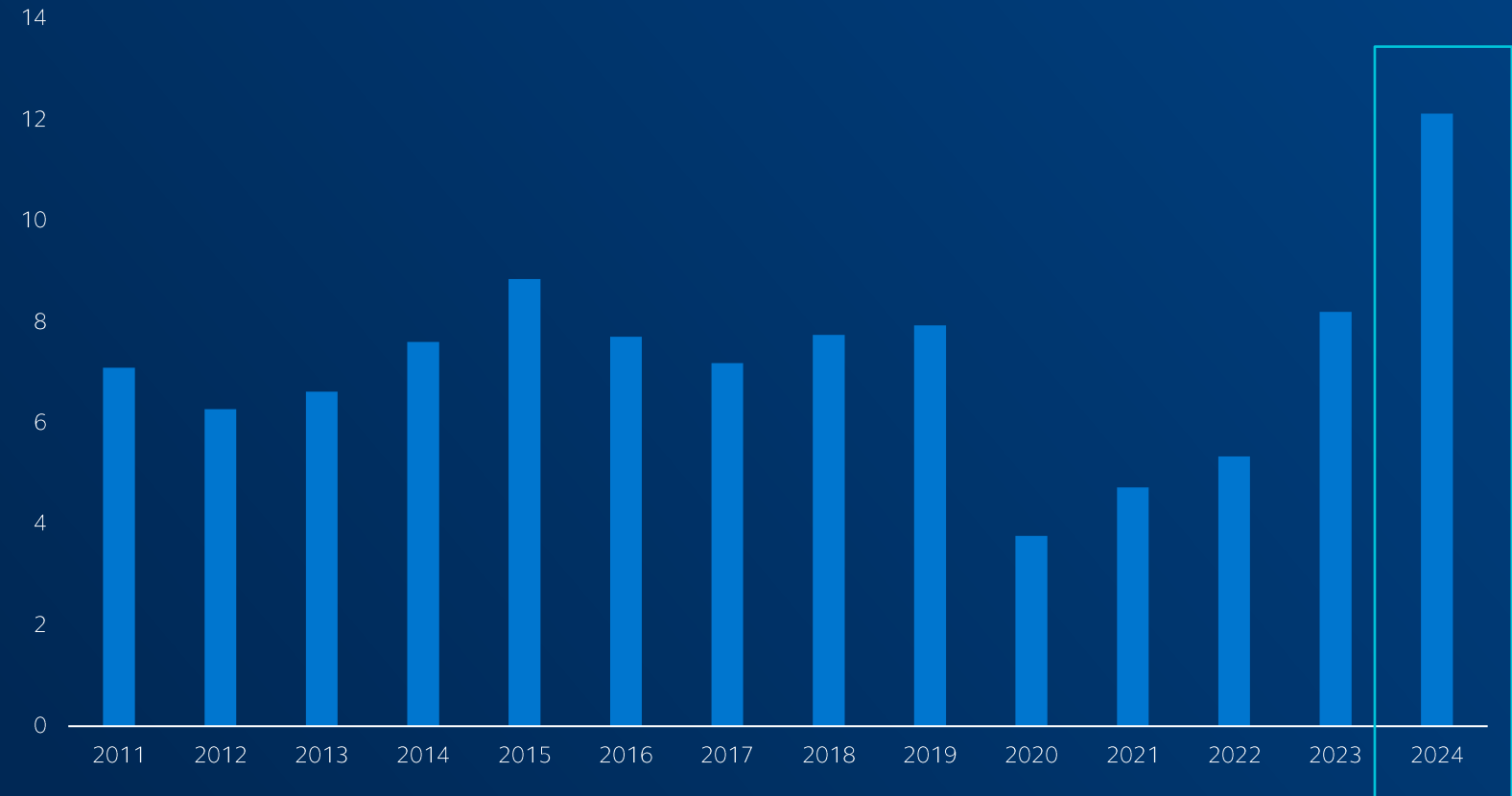
...As the asset class has gained traction among global investors

### Hotel investment share of total European property volume reached an all-time high in 2024

- Investors increased their exposure to the European hotel sector amid favorable operational performance and a positive short and medium-term outlook. Indeed, the European hotel share of total property volume reached 12% in 2024, the highest annual percentage ever recorded.
- A further testament to the growing investors appetite can be seen in JLL's hotel investor sentiment survey: A record 80% of investors intend to maintain or increase their capital investment in the hotel sector in 2025, the highest share since the survey began in 2000.

### European hotel investment volume as share of total European property volume

Percentage, annual, 2011 - 2024



Source: MSCI, JLL, Principal Real Estate, Q4 2024.

