

The Baltic Hotel Market

An overview of the capital cities



Baltic Hotel Market Overview

Introduction

Positive Demand and Performance Development

Supported by strong economic growth and investments, the Baltic region is rapidly growing in popularity. The Baltic economies are among the fastest developing in Europe, and the number of passengers at the capitals' airports have been growing between 4-8% annually, illustrating the continuous increase in international activity in the region.

The hotel markets in the capital cities have shown very positive development. Reviewing the last five years, hotel overnights have increased between 2-4% annually, with growth driven by both international and domestic demand. The growth in supply has been more modest, and consequently, has been outpaced by demand in all three cities. As a result, hotel performance has seen substantial development with the exception of Riga, where most new demand has been absorbed by steady additions in supply. In Tallinn, however, RevPAR has increased by over 6% annually, while Vilnius reached a 4% annual RevPAR growth in the last five years.

Strong Performance Attracts Large Hotel Pipeline

The strong hotel market performance has attracted the attention of international operators and investors, and a sizeable pipeline of new hotel developments is expected in all three markets. A total of 3,800 rooms are anticipated to enter the capital markets in the next two years, representing a c. 20% increase.

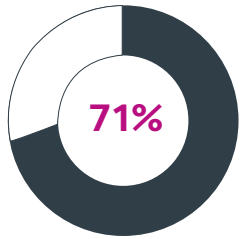
With relatively limited brand penetration and fairly low dominance of local chains, the Baltic markets have been attractive for international players to penetrate and expand in. In recent years, global brands such as Hilton and Marriott have made their entrance, while Radisson Group and Accor have continued to strengthen their positions as leading operators.

The notable increase in supply is likely to put some pressure on the performance of the capital markets in the short to medium term. However, with strong momentum in the markets, demand is anticipated to keep growing at a high rate and the long-term performance outlook remains positive.



Full Year 2017 KPI's

Tallinn - Estonia



Occupancy

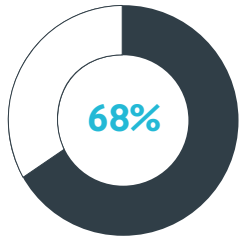
€75

ARR

€53

RevPAR

Riga - Latvia



Occupancy

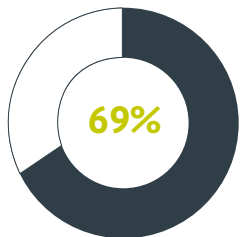
€62

ARR

€42

RevPAR

Vilnius - Lithuania



Occupancy

€64

ARR

€44

RevPAR



Economic Outlook

Record GDP growth – labour markets pose a challenge for future development

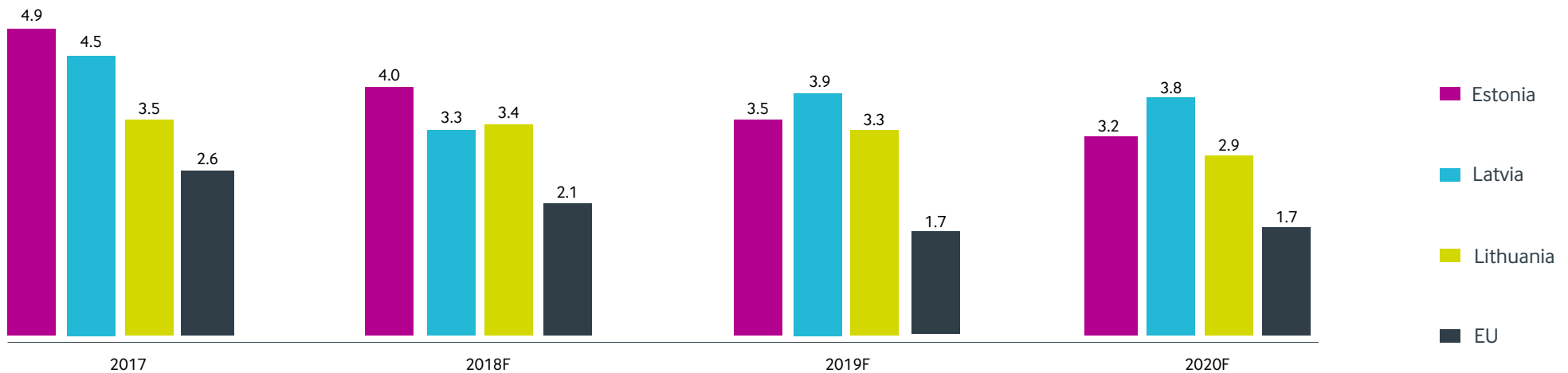
The Baltics are inhabited by close to 6m people, and Lithuania is the largest country with c. 45% of the Baltic population. On average every fourth person lives in one of the three countries' capitals.

