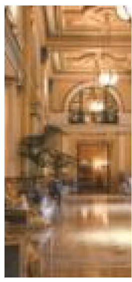
JUNE 2013 | PRICE £75

MARKET SNAPSHOT

BUDAPEST, HUNGARY

Lucy Payne
Consultant & Valuation Analyst





This market snapshot is part of a series of articles that HVS produces on key hotel sectors across Europe. In writing these articles we combine the expertise of HVS with STR Global data for each market. Our analysis is based on data for a sample of 52 mainly branded properties as provided by STR Global.

Highlights

- Hungary faces extreme challenges on both a political and an economic level. Following two years of consecutive growth, real GDP contracted by 1.7% in 2012, and it is expected to remain broadly flat in 2013, owing to weak domestic demand. According to the Economic Intelligence Unit's (EIU) May 2013 forecast, GDP is expected to grow by 0.8% in 2013 and 1.8% in 2014;
- However, tourism in the city is holding up and Budapest, Hungary's capital, attracted more than 3 million visitors and 7.3 million bednights in 2012, representing increases of 8.6% (visitors) and 10.6% (bednights) on 2011 and surpassing the peak levels of 2007 by more than 20%. The majority of these arrivals and bednights were generated by international travellers, which accounted for approximately 87% of arrivals and bednights;
- In 2012, the main international source markets for Budapest in terms of arrivals were Germany (9.4%), the UK (8.0%) and Italy (7.0%). Historically, Spain was a key source market but their share has contracted since 2007, most likely a result of domestic economic challenges. During the same period, arrivals from emerging markets China and Russia have more than doubled and now account for 2.2% and 4.0% of arrivals, respectively;
- Arrivals at Budapest Ferenc Liszt International Airport declined by 4.4% in 2012, following the collapse of the Hungarian national carrier, Malev;
- The meeting, incentive, conference and exhibition (MICE) sector in Budapest recorded a 24% increase in the number of meetings taking place in the city in 2011, making Budapest the 11th most important market worldwide in terms of international meetings. Figures for 2012 are unavailable at present, and the outlook remains unclear; international arrivals have grown but the pressing domestic economic and political challenges paired with the collapse of the national carrier may have had a negative impact;
- The good news is that the hotel performance figures for the past two years and the 12 months to March 2013 show that Budapest's hotel market is successfully recovering from the economic crisis, with considerable growth in occupancy and average rate. As a result, revenue per available room (RevPAR) rose in both euro and Hungarian forint;
- Two hotels entered the Budapest market in 2012. Development has now slowed, with just two hotels reported to be in the pipeline;
- Budapest's hotel investment market remains generally unremarkable, with only two single asset transactions and two portfolio transactions taking place in the past three years;
- As per the annual HVS Hotel Valuation Index (HVI), Budapest ended 2012 with values of around €136,000 or HUF39,200,000 per room for an internationally branded, four-star, city centre property.

Hotel Demand Patterns

Political and Economic Issues

As a country, Hungary faces extreme political and economic challenges. In April 2010, Fidesz – Hungarian Civic Union, the right-of-centre party, won an unprecedented two-thirds parliamentary majority. Since then, the country has faced a number of political issues with the government, under the rule of Prime Minister Viktor Orbán, making numerous controversial decisions that have been met with dissent as the country is seen to be moving away from democracy.

BUDAPEST NATIONAL BANK

As a result of the political issues, the country faces worsening economic challenges. From November 2011 to January 2012, three major credit rating agencies downgraded Hungarian debt to a non-investment speculative grade, in part because of political changes creating doubts about the independence of the Hungarian National Bank. Following this, the European Commission suggested that the new central bank regulations, allowing political intervention, seriously harm the country and therefore postponed talks regarding a financial aid package. Hungary then made small changes to the Central Bank law, and the European Commission agreed to resume talks with the International Monetary Fund (IMF). In September 2012, the government rejected conditions attached by the IMF to a €15 billion loan, and discussions are still underway to secure the financial aid package.

