Horwath HTL

Hotel, Tourism and Leisure *Celebrated 100 years in 2015*

Special Market Reports

Issue 83 - BUDAPEST

February 2017

MARKET FOCUS: BUDAPEST

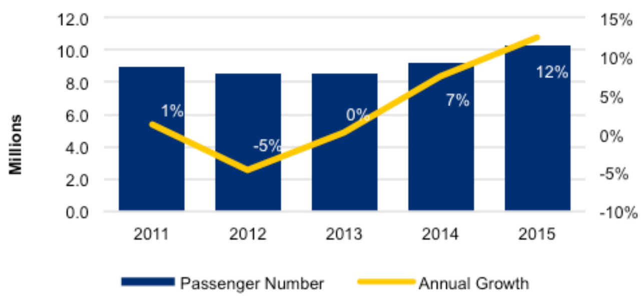
The general sentiment and year-to-date figures indicate a successful 2016 for Budapest hotels, both in terms of demand and supply growth.

Budapest – the growing capital city of Hungary boasts 1.8 million inhabitants, one fifth of the close to 10 million overall country population. As the cultural and economic centre of the country Budapest leads the way in tourism and hotel development as well.

In such turbulent times in Europe, Budapest as an international tourist destination competes not only with cities located in the CEE (i.e.: Prague, Vienna, etc.) but at least with other 80 cities in Europe (e.g. Florence, Berlin, etc.) including the global tourism market as well.

Budapest Airport has generated significant growth from the expanding number of low cost carriers. The airport set a new record in terms of total passenger numbers in 2015 (10 million passengers), also outperforming year-on-year growth rates of regional competitors such as Vienna, Prague, Bratislava and Warsaw.

Budapest Airport Passenger Volume



Source: Budapest Airport

Based on the airport passenger volume of H1 2016, it is projected that the number of passengers will reach 11 million (6.8% increase) in 2016, significant indeed. International connections are offered primarily within Europe, though also to an increasing number of direct destinations in Asia, the Middle East and North America. The primary feeder markets of the full service carriers have been the UK, Germany, Italy, Spain and the Netherlands. With over 90% average load factor the ratio of passengers flying with low cost carriers reached 50% of total by 2016 Q3.

Budapest the Unstoppable Destination?

Despite the recent (2014-2015) strong recovery of the Budapest hotel market the questions still remains: **What fuels the growth in 2016 and going forward?**

Firstly, the growth in tourism slowed this year in Europe following the various challenges that the continent's tourism has faced over the past year.
According to the World Tourism Organization (UNWTO International arrivals grew by 1.6% between January and September 2016, which was significantly lower than the growth of 4.6% seen in 2015.
However, Central and Eastern Europe (+5.3%) and Northern Europe (+6.4%) both performed well, with double-digit increases in countries such as Hungary and Ireland, according to UNWTO Barometer figures.

Budapest being far from unstoppable can undoubtedly ride the wave of the changing appetite of the typical travellers in Europe. As it was highlighted during the 24th World Travel Monitor Forum in Pisa; "Europeans changed their travelling habits this year by opting for safe destinations, including stagnation in sun & beach holidays, while going on more city trips".

In essence, while some destinations suffered serious damages due to terrorist attacks, Budapest as many others remained a safe and convincing option for leisure travellers.

Secondly, the much-criticized, nevertheless continuous, promotional efforts of the Hungarian National Tourist Office, the constant infrastructure improvements in the city centre and the advent of private-sector initiatives establishing quality attractions and entertainment hubs, all have contributed to Budapest becoming a better overall tourism product.

However, without the priceless international media coverage based on travellers' reviews and feedback, Budapest would have hardly made it back on the world tourist map. **The exciting yet affordable nature of the capital has been largely to thank for these stellar reviews and rankings, which drew satisfaction from leisure and business travellers alike and helped Budapest become a 'must see destination'.**

To name but a few, Budapest has been nominated the second best city in the world by CNN and third by the Huffington Post in 2014. Moreover, according to ELLE, Budapest is among the 10 most underrated cities in Europe and in one of the Travel Channel's 2016 articles the city earns a prestigious second place on a list that features Europe's 15 most beautiful destinations to visit.