The Baltic economies were severely affected by the dragged out 2008 financial crisis, but during the last few years, growth has picked up and the Baltic States economies are among the fastest growing in the euro zone. Growth has been fueled by increasing investments (supported by EU funding), the recovery of export markets and consumption, supported by wage increases. In 2017, Estonia surpassed expectations by reaching a real GDP growth of 4.9% - the highest single-year growth since 2011. Similarly, Latvia experienced its highest GDP growth in six years, reaching 4.5%, whereas Lithuania was able to achieve a high of 3.5%.

Despite strong growth momentum in the economies, forecasts are somewhat conservative due to challenges posed mainly by the labour markets. A shortage of skilled labour is limiting growth potential and scarce labour supply has been driving pay increases, with an annual growth rate of 7-8% in wages. While positive for private consumption, the wage increases create cost pressures and may lead to reduction in competitiveness, unless productivity keeps up with it.

Going forward, efforts to improve business environments, increase competitiveness, grow exports and resolve the shortage of skilled labour are key priorities to secure future growth. Overall, the short-term economic outlook in the Baltics remains positive and ahead of the Euro region.

Real GDP Growth Forecast (%)



Baltic Airports

Significant growth in passenger numbers supported by expansions

Tallinn Airport (TLL)

Is the smallest of the three Baltic airports, with connections to 39 destinations in the summer season. While the airport has reached an all time high in passenger numbers in 2017 (2.6m, +19%), the Port of Tallinn remains the key entry point to the market. With a lack of direct air routes to Asia, the ferry connection from Helsinki constitutes a main access point to the Baltics for emerging tourism from Asia.

4.4% CAGR

Riga Airport (RIX)