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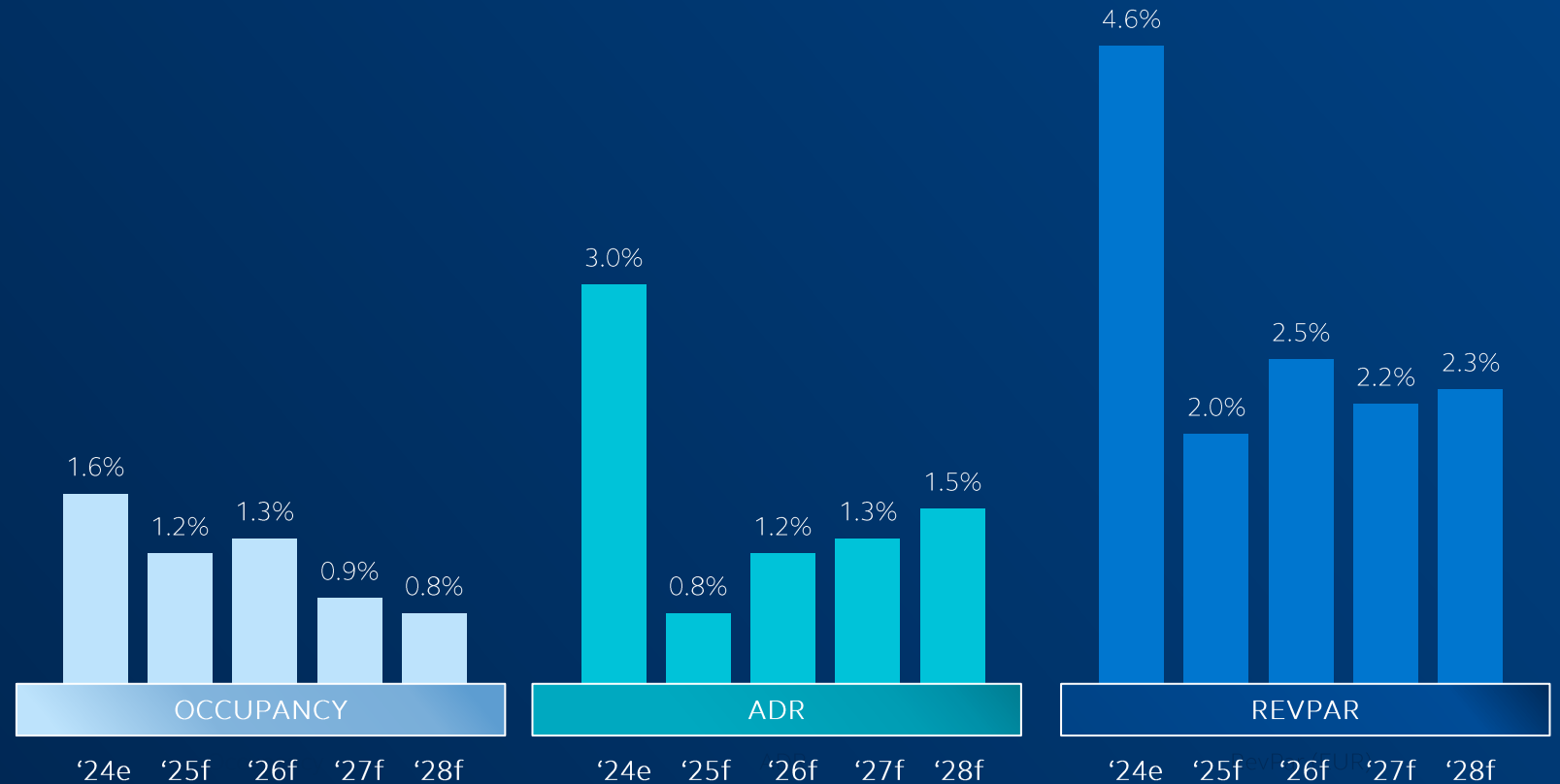
## OPERATIONAL PERFORMANCE

# Expectations are for steady (but more moderate) revenue growth

### After a period of very high growth, expectations are for a steadier period ahead

- Aggregated RevPAR\* growth for the 31 largest European hotel markets is expected to reach 4.6% in 2024, and 2.0% in 2025.
- ADR\* growth in 2024 has been fueled by above-average inflation and the return of both corporate and leisure events. However, traveler price sensitivity has increased, and it is likely to carry through in 2025, with the balance of RevPAR growth shifting towards occupancy.
- ADR will continue to rise at a subdued pace as the impact of persistent inflation over the last few years, alongside subsequent heightened interest rates, limit consumer spending.

### Hotel performance forecasts<sup>1</sup> European markets<sup>2</sup>, y-o-y change, 2024-2028



<sup>1</sup> Forecasts as of Q4 2024

<sup>2</sup> Aggregated performance of Amsterdam, Barcelona, Belfast, Berlin, Birmingham, Brussels, Budapest, Cologne, Dublin, Dusseldorf, Edinburgh, Frankfurt, Glasgow, Hamburg, Leeds, Lisbon, London, Madrid, Manchester, Milan, Munich, Paris, Prague, Rome, Stuttgart, Vienna, Warsaw, Zurich

Source: STR, Principal Real Estate, Q4 2024. \*RevPAR – Revenue per available room. ADR – Average daily rate. e – estimate; f – forecast

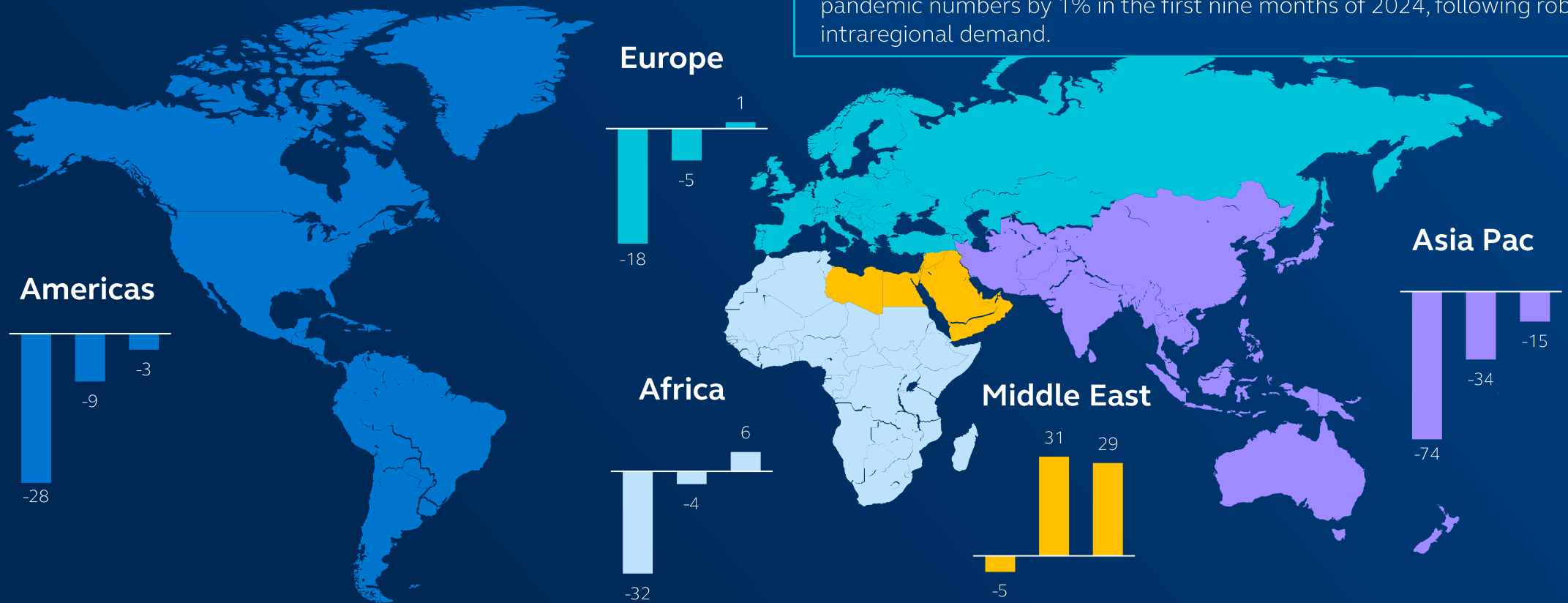
## DEMAND OUTLOOK

# International tourism arrivals on track for full recovery in Europe...

### International tourist arrivals

Percentage change in 2022, 2023 and 2024<sup>1</sup> compared to 2019

Europe, the world's largest destination region, saw arrivals exceed pre-pandemic numbers by 1% in the first nine months of 2024, following robust intraregional demand.