Budapest is one of the three finalists to host the 2024 Summer Olympic Games. Fellow candidate cities are Paris and Los Angeles. The winner will be announced in September 2017.
Budapest does have a fair chance, as it is the only small candidate city, which is considered a more sustainable alternative for future Olympics as a declared strategy of the IOC.

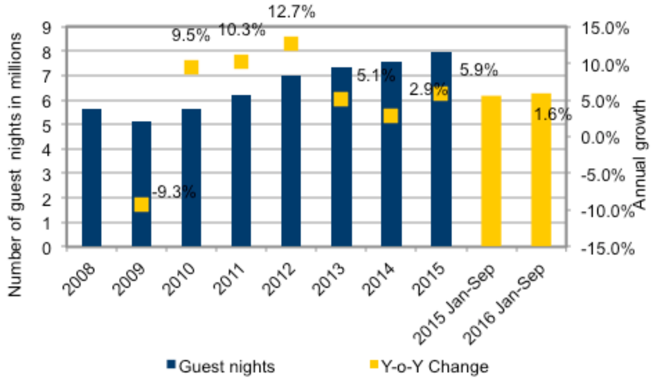
Although there have been a number of infrastructural developments recently, public transportation still needs to be improved. Special attention should be given to the accessibility from Budapest Airport including improved roads and proper rail network.

It is important to highlight that Hungary will host the World Aquatics Championship and the World Junior Swimming Championships in 2017. These will provide not only a solid base for summer hotel occupancy levels but also an excellent opportunity to further increase awareness of the capital and help the Olympic bid.

Growing Demand

With increasing visitation comes word-of-mouth, which has been positive and attracts not only a large amount of leisure tourists but has a positive impact on corporate group business, too, drawing increasing number of conferences to the city.

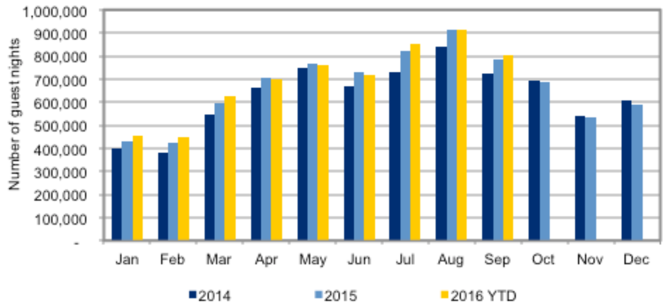
Hotel Guest Nights in Budapest - 2008-2016 YTD



Source: Hungarian Central Statistical Office

Global interest to visit Budapest has increased demand, not only during the typical peak periods (i.e. May to October) but also in off season and shoulder periods, making November, December, March and April busy months too. January and February also have witnessed a significant year-over-year increase this year.

Hotel Seasonality in Budapest - 2014, 2015 and 2016 YTD



Source: Hungarian Central Statistical Office

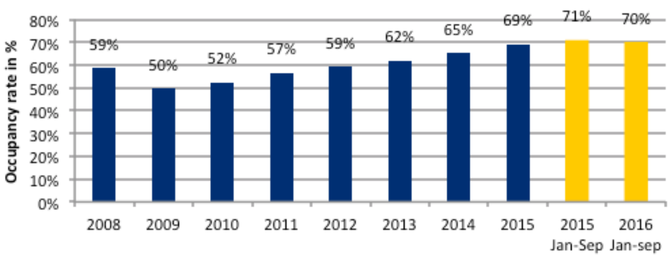
Year-to-date figures show a solid increase in the usually low season months in the first quarter, but a slowdown in the second quarter suggest that guest nights in 2016 exceed 2014 volumes.

Occupancy Trends

Since 2008, the year 2013 was the first time country-wide occupancy reached pre-crisis levels, which shows the magnitude of the negative impact the crisis had on the Hungarian hotel market.
The average occupancy level in Hungary in 2015 reached 54%, which compared to 69% in Budapest no doubt, underlines the clear leading position of the capital city.

In Budapest it was in 2014, when Horwath HTL witnessed the first cautiously optimistic steps market-wide with occupancy levels at upper-upscale hotels averaging in the low 70s, while most downtown mid-market and upscale properties reached a market average of 80% room occupancy. Both midscale and upscale properties in general achieved pre-crisis occupancy rates by the end of 2014 and most players focused on increasing room rates while maintaining or further increasing occupancy levels in 2015.
In 2016 occupancy levels hit the ceiling in most of the downtown properties with more tangible increase in ADR than in occupancy due to its already high levels.