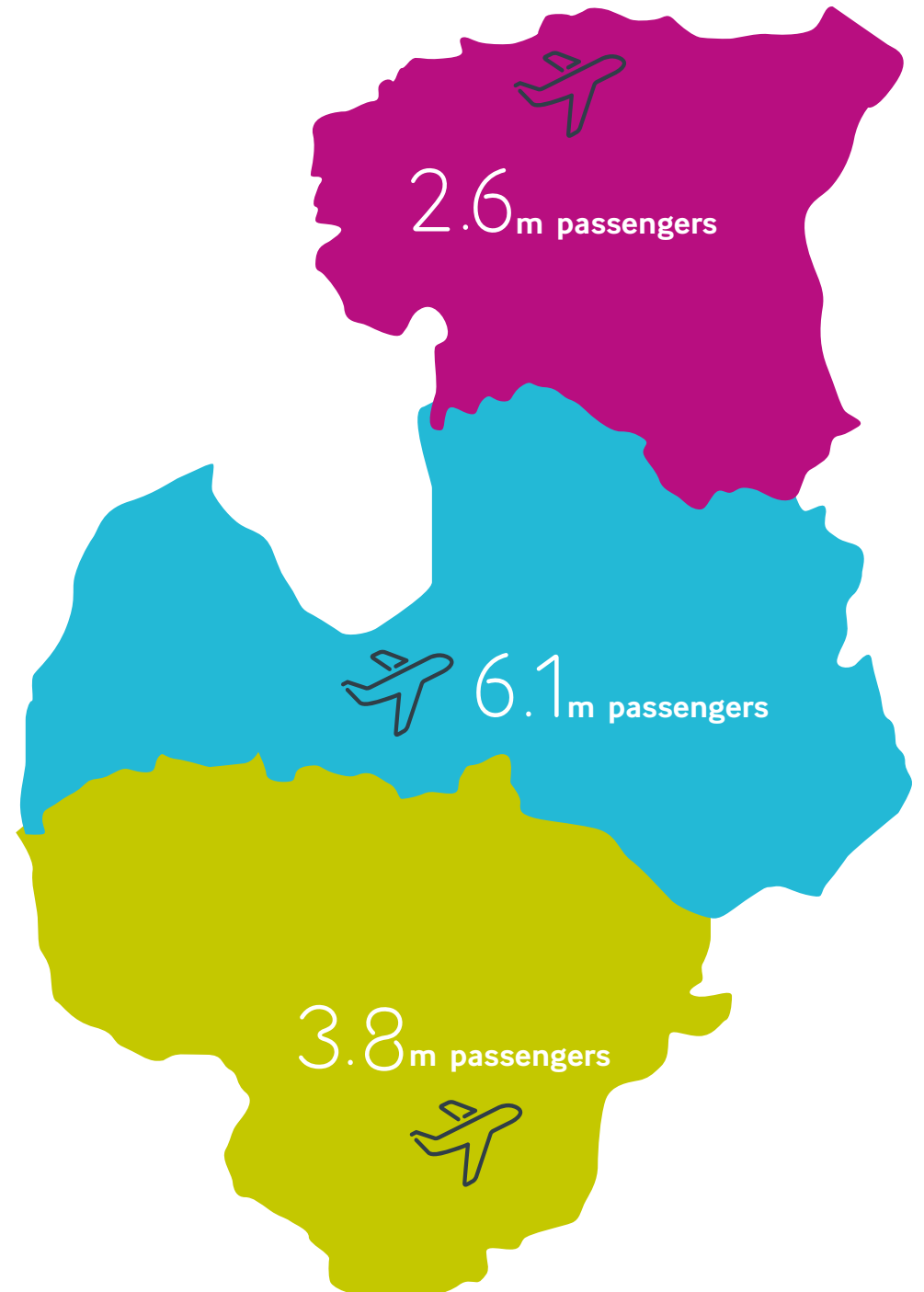
Is the largest air traffic hub in the region and the main hub for Air Baltic. The airport serves nearly half of the total number of passengers of the Baltic airports. The 20 airlines operating at the airport offer the widest network of direct routes in the Baltics, with almost 90 destinations in the summer season. The airport is currently implementing the last stages of an expansion project that, when finished, will increase the airport's capacity to 10m passengers annually.

6.8% CAGR

Vilnius Airport (VNO)

Is one of the fastest growing airports in Europe. The airport offers connections to 48 cities in 26 countries, and in 2017, 11 new routes were added. The airport is currently undergoing a major redevelopment that includes runways, terminal and traffic infrastructure. The project is expected to serve the growing amount of passengers and airlines, and enable continued future growth.

8.2% CAGR



Hotel Demand Overview

Continued growth from both domestic and international travel

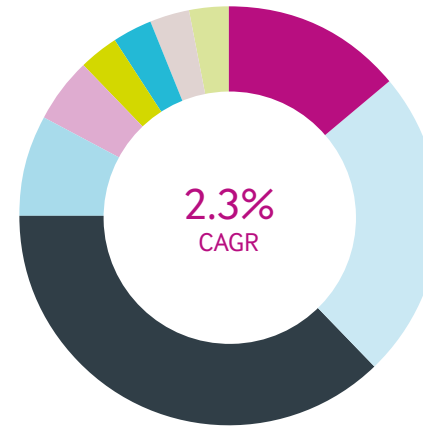
Tallinn is the leading market in terms of hotel overnights, however, Riga and Vilnius have been growing at an even faster rate. While international visitation is increasing rapidly in Vilnius (+15% in 2017), domestic travel is on the rise especially in Tallinn, where the growth in number of domestic overnights (+12%) far exceeded that of foreign overnights (+2%) in 2017.

Owing to the short distance from Helsinki and convenient ferry connections, Finnish visitation constitutes close to 40% of overnights in Tallinn; however, partly due to sharp increases in alcohol duty in 2017, Finnish overnights decreased by 6%. Russian visitation across the region has contracted in the last years as a result of economic EU sanctions and a weakened currency. However, demand seems to have picked up, as c. 10% growth was recorded across markets in 2017, and Russia remains within the top three source markets for all Baltic countries.

The Baltic markets have seen strong continued development in overnight demand.