<sup>1</sup> 2024 change based on the first nine months (January to September)

Source: UN Tourism, Principal Real Estate December 2024.

## DEMAND OUTLOOK

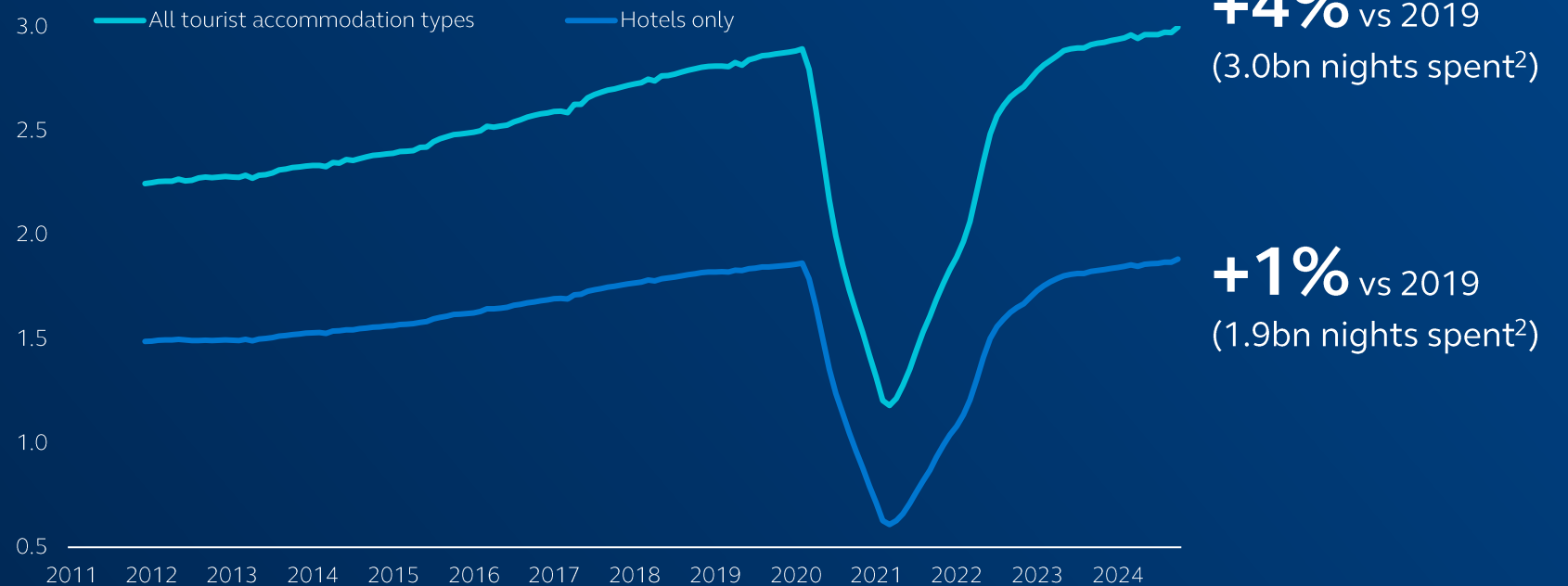
# ...and hotel nights spent are above pre-pandemic peak

### Hotel nights spent in European hotels are now above the 2019 level, and nearly 50% above 15 years ago

- Much of the growth in the last few years in hotel revenues has been driven by rate. However, as the chart shows, actual occupied hotel nights have also now recovered to above pre-pandemic levels.
- The chart also demonstrates how quickly hotel demand recovered from what was an unprecedented drop during COVID-related lockdowns and travel restrictions.

### Number of nights spent in tourist accommodation<sup>1</sup>

EU 27 countries\*, billions, 12-month rolling, monthly



<sup>1</sup> Tourist accommodation types include hotels, short-stay accommodations, camping, trailer parks and others.

<sup>2</sup> Based on the 12 months to October 2024

Source: Eurostat, Principal Real Estate October 2024

\*EU27 countries (Belgium, Bulgaria, Czech Republic, Denmark, Germany, Estonia, Ireland, Greece, Spain, France, Croatia, Italy, Cyprus, Latvia, Lithuania, Luxembourg, Hungary, Malta, Netherlands, Austria, Poland, Portugal, Romania, Slovenia, Slovakia, Finland, Sweden)