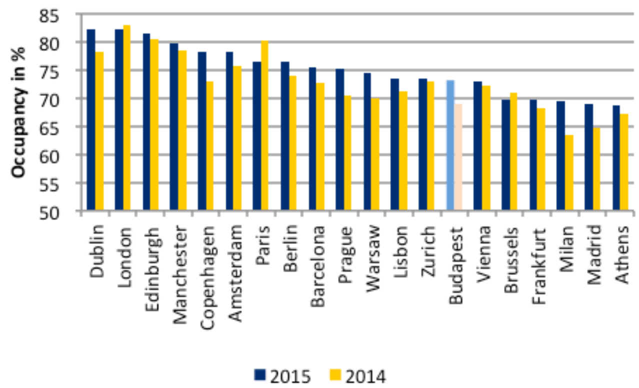
Development of Occupancy in the Budapest Hotel Market



Source: Hungarian Central Statistical Office

Based on the European Hotel Review of STR Global, Budapest ranked as number 14 with 69% occupancy in 2015 out of the 31 comparable cities in the study just below Zurich, Prague, Warsaw and above Vienna, Brussels, Frankfurt and Milan to name a few.

Ranking of EMEA Markets by Occupancy in 2014 and 2015

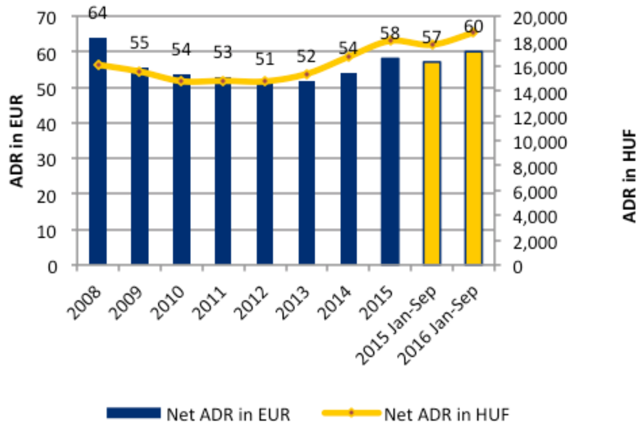


Source: STR

ADR Trends

In terms of ADR trends, from a long awaited but modest growth in 2014, rates grew significantly over the course of 2015, which could not be continued with the same pace in 2016 but still showed a steady increase overall.
On average, 5-6% year-over-year ADR growth is expected in the upper-upscale hotel segment in 2016, which naturally induces the growth of ADR in the midmarket and upscale properties, where rate increases are expected to show even higher growth in the range of 6-8% on an annual basis.

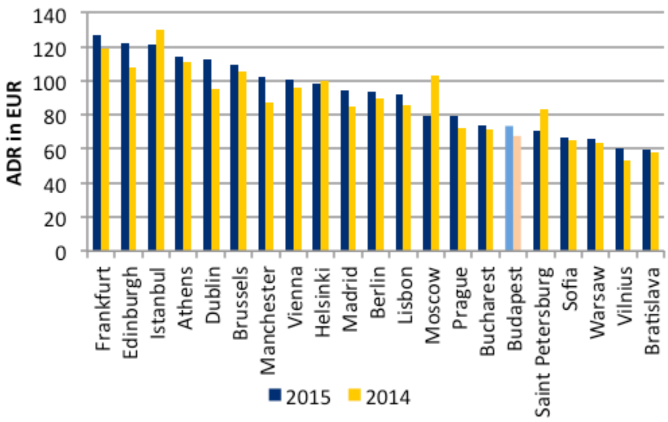
Development of ADR in the Budapest Hotel Market



Source: Hungarian Central Statistical Office

Based on the European Hotel Review for 2015/2014 prepared by STR Global we present the competitive position of Budapest within the 31 comparable destinations in the chart below.