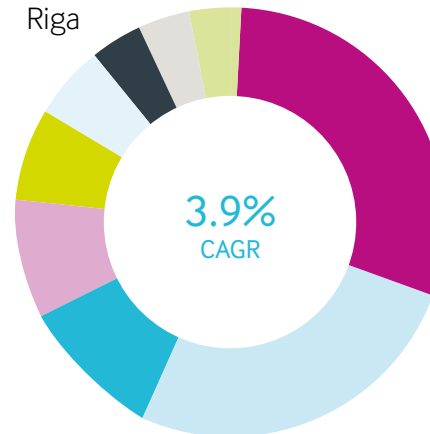
Hotel Overnights 2017

Tallinn



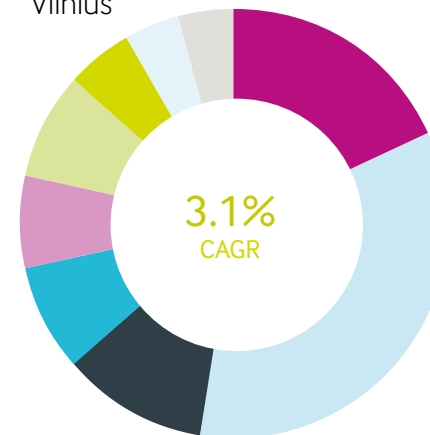
2.7 m nights

Riga



2.3 m nights

Vilnius



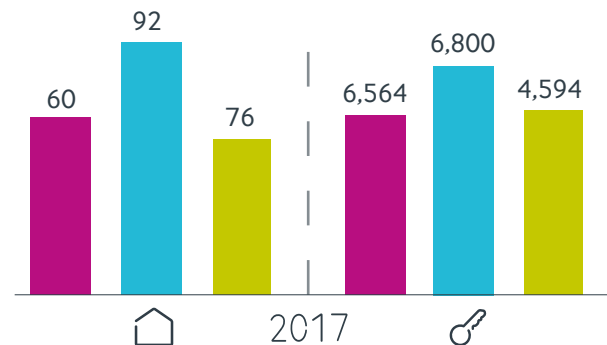
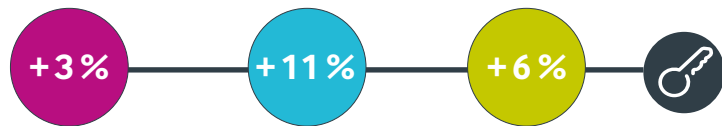
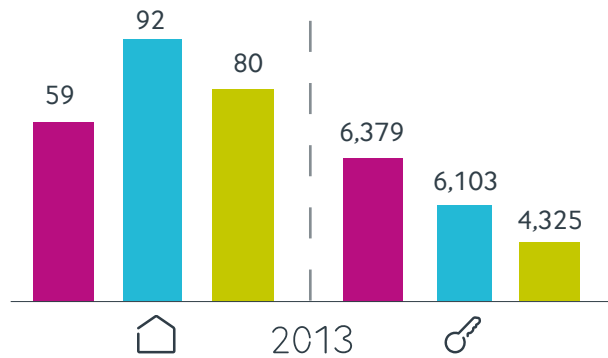
1.6 m nights

Hotel Supply Overview

Moderate growth in supply

Despite a steady increase in overnight demand, development in supply has been slower overall. While the room stock has been growing in all three cities, the number of hotel establishments has remained largely the same. These figures indicate a typical trend in developing markets where larger players replace smaller players, often independent hotels.

While supply in Tallinn and Vilnius has grown by 3% and 6% respectively over the last five years, Riga has attracted most of the new supply with steady increases in the amount of rooms annually. In 2017, notable new openings were the 141-room Kempinski and 178-room Park Inn in Riga, while Tallinn saw the opening of the 81-room Centennial by local player Unique Hotels Group.