## DEMAND OUTLOOK

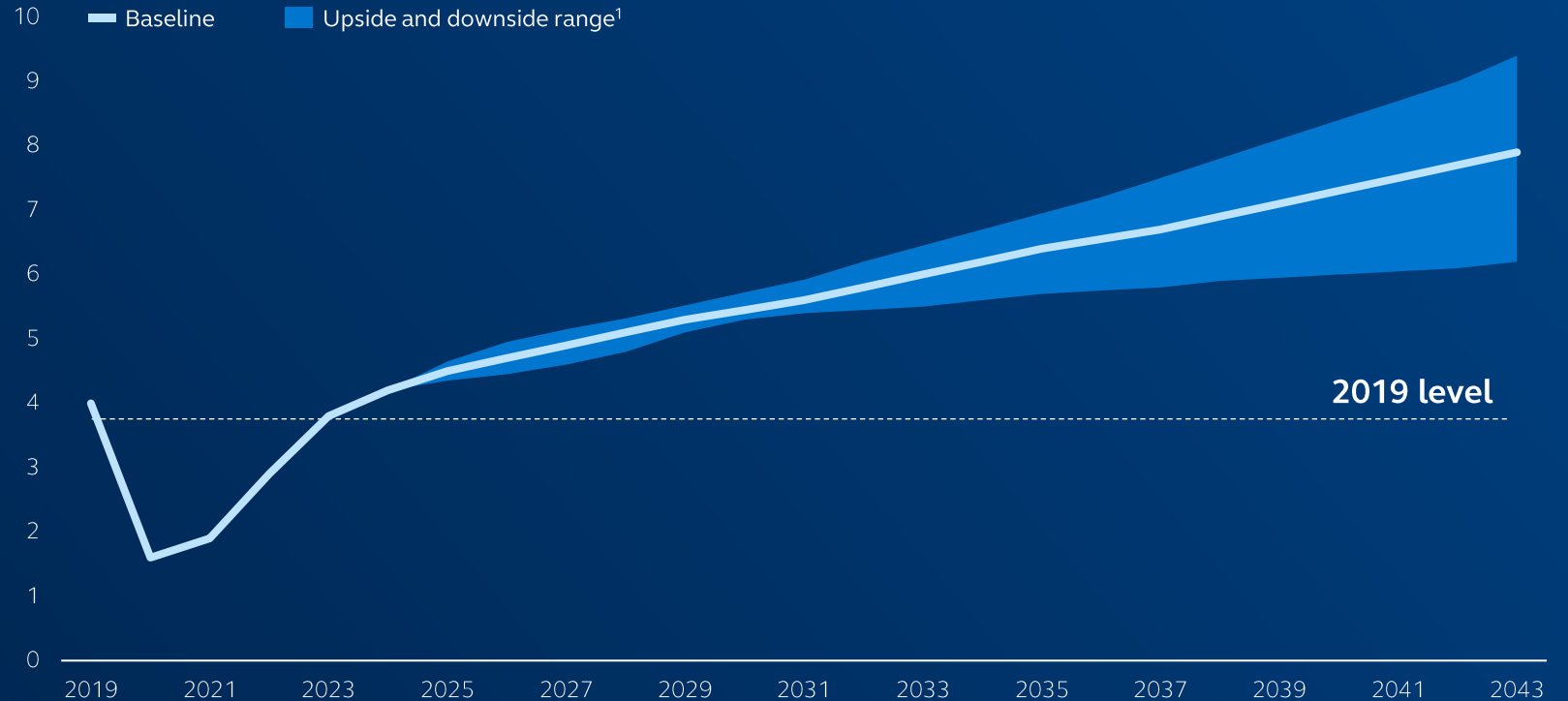
# Global air passenger projections are positive...

### Air passenger numbers are projected to reach an all-time high in 2025

- Global passenger numbers have increased by 11% in 2024 over the year prior, in line with the growth rate observed over the last decade.
- Global passenger traffic is projected to continue to grow in 2025, albeit at a slower pace, equal to 6%. Nevertheless, air traffic is likely to reach an all-time high in 2025, driven by persistent demand and the expansion of airline operations.

### Global air passenger numbers

*Billion passengers, adjusted*



<sup>1</sup> The upside potential if a positive surprise were to occur, such as peace in Ukraine and the Middle East. The downside risks include a deteriorating geopolitical environment and greater policy instability. The balance of risks remains skewed to the downside, both in the near term and over the longer horizon, influenced by unfavorable long-term trends.

Source: IATA, Principal Real Estate December 2024

## DEMAND OUTLOOK

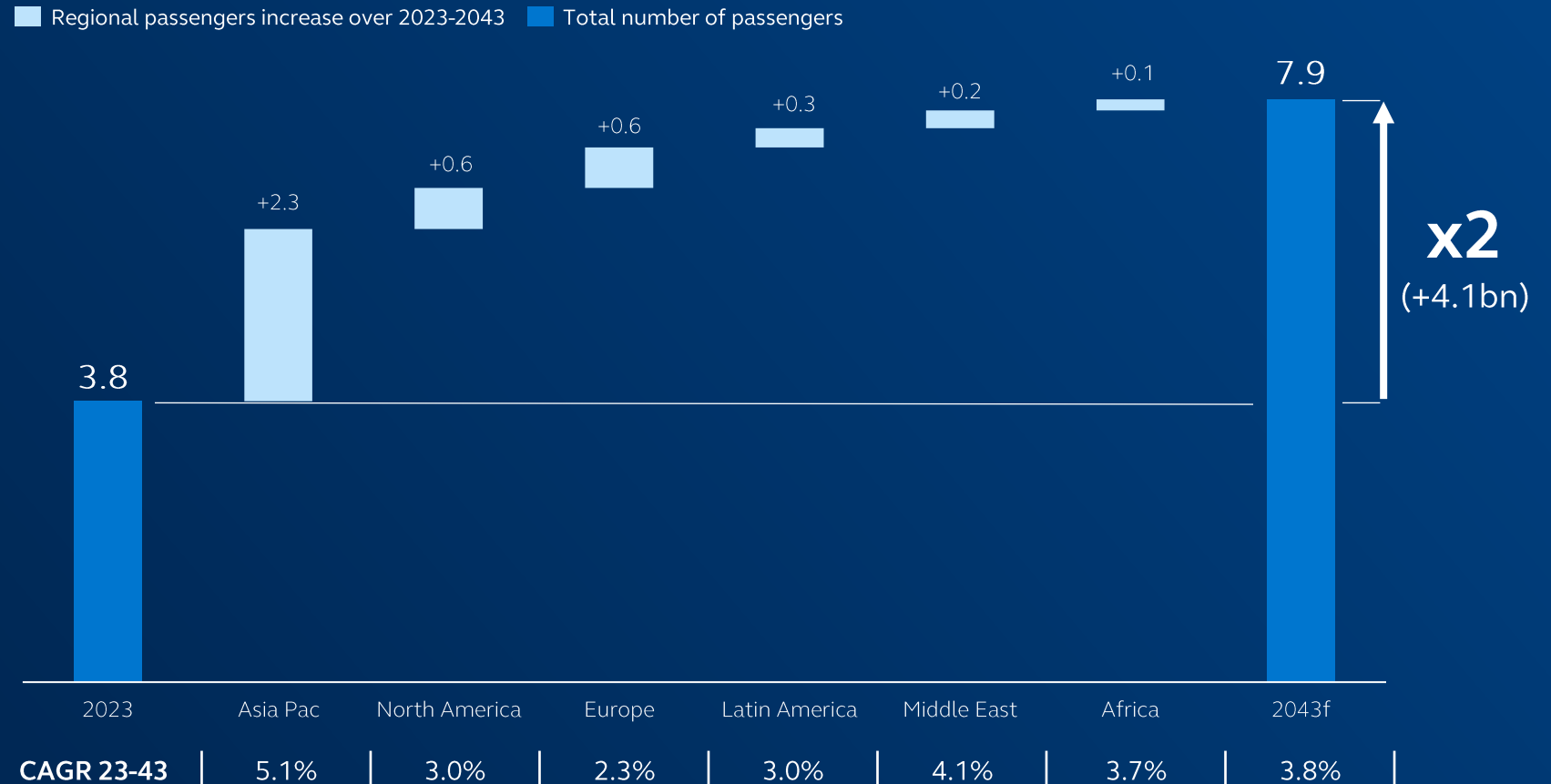
...and expected to double over the next 20 years

### Future air passenger growth will likely be driven by Asia Pacific, followed by North America and Europe

- Over the next two decades, the number of global passengers is projected to increase at a compound annual growth rates (CAGR) of 3.8%, leading to a net addition of over 4.1bn passenger journeys. This increase would bring the global number of passenger journeys to 7.9bn in 2043, which is double the pre-pandemic level.
- The European market is expected to see a more modest increase in demand, with a CAGR of 2.3% over the next 20 years.
- However, the increase in international traffic from other parts of the world will likely contribute positively to tourism in Europe.