Ranking of EMEA Markets by ADR in 2014 and 2015



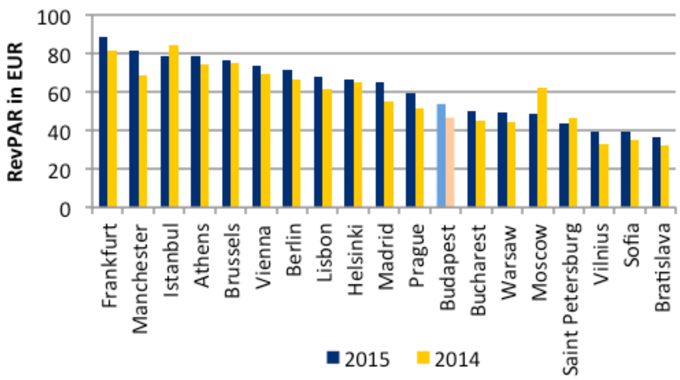
Source: STR

The average daily rate (ADR) chart highlights the potential Budapest has, as it is ranked among the lowest-ADR cities in Europe, despite its high room occupancy levels.

RevPAR Trends

The corresponding revenue per available room (RevPAR) chart below reconfirms that Budapest has significant upside potential in better utilising its potential by increasing prices to match the growth in occupancy.
A market-wide acknowledged pricing strategy would provide for RevPAR improvements thus a significantly more profitable industry.

Ranking of EMEA Markets by RevPAR in 2014 and 2015

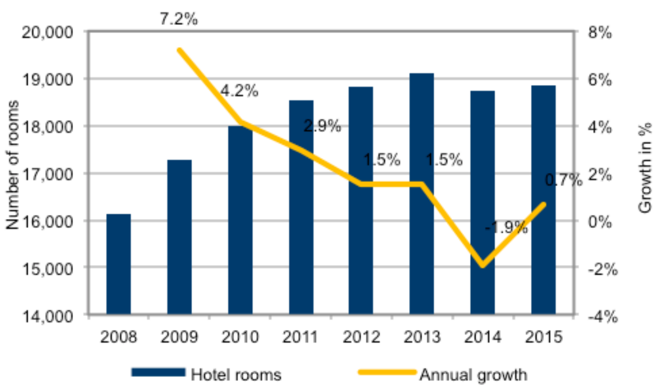


Source: STR

Supply Overview

The recent rediscovery of Budapest and with it the sudden increase in demand naturally induced an increase in hotel supply, such as in the upscale boutique sector with the openingof Aria Hotel and Prestige Hotel in 2015 and the Hotel Moments in 2016.

Development of Hotel Room Stock in Budapest 2008-2015



Source: Hungarian Central Statistical Office

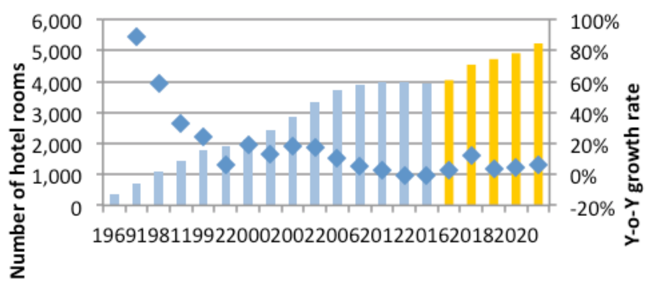
The development of hotel room stock in Budapest was continuously rising between 2010 and 2013, however the period was followed by a slight fluctuation, which was mainly caused by the closing of rooms for renovation in many hotels in each category, primarily due to rebranding or facility upgrades.

A total of close to 19,000 rooms were registered in 2015 in Budapest and preliminary data indicates further growth in hotel room supply for 2016.

Future Supply

Horwath HTL believes that without available and affordable local bank financing for hotel developments, new supply will only enter the market if backed by cash-rich developers.
What is certain, however, is that hotelier and investor confidence has been restored in the Budapest hotel market, proven by the mushrooming hotel projects seen across downtown Budapest and which are likely to add more than 3,500 hotel rooms by the end of 2021.

Budapest 5-star Hotel Supply Evolution



Source: Horwath HTL research

Research by Horwath HTL indicates that the upper-upscale hotel market has showed significant and constant growth until 2012, when the Buddha Bar Hotel entered the market. The luxury hotel market – owned by the Four Seasons Gresham Palace since its opening in 2004 – more than doubled with the opening of the Aria Hotel with limited room count in 2015 and the opening of Ritz-Carlton in 2016 – a conversion of the former Le Meridien.