■ Tallinn ■ Riga ■ Vilnius



Hotel Performance

Positive development in KPI's

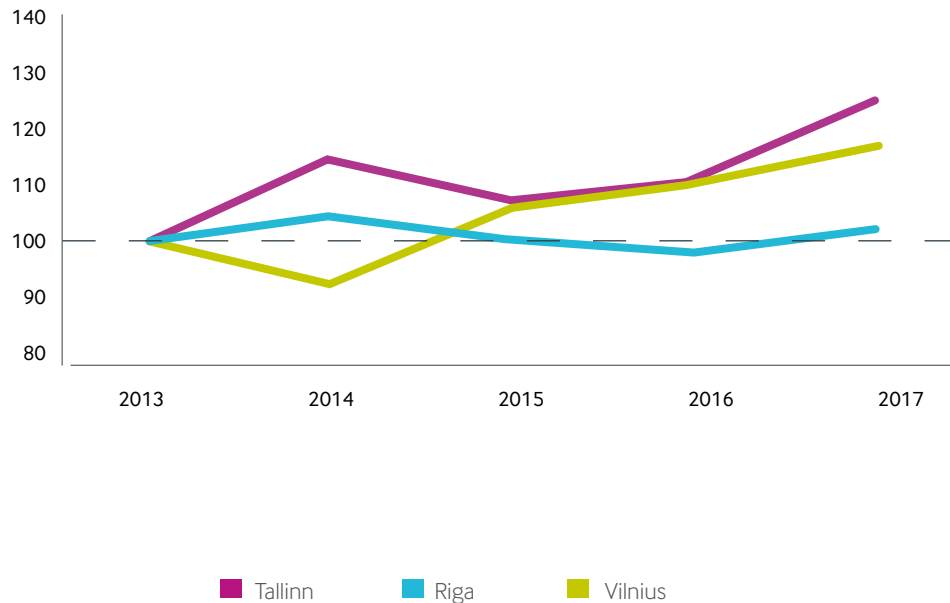
Key performance indicators in the Baltic capitals show a positive trend over the past five years. In line with demand outpacing supply, RevPAR has grown by 19% in Vilnius and an astonishing 28% in Tallinn. After a dip in 2014, the Vilnius market has bounced back and shown strong RevPAR growth since, driven by a steady development in both occupancy and ADR. The momentum seems to continue especially in the rates, as Vilnius H1 2018 ADR is up 5.7%. However, the rate increases seem to have slightly affected occupancy, leaving the H1 2018 RevPAR at 2.9% above previous year's values.

Tallinn has been the strongest performing market, with the highest occupancy and ADR levels, and the fastest RevPAR development in the Baltics. Tallinn reached a historically high ADR in 2014, followed by a slight reduction in 2015 and has developed positively thereafter. Occupancy, on the other hand, has

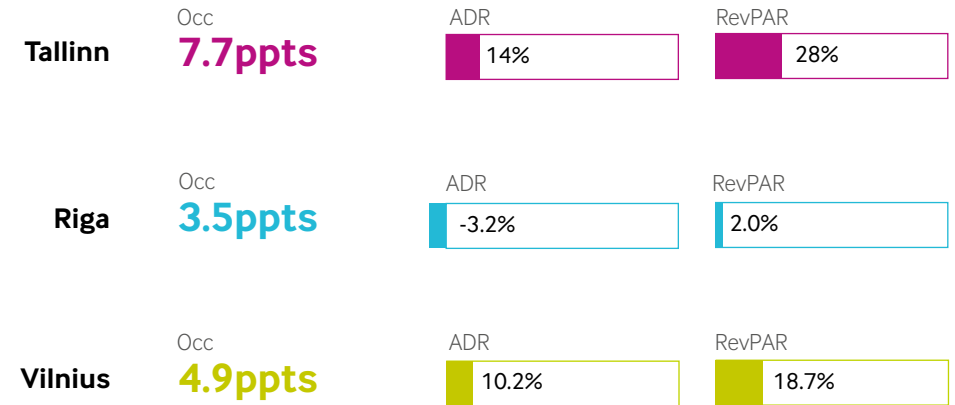
shown steady growth over the period under review. Tallinn's remarkable 2017 performance was certainly boosted by Estonia's EU presidency, but H1 2018 performance reveals that development has continued in both occupancy and ADR, boosting RevPAR by 4.2% above last year's corresponding period.

With only 2% growth in RevPAR between 2013-2017, the Riga market has not kept up the growth rate of its neighbouring capitals. While demand has been increasing steadily, the rapid additions in supply have forced rates down and kept RevPAR growth to a minimum. After recovering in 2017 from dropped rates caused by a wave of new supply in 2015, the market is finally seeing growth. H1 2018 shows a remarkable 18% RevPAR increase from last year equally driven by occupancy and ADR, which gives a highly positive signal for future performance.