### Global air passenger forecasts by source region<sup>1</sup>

Billion passengers, adjusted, baseline projection



<sup>1</sup> Regions represent geographical regions of traffic origin

Source: IATA, Principal Real Estate December 2024

## DEMAND OUTLOOK

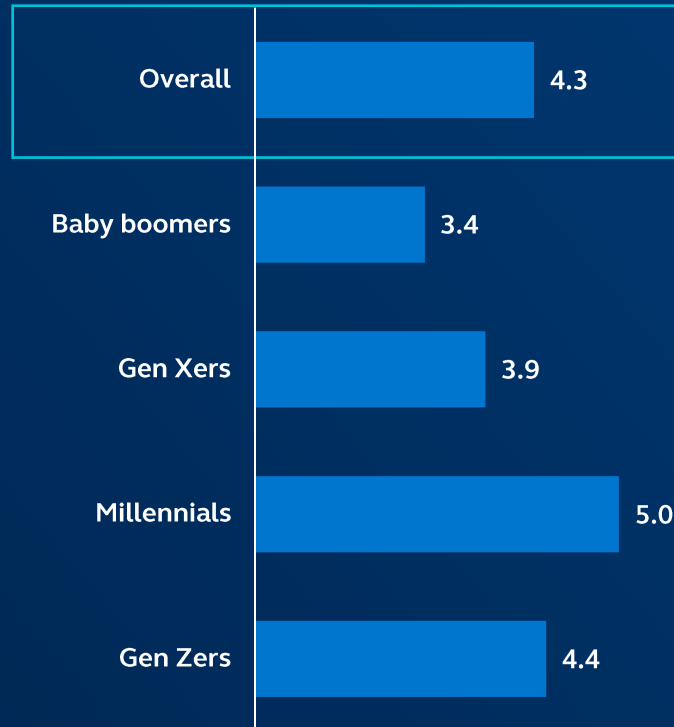
# Younger generations are prioritizing new experiences and travel

### Younger travelers are focusing on experiences (like travel) over possessions

- For many, travel isn't merely an interest but rather has become a priority, even in times of uncertain economic conditions.
- Newer generations seem to prioritize experiences over possessions, driven by a thirst for novelty.
- Additionally, the proliferation of low-cost carriers, mobile connectivity, translation software, social media, and remote working are all contributing to lowering the barriers to spending time away from home more frequently.
- In other words, travel is expected to remain one of the fastest-growing areas for consumer spending and the hotel sector is poised to benefit from this.

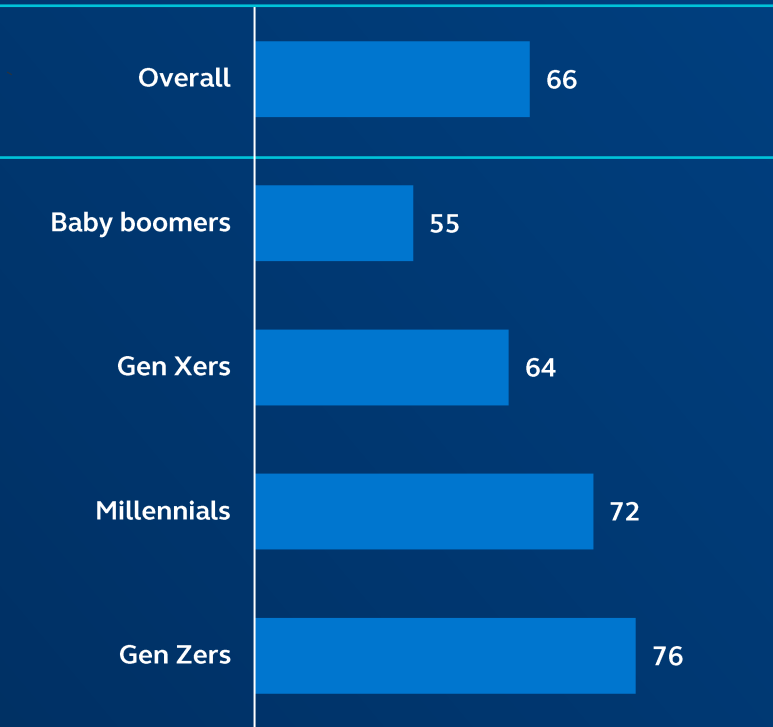
### Number of trips<sup>1</sup> taken in 2023

Average number of total respondents



### Share of people with increased interest in travel

Percentage of total respondents



Baby boomers = age 58+, Gen Xers = age 42 to 57, Millennials = age 26 to 41, Gen Zers = age 18 to 25. Survey findings are based on more than 5,000 interviews carried out from February to March 2024.