The likely evolution of future supply is also illustrated in the chart above from 2017 till 2021 suggesting an increased appetite of hotel developers and showing an upswing in upper-upscale and luxury hotel developments, many of which are old projects coming finally to realisation (e.g. Ballet Institute, Rácz Hotel, etc.).

All in all approximately 1000-1100 new upper upscale and luxury hotel rooms are expected to enter the market in the next 5 years, amounting to an expected 28% growth in the upper upscale and luxury hotel supply compared to 2016.

The downtown mid-market and upscale hotel market has seen sizeable and continuous supply expansion with 40-100 room select service independent hotels for two main reasons:

- the increased amount of leisure travellers;
- restricted financing from local banks and financial institutions, which discourage developments with F&B and other facilities.

It is important to highlight that capital-intensive upper-upscale and luxury hotel developments will be completed despite local banks' reluctance to finance such projects, as foreign investors will likely secure necessary financing from abroad or build by initially using own funds.

Outlook

With the expected but still pending completion of the 4,000-seat new congress centre, the city would be able to host events, which could lead to more city-wide sell-out nights, hence increased room rates and profitability.

The countryside hotels will benefit from improved economic activity and the growth in purchasing power of the local population, as they are the staple drivers of demand, while markets from neighbouring countries continue to fill hotel rooms.

Horwath HTL believes that significant improvement in the countryside hotel sector can only be achieved with the development of large scale attractions, which would boost domestic as much as international demand for hotel rooms.

Despite all the above, it is imperative to highlight that Budapest as a destination needs focused efforts by all tourism stakeholders to be able to maintain sustainable growth.

Meagre accessibility and the poor sense of arrival from Budapest Airport is an ever-returning weakness, as is the lack of the long-promised completion of a proper international quality congress centre.

The completion of the convention centre would elevate Budapest to a new level of competition. Should the right to host the 2024 Summer Olympic Games be awarded, Budapest would have the challenge and the opportunity to turn into the failure of an Athens or the success of a Barcelona.

Horwath HTL can conclude that in 2016, Budapest's upper-upscale and luxury hotels were able to achieve and even exceed pre-crisis (2007) RevPAR figures. In the mid-market and upscale hotel segments especially, the downtown boutique hotels reached occupancies well above 80% and started pushing rates up by 6-8% year over year. The market-wide ADR however is still below the 2008 figures in euros and only exceeds it in the local currency.

The general sentiment and year-to-date figures indicate a successful 2016 both in terms of demand and supply growth. Strategy and focus is needed to fuel momentum and slowly shift the city's positioning from a hip and cheap weekend getaway to an exciting and quality year-round destination, maintaining a healthy value-for-money proposition.

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Attila Radvánszki joined Horwath HTL in 2012 August. Since his arrival he has taken part in the concept development of various tourist attractions and hotels, and assisted in the preparation of market and financial feasibility studies in Hungary, Russia and numerous CIS countries.

He graduated from the International Business School, Budapest – fully accredited by Oxford Brookes University – with First Class Honours in Travel & Tourism Management in 2011. As part of the academic programme Attila completed several modules, such as: Strategic Planning, Marketing Communications, Tourism Destination Management, Management and Financial Accounting, Research Methodology, Corporate Governance, Human Resource Management, etc.

During his studies Attila completed two industrial placements, the first of which during his secondary school studies in Davos, Switzerland, where after attending a course in the Swiss School of Tourism & Hospitality in Chur he worked as an F&B Assistant at the Hotel Grisha.

As per the second placement he spent 12 months in the Kempinski Hotel Corvinus Budapest 5-star luxury hotel as a Management Trainee where he had the opportunity to prove himself in almost all the departments of the property with a focus on Yield & Revenue, E-Commerce, PR & Marketing and Corporate Sales areas.
Working at Kempinski Hotel Corvinus, Attila participated in numerous trainings in hotel management. In 2010 Attila left Kempinski Hotel Corvinus in order to finish his studies, which he has completed with First Class Honours.

Before joining Horwath HTL in Budapest, Attila moved to the renowned resort town of Bournemouth, United Kingdom after graduating in fall 2011 to broaden both his international and professional experience. After completing a short course in International Business Communications in Finance & Accounting at M.L.S International College he worked as the Bar Manager in the Britannia Hotel Bournemouth.

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