BY CATHERINE CHETWYND

EASTERN EUROPE

REALISING POTENTIAL

Global uncertainty is having a particular impact in Eastern Europe – but investment is showing this part of the world is rising to the challenge

WHEN THE CREDIT CRUNCH HIT, hotel investors retrenched to the familiarity of Western Europe and key markets. Since then, some Eastern European destinations are gaining traction, but it's not an easy journey.

"We are seeing interest in Warsaw, Prague, Budapest… the more mature gateway cities," says Sophie Perret, director of hotel consultancy HVS. "Investors feel there is value to be had there and less risk." But she adds: "We have seen interest and appetite, but not much activity."

The migrant crisis may also have political repercussions, as is evidenced by the recent election in Austria, where an extreme right-wing party missed victory by a hair's breadth. "The East European markets have aspirations to become more integrated, but they if became more anti-EU, there could be a different dynamic," adds Perret.

The barometric progression of the Russian rouble – which has swung wildly between R40 and R100 to the euro, settling (for the moment) at around R73 – has also had a wider spin-off, with instability and rising prices deterring investors in Russia. Meanwhile Russians are travelling to former Soviet Bloc countries, where in most they don't need a visa, says Rezidor Hotel Group regional vice-president David Jenkins. "We have hotels in all these places, so it's very stimulating for business."

UPBEAT OUTLOOK

Accorhotels gives an upbeat outlook: "The economic conditions in Eastern Europe are positive and we are reporting robust growth in all our markets – with RevPAR [revenue per available room] up 10.6 per cent in 2015 over the previous year," says Gilles Clavie, CEO of Orbis Group, business partner of Accorhotels in Eastern Europe.

"If you look at Warsaw, Gdansk, Budapest or Prague, it becomes clearer every day that Eastern countries offer more value for money but also high level MICE [meetings, incentives, conventions and exhibitions] services. There is an immense undiscovered incentive potential."

And according to the HVS *2016 European Hotel Valuation Index* (*HVI*): "We note that 2015 was a particularly good year for the Eastern European market, which was able to bounce back from declining values in 2014 to reach a 5 per cent increase in room values and match the European average for the year."

Many Eastern European countries are heavily influenced by their Western neighbours. "Germany has a lot of influence in Poland and the Czech Republic, as has Austria; and the Scandinavian countries in the Baltics," says industry consultant Melvin Gold. Scandinavian companies are relocating to the Baltics for cheaper payrolls, lower rent and the well-educated population.

The hotel scene in Eastern Europe is still largely populated by core brands and the majority of the pipeline is in the midscale segments, with 24 per cent occupied by upper-midscale and 8 per cent midscale, according to hotel data analyst STR. This leaves great opportunities for budget hotels and lifestyle brands.

Above: Warsaw, Poland **Main picture:** Prague, Czech Republic

RUSSIA

After Russia annexed Crimea, ensuing European Union sanctions left Russian banks unable to borrow and lend only at extortionate interest rates.

Until then, Russians were among the most dynamic investors abroad: there is Russian development money throughout Eastern Europe. They were more adventurous than Western investors because they already had a long-standing relationship with governments, businesses and the private economy, and understood the Eastern European market better.

"Western investors still needed another ten years to get the Cold War out of their head," says PWC partner Nicolas Mayer.

But investment has not ground to a halt. "We are seeing hotel activity in Moscow, St Petersburg and in the far east of Russia, and in some regional cities as well," says Rezidor's Jenkins. "People do have some cash available and see that now is the time to invest because, when the market does finally come back, it may be too late; it is time to invest ahead of the curve."

And in 2013, IHG announced an agreement for the development of a number of Holiday Inn Express hotels in Russia, to be completed by 2019. It has already opened Holiday Inn Express Voronezh Kirova and Hotel Indigo St Petersburg Tchaikovskogo, introducing both brands to the country.

Although average rates are "still fragile", with both cities experiencing drops over the last year (*HVI*), Russia will be hosting the 2018 FIFA World Cup and is investing an estimated US$10 billion to develop infrastructure, which will attract business.

However, the picture is not rosy. "Russia is going through recession and, with sanctions and the falling price of oil, there is an unfortunate set of circumstances," says HVS's Perret. "Also, the country's long-term prospects are difficult to assess: what happens post-Putin, who comes next and what is this person going to do? The country has become very nationalistic and that doesn't make investors feel comfortable either."

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POLES APART

However, it looks as though Poland may have benefited from the turn away from Russia. "Poland is of greatest significance. It has a lot of big cities – Warsaw, Krakow, Poznan and the Three Cities – Gdansk, Gdynia and Sopot – and it is ripe for budget hotel development," says Melvin Gold. Rezidor recently acquired a stake in German economy brand Prizeotel and properties in Eastern Europe follow.

Hotel management company Hotels Development Europe represents investors in Wroclaw, where a Doubletree by Hilton is opening as part of a €100 million project, which president Yossi Wircer describes as "probably a hotel icon, not only for the city but for the whole of Poland". Also in the pipeline is a new Holiday Inn in Krakow and a €25 million luxury lifestyle hotel in the city's centre.