<sup>1</sup> Including domestic and overseas

Source: McKinsey State of Travel Survey, Principal Real Estate, Q2 2024

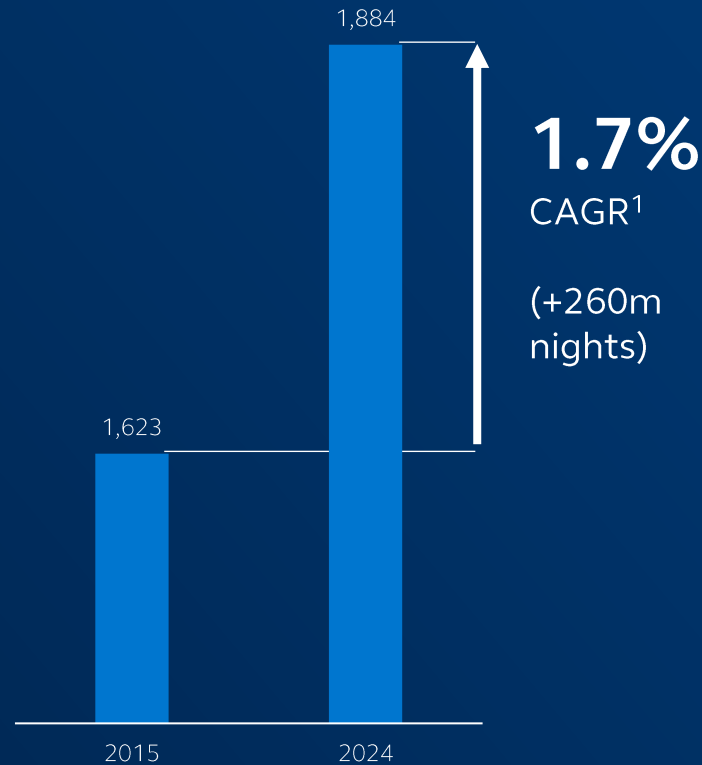
## SUPPLY OUTLOOK

# European hotel supply growth has been slower than demand...

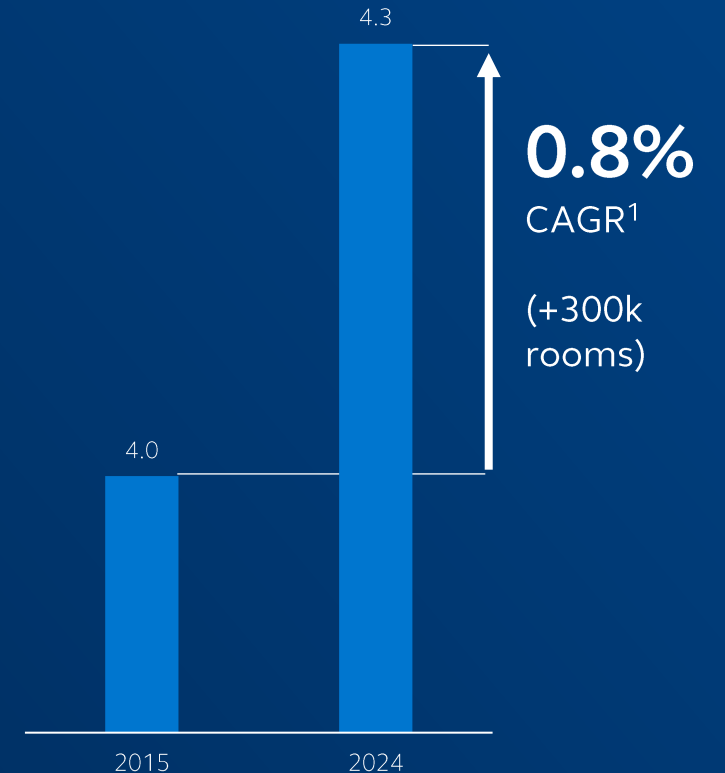
### The supply/demand growth imbalance over time is a driver of hotel performance

- The global economy has been growing, with a few notable interruptions, for the last decade.
- In that time there has been a significant shift in wealth, with a growing middle class in developing nations who have spending power and the desire to travel. There are now more middle-class people in India and China than there are people in Europe.
- Over the same period, supply of hotels in Europe has been growing slowly. It is difficult to build new hotels in European cities and frequently where new supply does get built it is in secondary or tertiary locations.
- This demand/supply growth imbalance over a prolonged period has been a driver of long-term steady growth in hotel operating performance.

### Demand: # of nights spent in hotels Million nights, Europe



### Supply: Total # of hotel rooms Million rooms, Europe



<sup>1</sup> Compound annual growth rate or is the annualised average rate of growth between two given years