5-year RevPAR Development



Occupancy, ADR and RevPAR (Total Growth Between 2013 and 2017)



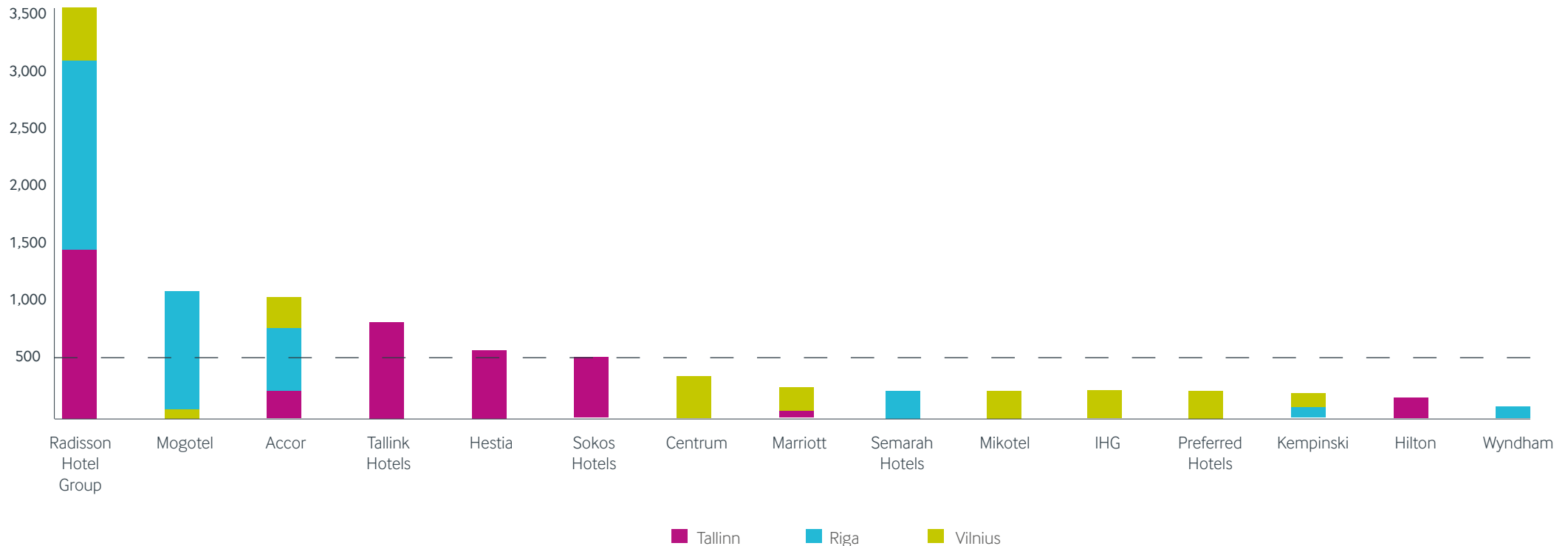
Key Operators

Markets becoming more international - Radisson Hotel Group is the leading operator

The Baltic hotel markets are rather fragmented in terms of operators, with a mix of international, local and independent players. The brand penetration is on the same level in Tallinn and Riga, where brands account for 52% of the room stock. Vilnius is a more fragmented market, with only 38% of supply branded. Radisson Hotel Group is the dominant player in all three markets, operating nearly a fifth of all rooms combined. After Radisson, the leading positions vary depending on the market, with Tallink Hotels and Hestia controlling in Tallinn (11% and 8%), Mogotel and Accor Hotels in Riga (15% and 7%), and Centrum in Vilnius (8%). As larger domestic chains only control c. 20% of the respective markets, the door is left ajar for other international players to enter.

International operators have steadily increased their presence in the Baltics. The opening of the 202-room Hilton Park in Tallinn in 2016 and the opening of Grand Hotel Kempinski in Riga in 2017 are examples of recent market entry by international players. With the internationalisation of the markets, we can expect to see increasing utilisation of active revenue management and subsequently, improved market performance reducing the reliance on OTAs, bringing new concepts for various segments and more transparency to the market. Considering the low overall brand penetration and anticipated growth in demand, there is still plenty of room for international hotel groups to strengthen their positions.