Airport Demand and the Collapse of Malev

The city is served by Budapest Ferenc Liszt International Airport (formerly known as Budapest Ferihegy International Airport). The airport was impacted by the economic crisis, with arrivals declining by 1.7% and 4.1% in 2008 and 2009, respectively. In 2011, as conditions improved, the airport carried almost 8.9 million passengers, an 8.8% increase on the previous year. Despite this, in 2012 the airport experienced a drop in passenger numbers, which reached just 8.5 million, owing to the collapse of the Hungarian national carrier, Malev.

The collapse of Malev followed the European Commission ordering the airline to repay various forms of state aid that it received between 2007 and 2010. Sources suggest that nervous suppliers demanded advance payments, which the airline was unable to provide; as a result, two of its aircraft were prevented from taking off from Dublin and Tel Aviv, prompting the decision to ground all Malev aircraft worldwide on 3 February 2012. Thus, in 2012 there was a significant rearrangement in the airline market at Budapest's airport, with low-cost carriers taking up many of the vacant slots and increasing their share from 26% to 52%.

It is important to note that following the Malev grounding there was a significant 20% drop in air traffic movements (the number of takeoffs and landings) at the airport, resulting in levels similar to those recorded ten years ago. The grounding of Malev had a knock-on impact on the airport, forcing it to introduce a number of cost-cutting measures, such as the closure of Terminal 1 at the end of May 2012 and the shelving of planned investments of approximately €30 million.

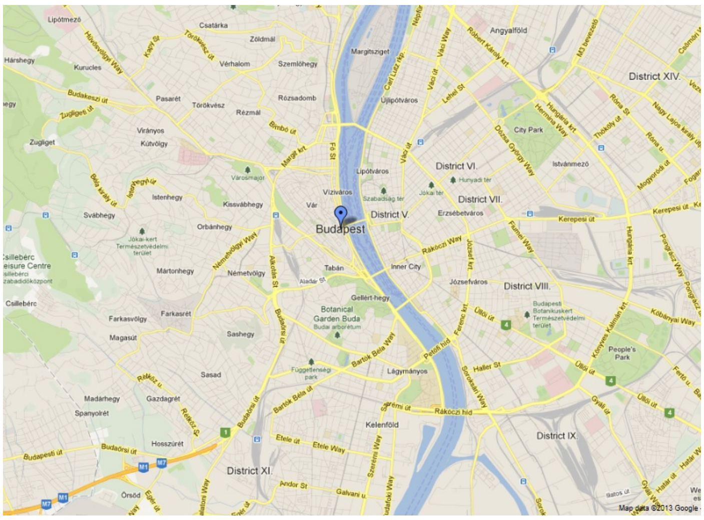
International Tourism Demand

International visitor arrivals were negatively impacted by the global economic crisis, with a fall of more than 10% recorded in 2009. Following this, substantial growth has been recorded, with arrivals growing by an average compound annual rate of 11.3% over the past three years. International arrivals now stand at almost 2.7 million and have far surpassed the peak levels of 2008 (2.2 million). Furthermore, the collapse of Malev in 2012 does not seem to have negatively impacted international tourism, possibly a result of the increased number of low-cost carriers offering flights. Tourism demand is dominated by international travellers, which accounted for 87% of total arrivals in 2012.

Bednights in Budapest are also driven by international demand, which accounts for 88% of total bednights in the capital. Total bednights declined in 2008 and 2009 as a result of the economic crisis, before showing significant growth between 2010 and 2012. International bednights have achieved a compound annual growth of 11.2% over the last three years.

The main international source markets for Budapest in terms of arrivals are Germany, the UK and Italy. In 2012, Germany accounted for 9.4% of total international arrivals in Budapest, while the UK and Italy accounted for 8.0% and 7.0%, respectively. Arrivals from the majority of markets showed growth in 2012 on the previous year, with the exception of markets in economic difficulty such as Cyprus, Greece and Portugal. Other important international markets include the USA, Spain and France.