Source: Eurostat, STR, Principal Real Estate Q4 2024



## SUPPLY OUTLOOK

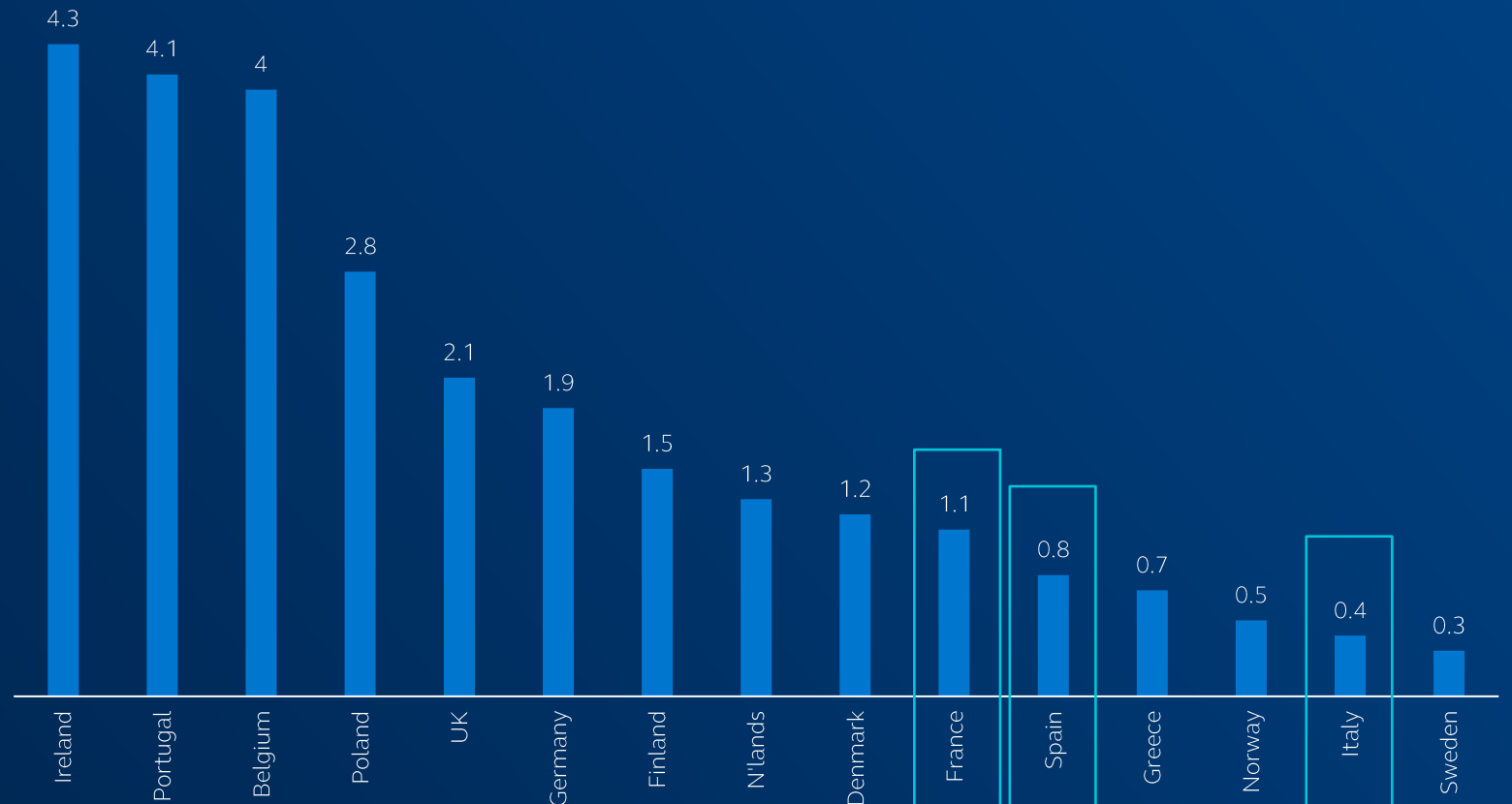
# ...and remains constrained

### Current supply growth remains weak

- Hotel supply continues to grow relatively slowly in an environment where developing new properties in the centre of many historical cities is extremely difficult.
- As shown in the chart, supply is growing very slowly in key European countries.
- Italy (0.4%), Spain (0.8%) and France (1.1%) are three of the biggest tourist destinations globally and these modest supply growth figures are a further support to operational income when balanced against demand side growth.
- Although Portugal (4.1%) and Ireland (4.3%) seem higher it should be remembered these are very small markets and therefore new hotels have a much larger impact.

### Number of rooms under construction compared to the current stock

Percentage, 2024



Source: Lodging Economics, Principal Real Estate Q4 2024

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## SUPPLY OUTLOOK

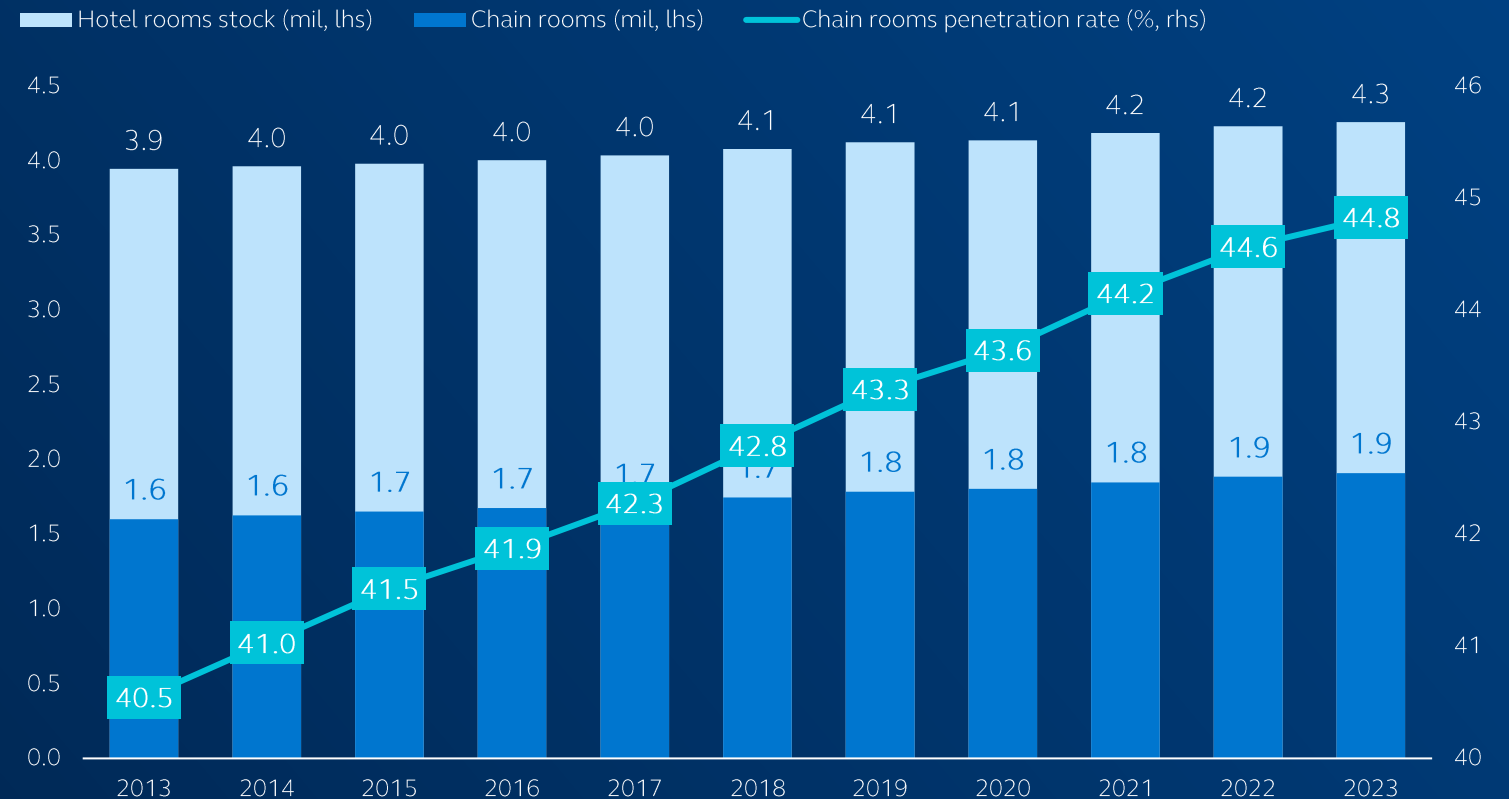
# ...Driven by chain hotels

### Hotel chains market share has grown steadily (from a low base)

- Over the last few years, the penetration of chain hotels by rooms count into the European market has gradually and steadily increased, although it remains at only 44.8%.
- There are also a number of countries which have an even lower penetration rate. Take Italy as an example. Although chain hotels market share has increased by four percentage points over the last ten years, it only reached 17.8%, a level which is well below the European average. In addition, the Economy segment in Italy remains an untapped space for hotel chains, with only 2% market share.