"The hotel sector is quite busy," says Wircer. "Marriott-Starwood, IHG, Hilton and Accor all have development people or offices in Poland and are working very aggressively to get contracts. Poland is appealing because Russia isn't any more – it's very simple; and because only 25 per cent of hotel rooms are branded, there is great potential for branded hotels to come into the market."

In addition, a Marriott Courtyard is under construction in the business district of Warsaw and a Holiday Inn is due to open in 2018. "After that, development would probably be in secondary destinations such as Gdansk, Poznan, Szczecin, Krakow and Wroclaw," says Wircer. "Krakow is very attractive to investors. It is the most visited city in Poland and tourism is very strong."

AND FARTHER AFIELD…

Choice Hotels is also looking to expand its mid-market hotel offering into primary and secondary cities in Poland as well as into Balkan capital cities. "As a pure franchisor, ▸

we look to cooperate with well established local operators who have local market expertise that we can combine with our global marketing and distribution capabilities," says Choice Hotel's European corporate sales director, Brian Garvan.

Similarly, IHG sees a gap in the Poland and Russia markets for Holiday Inn and Holiday Inn Express, and taps into local knowledge. "The key is to speak the language. For example, in Russia, our development team is made up of Russians, who are based in Moscow and who know how to do business in Russia. We also have local resources across the region," says IHG's European chief development officer, Rob Shepherd.

STAND-OUT APPEAL

Mature markets Warsaw, Prague and Budapest still stand out as having greatest appeal to investors. "Performance has recovered and there is value in those propositions because price-per-key hasn't gone back to peak levels," says HVS's Perret.

This is backed up by James Parsons, head of business development at STR. "They have all performed very well over the past 18 months, which is attracting the interest of investors," he says.

Mature markets Warsaw, Prague and Budapest still stand out as having greatest appeal to investors

Budapest has bid for the 2024 summer Olympics and Paralympics, and is hosting the Fina (swimming) World Championships in 2017. "Hungary has a dynamic new minister of tourism and Budapest is focusing on upgrading from backpackers to more diversified upscale or midscale sustainable tourism," says PWC's Mayer. Broadened hotel infrastructure will follow.

And a recent revision in the country's Fitch rating from BBB- to BB+ suggests its financial troubles are on the wane. "The improving financial stability provides a better backdrop for investment decisions and the lower costs of financing the country's borrowing should result in more funding being available for investment into infrastructure projects that improve Hungary's competitiveness," says Mark Hennebry, hotels director at CP Holdings.

Budapest is already a successful meetings and incentives destination, but the airport is disproportionately poorly connected compared to the importance of the destination. "They are working on that but it will take another two or three years. They could offer a 'Paris experience' at half the cost, but they need to make it easy for event organisers to bring 2,000 people from across the world," says Mayer.

In short, the potential for Eastern Europe is huge and, in some cases, is being fulfilled, but the largest uncertainty lies in "the escalation or deterioration of relations between the Eastern and Western blocs", as Nicolas Mayer puts it. And one thing investors don't like is uncertainty.●

Baltic paradox

BECAUSE THE THREE BALTIC CAPITALS, Riga, Tallinn and Vilnius, are in the EU, cash is available and at low interest. "Hotels remain a very attractive asset class in the Baltic states," says Rezidor's David Jenkins.

Rezidor has 18 hotels in the region, plus an active pipeline, and the young, well educated, tech-savvy population is ideal for the group's lifestyle property, Radisson Red. "Tallinn, Riga, Vilnius are targets," Jenkins says.

Hilton is also targeting the area. "Hilton Worldwide is seeking opportunities in the Baltics to build on June's opening of Hilton Tallinn, which will become our first property in the region," says regional vice-president Mike Collini. "We feel Hilton Garden Inn has particular potential as a mid-market proposition."

However, since NATO threatened to deploy four battalions (approximately 4,000 troops) in the Baltic countries (and Poland) – which had the Russians up in arms, literally and figuratively – these states have been a less sure investment prospect.

"When I speak to people in the Baltic region, they are truly concerned about political stability," says PWC's Nicolas Mayer.

But although this may deter institutional investors, who are conservative in their approach, that potential gap could still be filled by local or foreign interests.

Hotel pipelines in Eastern Europe

IN 2016 AND 2017, Marriott is opening Courtyard by Marriott Brno, Czech Republic; Marriotts in Voronezh (pictured) and Nizhny Novgorod, Russia; Moxy Tbilisi, AC Hotel Wroclaw Old Town, Poland; Krasnodar Marriott Hotel, Russia; and Renaissance Warsaw Airport, Poland. It recently announced Bulgari Moscow, Russia, 2019.

By the end of 2016, Accor will have opened six Ibis properties across Poland, including an Ibis/Novotel, and an Ibis and a Pullman (separately) in Riga, Latvia. In 2017, a further eight Ibis hotels, including a joint Ibis/Novotel, will come on line in Polish cities.

Carlson Rezidor has 13 hotels in different stages of development in Eastern Europe – Radisson Blu hotels in Russia, Armenia, Georgia and Belarus; and Park Inn by Radisson hotels in Latvia, Georgia and Ukraine.