The international MICE segment has been significantly affected by the global economic crisis, with the number of international events hosted in the city declining by 14.8% and 5.4% in 2009 and 2010, respectively, according to the International Congress and Convention Association (ICCA). As international tourism demand grew in 2010, it would suggest that the gap in the international MICE market was filled with leisure tourism. In 2011, Budapest hosted 108 international meetings compared to 87 the previous year, making it one of the biggest climbers in terms of international meetings, jumping from 18th position in 2010 to 11th position in 2011. According to the Budapest Convention Bureau, more than 80% of conference participants are from outside Hungary. Figures for 2012 are unavailable at present, and the outlook remains unclear; international arrivals have grown but the pressing domestic economic and political challenges paired with the collapse of the national carrier may have had a negative impact.



Domestic Tourism Demand

Domestic tourism also grew in 2010 and 2011, again surpassing the peak of 2008 to reach almost 415,000. Despite this, in 2012 domestic arrivals contracted by 4.2%. Bednights followed a similar pattern, with notable growth recorded in 2010 and 2011, followed by a decline in 2012, this time of 3.6%. These recorded declines in domestic tourism are an expected consequence of the challenging political and economic conditions detailed earlier in this report.

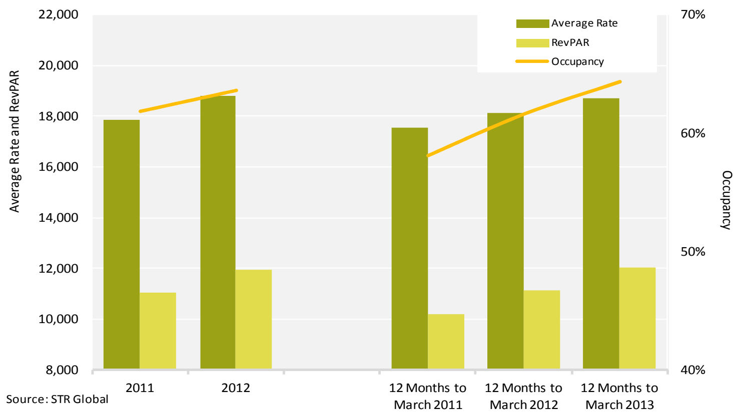
Hotel Performance

The analysis in this market snapshot is based on a sample of 52 hotels in Budapest. Charts 1 and 2 show Budapest's hotel market performance in both euro and Hungarian forint.

In 2011, room occupancy grew by a significant 7.0% as the market continued to recover from the depths of the global economic crisis and the significant falls in occupancy this caused in 2009. Following two consecutive years of decline, in 2011 hoteliers were able to increase average rate to HUF17,858, a 1.9% increase. This dynamic resulted in a RevPAR increase of 9.0%.

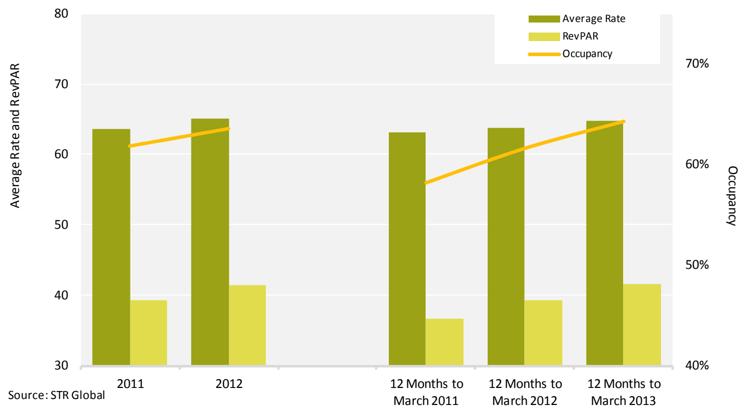
The growth in occupancy continued into 2012, with a further rise of 2.8% to 64%. This was accompanied by a significant increase in average rate of 5.3%, to HUF18,803, leading to an increase in RevPAR of 8.3%. Despite this growth, it is important to note that RevPAR declined drastically following the onset of the global economic crisis in 2008, and therefore the levels achieved in 2012, in both euro and Hungarian Forint, are well below the peak levels achieved in 2006 of €53 or HUF 14,206.