Largest Hotel Operators by Room Count



Hotel Development Outlook

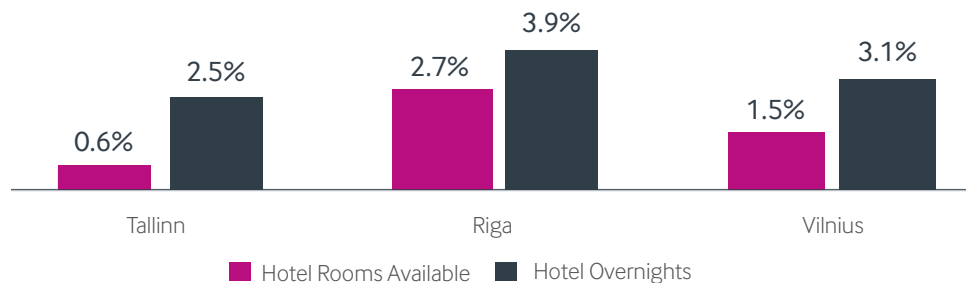
Positive market performance attracts large pipeline

Strong increases in demand, which have exceeded the growth rate of supply in all three capitals during the last five years, have attracted the attention of developers and investors. As a result, large increases in supply are expected in all three markets.

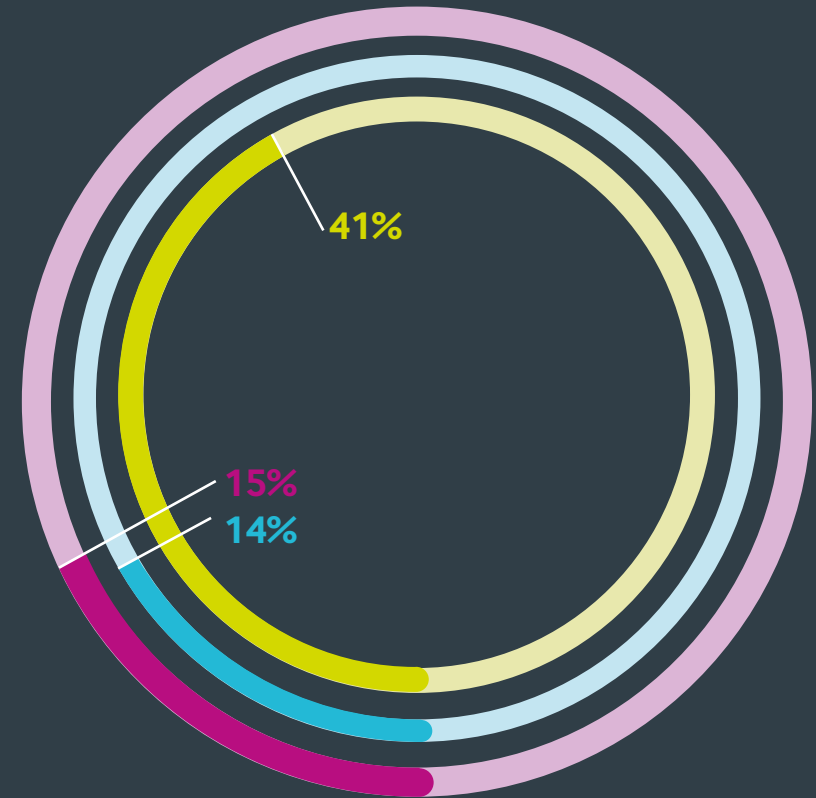
After several years of relatively modest growth in supply, Vilnius is currently having the largest pipeline with c. 1,900 new rooms expected to enter the market by 2020, increasing the existing offering by c. 41%. Tallinn and Riga both have around 15% increases to absorb respectively – close to 1,000 rooms in both markets in the next few years.