### Hotel chains market share

Europe<sup>1</sup>, 2013-2023



<sup>1</sup> Includes top 10 European tourist markets, namely Austria, Belgium, France, Germany, Greece, Italy, Netherlands, Portugal, Spain, and the UK.

Source: STR, Principal Real Estate Q4 2024

## OPPORTUNITY

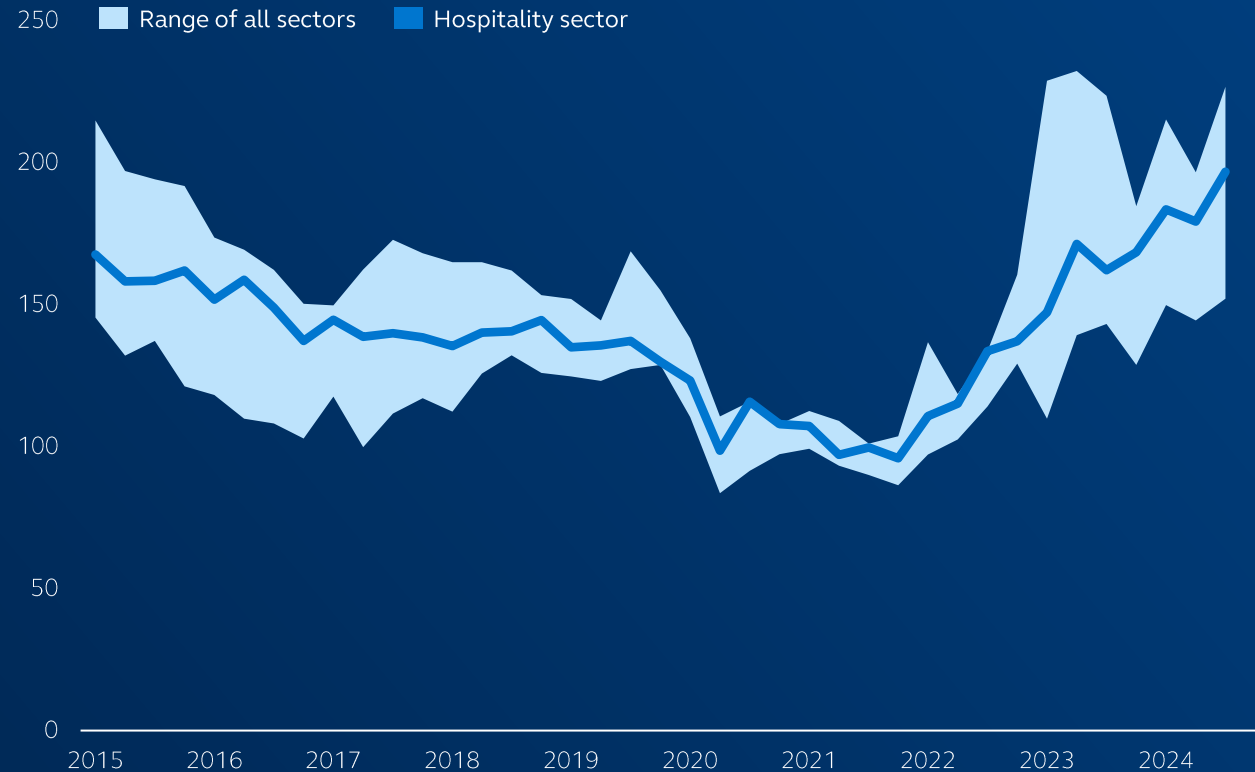
# ...While small / independent operators remain vulnerable

### COVID was a major shock whose effects are still being felt

- Following COVID, the trading market in European hotels has recovered but the challenges for some owners, especially smaller owners, have remained.
- Many came through COVID times by taking on more debt and in the recent higher interest rate period this has increased financial strains.
- In this environment we see opportunity for sophisticated investors with a track record in hotels to capitalise on the market and acquire well-located assets at historically low pricing.
- Repositioning those assets into current strong trading conditions has the potential to result in attractive returns.

### Business bankruptcy

EU 27, Seasonally adjusted, index, quarterly, 2021 = 100



<sup>1</sup> Range includes (a) industry, construction and market services, (b) industry (except construction), (c) construction, (d) wholesale and retail trade; repair of motor vehicles and motorcycles, (e) transportation and storage, (f) hospitality (accommodation and food service activities), (g) information and communication, (h) financial and insurance activities; real estate activities; professional, scientific and technical activities; administrative and support service activities, (i) education; human health and social work activities.

Source: Eurostat, Principal Real Estate Q3 2024

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## OPPORTUNITY

# Hotel innovators / hotels of the future

With information available at a click of a button, the rise of social media, technological innovations, growth in travel, innovative products and brands have emerged to cater to the changing needs of today's travellers whilst larger hotel groups have been less agile and slower to adapt. Investors looking at the hotel market today may want to consider focusing on the types of hotels outlined below.



### DIGITAL BRANDS

- Fully digitalised hotel operations, hotel significantly reducing operating cost
- Offer services via smartphone apps
- Lower operating costs = higher rents. Can profitably operate smaller hotels where traditional models cannot



### HYBRID HOSPITALITY

- Blends hotel with other property types/ demand drivers creating unique offering
- Synergies from non-hotel element drive performance
- Cater to a demand segment/ demographic with offering gap



### (TRUE) LIFESTYLE BRANDS

- Focus on food & beverage, design aesthetics, and attracting locals to create life in the lobby & place people want to be
- Attractive, 'trendy' environment increases room rates
- Create higher revenue and profit per sqm vs. traditional hotel

Source: Principal Real Estate, December 2024. The recommendations above reflect our views on relative opportunities over a 12-month horizon. It is not intended to be, nor should it be relied upon in any way as a forecast or guarantee of future events regarding particular investments or the markets in general.

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# CONCLUSION

## European hotels: A prime opportunity in 2025

### Real estate has reached a turning point

After two years of correction, we feel confident that a gradual recovery has begun, amid more accommodative monetary policy, lowering capital costs, and improved clarity on real estate pricing.

### European hotel sector leads the way

European hotels has been one of the most resilient sectors over the last two years, and we believe it will continue to present a compelling investment case, amid strong fundamentals, widening supply-demand imbalance, and a positive long-term tourism outlook.

### An attractive entry point in 2025

European hotels represent one of our preferred choices for 2025 alongside global data centers, logistics, and residential sectors. In particular, we see an opportunity window to acquire and reposition underinvested but well-located hotel assets.



Source: Principal Real Estate, January 2025.

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