CHART 1: HOTEL PERFORMANCE IN BUDAPEST 2011-13 (HUF)



Source: STR Global

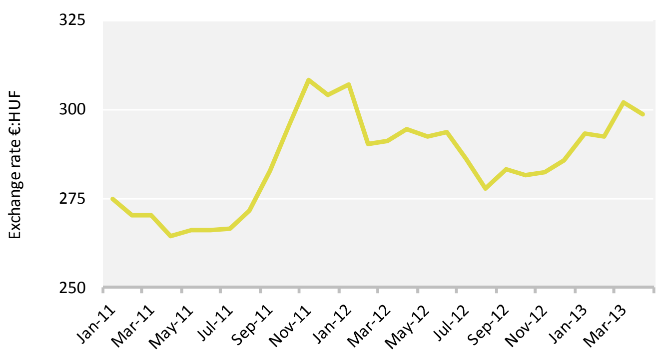
CHART 2: HOTEL PERFORMANCE IN BUDAPEST 2011-13 (€)



Source: STR Global

The figures for the rolling 12 months to March show a similar picture, with occupancy growing by a significant 8.0% in 2010/11, a further 6.0% in 2011/12 and by 4.4% in 2012/13. In Hungarian forint, average rate fell by 4.1% in the 12 months to March 2011, before rising by 3.1% in 2011/12 and 3.4% in 2012/13, highlighting the market's recovery following the economic crisis. In terms of RevPAR, the last three years have recorded consecutive positive growth as a result of the recovering occupancy and average rate.

CHART 3: EXCHANGE RATE FLUCTUATIONS – JANUARY 2011-APRIL 2013 (€:HUF)



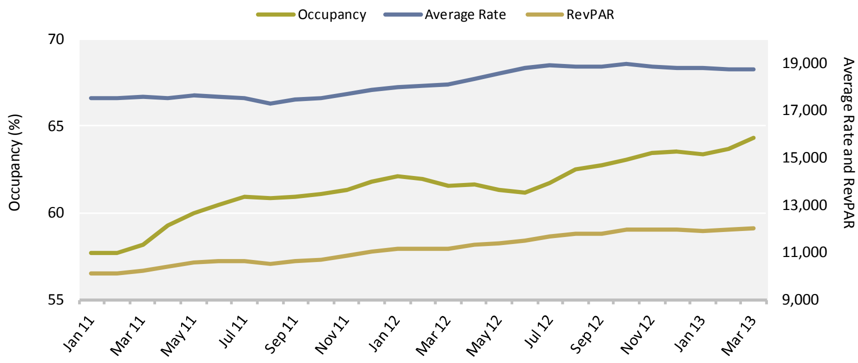
Source: OANDA

The increases in average rate, and therefore RevPAR in euro, were not as pronounced owing to currency fluctuations (see Chart 3). In 2011, average rate increased by 0.9%, leading to a 7.9% rise in RevPAR. In 2012, average rate grew by 2.3%, leading to a 5.2% increase in RevPAR. The year-to-March figures are also not as pronounced in euro as they are in Hungarian forint. In 2011/12 and 2012/13, average rate grew by 0.8% and 1.5%, respectively, leading to RevPAR increases of 6.8% and 6.0%, respectively.

Chart 4 shows the monthly moving average of hotel occupancy, average rate and RevPAR in Hungarian forint from January 2011 to March 2013.