Following the opening of the Hilton Park in Tallinn in 2016, Hilton is continuing its penetration in the Baltics with a Hilton Garden Inn in Riga and a Hilton Garden Inn and a DoubleTree by Hilton in Vilnius. After soft branding the Hotel Telegraaf in Tallinn into their Autograph Collection in 2017, Marriott recently opened a 199-room Courtyard in Vilnius and is entering the Riga market with a 239-room AC by Marriott in 2019. Local player Mogotel has aggressive expansion plans in Riga, where four new Wellton hotels with a combined c. 475 rooms are planned to open in the next two years. In 2019, we may see the entrance of Norwegian concept Citybox in Tallinn with 270 rooms.

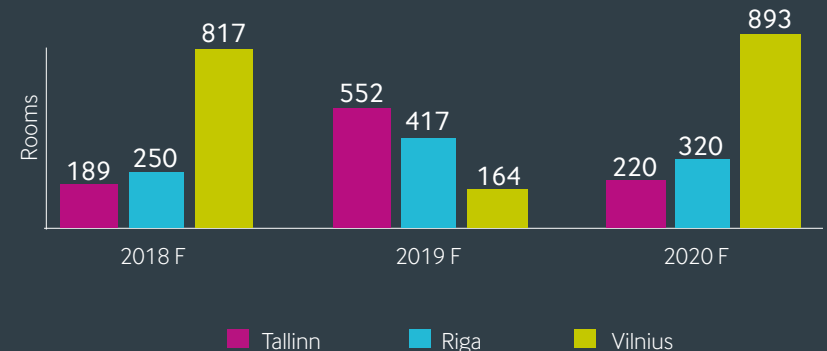
Room Supply vs. Demand (CAGR 2013 - 2017)



Potential Increase in Supply 2018-2020*



Annual Room Pipeline 2018-2020



*Note: Pipeline as % of existing supply
Sources: Christie & Co Research and Analysis

Opportunities in The Baltics

Rising stars

The Baltic Hotel market has not yet reached its true potential.

After some economically challenging years, the Baltic States are recovering well, and as more travellers are visiting these markets and positive RevPAR growth continues, the markets are finally starting to demonstrate positive fundamentals.

Although the Baltic States' hotel investment markets are still more or less in their infancy, an increasing number of domestic and international investors are convinced about the potential in these markets. Apart from the improvement in KPIs, there are development plans for some major conference and congress facilities, creating more opportunity as large international conferences and congresses constantly seek new venues and destinations. In addition, there are a few large infrastructural developments such as the Baltic Rail project, which would further improve the accessibility of these markets.

As the yield battle still soars in the key European markets, it shifts the international investors' focus towards hotel assets in the secondary European capitals with more attractive yields. The overall economic growth in the Baltics, and in particular the good economic growth of the key feeder markets, coupled with favourable property prices in comparison to key European markets such as London, Paris or Munich will continue to attract the attention of opportunistic regional and foreign investors.

After a very quiet period of almost no transactional activity in the years following the global financial crisis, the capital cities have seen some activity lately. In addition to minor local transactions, large corporate-like transactions have taken place in recent years. These transactions, together with some assets on the market currently, underline the rising interest of both domestic and international players.

Selected Transactions

Year	2017	2017	2016
City	Tallinn	Riga	Tallinn
Property	PK Hotel Ilmarine	PK Hotel Riga	Hilton Tallinn Park Hotel
Category	Midscale	Midscale	Upscale
Rooms	105	88	202
Buyer	SIA Sisne Invest	SIA Sisne Invest	East Capital Baltic Fund III
Seller	Pro Kapital	Pro Kapital	Jessy Investments



Helsinki Office

Technopolis Ruoholahti 2
Energiakuja 3
00180 Helsinki

London Office

Whitefriars House
6 Carmelite Street
London EC4Y 0BS

Contacts

Kimmo Virtanen

Director

Scandinavia, Russia and the Baltic States
T +358 9 4137 8500
E kimmo.virtanen@christie.com

Markus Hagelstam

Consultant

Scandinavia, Russia and the Baltic States
T +358 9 4137 8503
E markus.hagelstam@christie.com

Olga Kiilunen

Senior Consultant

Scandinavia, Russia and the Baltic States
T +358 9 4137 8502
E olga.kiilunen@christie.com

In co-operation with:

**BENCHMARKING
ALLIANCE**

Benchmarking Alliance Nordic AB
info@benchmarkingalliance.com

 **CHRISTIE & CO**