In terms of average rate and RevPAR, Chart 4 shows a relatively flat performance, although an upwards trend can be identified, highlighting Budapest's recovery from the global economic crisis. Over the same period, it is interesting to see significant growth in occupancy. It is clear that as a market Budapest is struggling to grow average rate over occupancy; despite this, as long as occupancy continues to grow hoteliers should be able to slowly increase average rate, leading to continued increases in RevPAR. STR Global forecast moderate growth in hotel performance in 2013, which is expected to pick up in 2014.

CHART 4: 12-MONTH MOVING AVERAGE – OCCUPANCY, AVERAGE RATE AND REVPAR JANUARY 2011-MARCH 2013 (HUF)



Source: STR Global

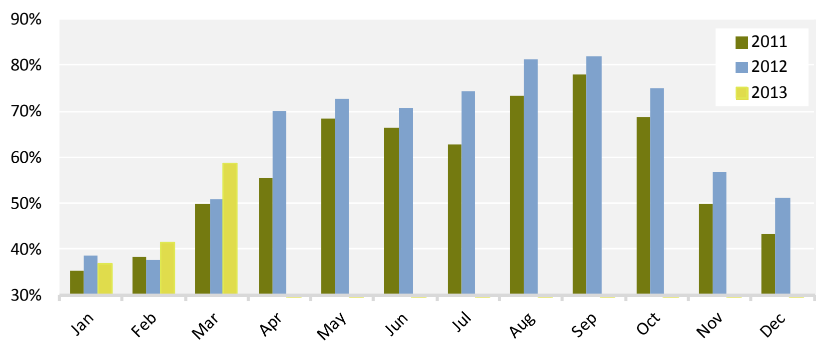
Seasonality

Chart 5 shows the seasonality for the hotel market in Budapest for 2011, 2012 and year-to-March 2013. It is evident that the hotel market is recovering from recent challenging times, as 2012 occupancy levels clearly exceeded those reached in 2011. This positive trend is continuing into 2013, with February and March showing continued strong growth.

Historically, the busy period in Budapest is the summer months of July, August and September, on account of the warm weather at this time of year. Despite this, the market has a good balance between business and leisure travel and is therefore able to achieve a relatively high occupancy throughout the year.

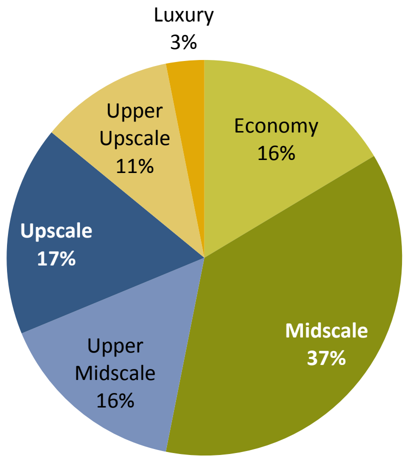
The strongest months in terms of occupancy are April through to October, with occupancy remaining above 70% for these months. The dip in occupancy experienced between November and February is typical of most markets, owing to Christmas holidays and the winter season.

CHART 5: SEASONALITY – BUDAPEST MONTHLY OCCUPANCY 2011, 2012 AND YEAR-TO-MARCH 2013



Source: STR Global

CHART 6: HOTEL SUPPLY IN BUDAPEST



Source: STR Global

Supply

Hotel supply in Budapest consists of approximately 256 hotels, ranging from economy to luxury, with a total of more than 22,000 rooms. Although, the city's hotel supply covers all categories, the majority are midscale and upper midscale hotels, which together account for 53% of the total room supply. There are currently just eight luxury hotels in the market, accounting for a mere 3% of hotel rooms in Budapest, including a number of internationally branded hotels. Chart 6 shows the breakdown of the current supply in Budapest.

New Supply

Notable hotel openings in Budapest in the past few years include the Buddha-Bar Hotel Budapest Klotild Palace and the Park Inn by Radisson Budapest. The 102-room Buddha-Bar hotel opened in June 2012, on the corner of Váci utca, one of Budapest's most famous streets. Buddha-Bar Hotels also has a property in Prague. The 138-room Park Inn by Radisson opened more recently, in December 2012, in Budapest's business district. Additionally, in December 2012 the boutique Hotel Nemzeti Budapest was added to Accor's M Gallery Collection following an extensive renovation.

CHART 7: RECENT HOTEL OPENINGS AND DEVELOPMENTS

Future/Recent Openings	Category	Number of Rooms	Opening Date	Status
Buddha-Bar Hotel	Upper Upscale	102	Jun-12	Recently Opened
Park Inn by Radisson	Upper Midscale	138	Dec-12	Recently Opened
Hotel at Budapest Ariport	Upscale	200	2014	Rumored
Renaissance Budapest	Upscale	185	—	On Hold
Total		625		

For now, it seems that hotel development has slowed, with only two hotel projects in the pipeline (one of which is on hold), a likely result of the effects of the economic crisis and the difficulty of securing debt finance. We understand that an upscale hotel will be opening at Terminal 2B at Budapest Ferenc Liszt International Airport in 2014, and will be operated by an international operator which is yet to be confirmed. In addition, we understand that Marriott plans to open a 185-room Renaissance hotel in Budapest; however, this project has been postponed due to construction delays and no opening date is available at present.

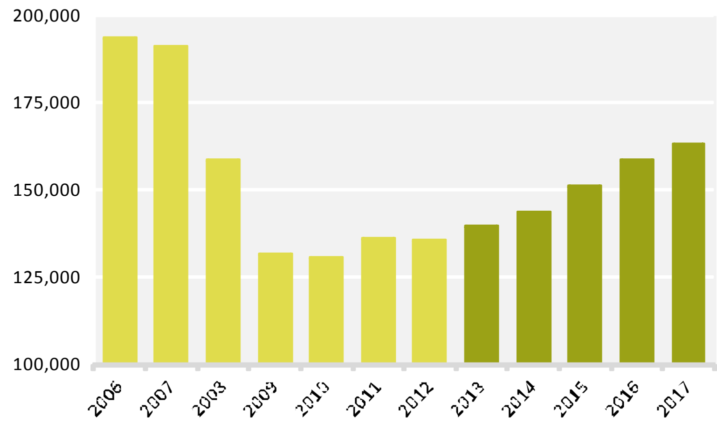
Hotel Investment and Values

Budapest has a relatively illiquid hotel investment market, with just two reported single asset hotel transactions of more than €7.5 million and two portfolio deals taking place in the last two years.

In November 2011, the State General Reserve Fund, an Omani sovereign wealth fund, completed the purchase of the 179-room Four Seasons Hotel Gresham Palace for a reported €70 million. The hotel was acquired from Avestus Capital Partners and continues to be operated by Four Seasons.

In May 2012, Al Habtoor Group acquired Le Méridien Budapest from Hungary-based Central European Estates, a subsidiary of Israeli conglomerate Premium International Holdings, for €60 million. The 218-room landmark hotel was built at the beginning of the 20th century and originally known as the Adria Palace. It became the tenth property in Al Habtoor Group's portfolio and its first asset in Europe. Starwood Hotels & Resorts will continue to run the hotel.

CHART 8: EVOLUTION OF HOTEL VALUES PER ROOM – BUDAPEST 2007-17(€)



Source: HVS – London Office

In addition, in 2011, the 402-room InterContinental Budapest was sold by the Morgan Stanley Real Estate Fund as part of a portfolio of seven InterContinental hotels across Europe. The portfolio was acquired by Lebanese businessman Toufic Aboukhater for a reported €450 million. In 2012, six of the hotels in this portfolio, including the InterContinental Budapest, were sold by Toufic Aboukhater to Ghanim Bin Saad Al Saad.

From our valuation experience and knowledge of the market, we estimate that hotel values in Budapest have evolved and will grow as shown in Chart 8. Following sustained growth, the value per room peaked just below €194,000 (HUF51,200,000) in 2006, before declining for four consecutive years; an obvious impact of the economic crisis. In 2011, values grew for the first time since 2006 by 4.0% in euro and 12.3% in Hungarian forint, but were still considerably lower than the peak of 2006 at €136,000 (HUF40,500,000) per room. In 2012, as a result of the continued economic difficulties in Budapest, values per room dropped slightly. The drop in value was primarily investor driven, not performance driven.

As per our annual European Hotel Valuation Index report (HVI), Budapest is 25th in terms of value per room (in euro). Budapest ended 2012 with values of €135,600 (HUF39,200,000) per room for a typical internationally branded, four-star, city centre property. This falls below the average value per room for the 32 cities covered by the HVI, which was €240,000 in 2012.

HVS forecasts that the value per room will rise to €163,000 or HUF43,100,000 (at current exchange rates) by 2017, an increase of around 20% in euro and 10% in Hungarian forint on 2012 prices.

Conclusion

Tourism demand in Budapest is strong. Following the global economic crisis, international demand has increased consecutively for three years and is currently the highest it has ever been. Domestic demand increased in 2010 and 2011; however, it dropped in 2012 owing to tough domestic economic and political conditions. Despite this, overall tourism demand peaked in 2012 at more than 3 million, since 87% of total arrivals are international; if this was not the case the outlook would be bleak.

Following some challenging times in 2009 and to a certain extent 2010, recovery in hotel performance in Budapest is well underway. The increased tourism demand is having a positive impact on hotel performance with year-to-March 2013 figures showing strong growth in occupancy, average rate and therefore RevPAR. RevPAR growth has primarily been driven by occupancy in the past few years. The development pipeline seems to have slowed in 2013 and this is encouraging for hoteliers, as limited additions to supply in the market will allow average rates to increase.

Historically, the hotel investment market in Budapest has been slow and this is unlikely to change in the near future, as tough economic conditions mean debt financing in Central and Eastern Europe remains hard to source.

The Budapest hotel market is clearly on the path to recovery. However, owing to the challenges resulting from the both the global economic crisis, and the more current political and economic difficulties, it will be some time before hotel performance returns to pre-crisis levels and transactions, development pipelines and values grow significantly.

About HVS

HVS is the world's leading consulting and services organization focused on the hotel, mixed-use, shared ownership, gaming, and leisure industries. Established in 1980, the company performs 4500+ 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 30 offices and 450 professionals, HVS provides an unparalleled range of complementary services for the hospitality industry. www.hvs.com

Superior Results through Unrivalled Hospitality Intelligence. Everywhere.

About STR Global

STR Global provides clients – including hotel operators, developers, financiers, analysts and suppliers to the hotel industry – access to hotel research with regular and custom reports covering Europe, the Middle East, Africa, Asia Pacific and South America. STR Global provides a single source of global hotel data covering daily and monthly performance data, forecasts, annual profitability, pipeline and census information. STR Global is part of the STR family of companies and is proudly associated with STR, RRC Associates, STR Analytics, and HotelNewsNow.com.

About the Author

Lucy Payne is a Consultant & Valuation Analyst with HVS's London office. Lucy holds a BSc (Hons) in International Hospitality and Tourism Management from the University of Surrey and a certificate in Hotel Real Estate Investment and Asset Management from Cornell. She joined HVS as a Market Intelligence Analyst in 2010 and since then has worked on a number of assignments across Europe and Africa.

For further information, please contact:

Lucy Payne – Consultant & Valuation Analyst, HVS
lpayne@hvs.com +44 20 7878 7757

Naureen Ahmed – Manager, Marketing and Analysis, STR Global
nahmed@strglobal.com +44 20 7922 1965