

KEYNOTE INTERVIEW

Modern travelers demand more in southern Europe



*Portugal and other Southern European countries are ripe for a repositioning play thanks to changing market dynamics, say Arrow Global's **John Calvao**, **Thomas Rubi** and **Marten Foxon***

The huge resurgence in travel since the covid-19 pandemic, combined with new demand from North American tourists, is ushering in a new era for upmarket, multi-purpose resorts in Southern Europe, according to Arrow Global. The London-based alternative asset manager is now gearing up to tap into these opportunities, explains John Calvao, fund principal; Thomas Rubi, global head of hospitality; and Marten Foxon, managing director of portfolio management.

“Expectations about service levels have changed. You only have to go to a Greek island or parts of Italy or Spain to see that the quality of hotel stock is

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so different from how it was 20 or 30 years ago. And there is still room for a lot more,” Calvao says.

Q What are the key trends driving market consolidation?

TR: Traditionally, a place like Faro in southern Portugal has been a gateway market for European cities, but it is now acting as an overflow for international travel. Airlines, including an inaugural service from New York with

United Airlines, will be offering direct service from North America, and the amount of lift into tier-two and tier-three cities will start to connect what was previously unconnectable. It will open Portugal up to a new clientele. These infrastructure improvements are a catalyst for us to unlock the full potential and reduce the typical seasonality in some of those developments that have been primarily a beach and sun destination for traditional holiday makers from Northern Europe, and golfers in the winter.

JC: Since the pandemic, short-haul travel suddenly came into focus again,

partly because of capacity and partly because of the cost of flights – which have increased materially. We are trying to adapt and diversify our hospitality offering to satisfy that new clientele, and international travelers more broadly.

The opportunity set is to develop locations, amenities and hotels that cater to the needs of these new travelers as they continue to evolve over the next few years. American clients are not only relatively new to the market, but they have different wants and needs. And they are generally also a better paying visitor. Part of that has to do with frequency – when they come to southern Europe, it is usually a family trip where they spend seven or 10 days as their main vacation.

MF: The trajectory for leisure travel, and business travel to a certain extent, is constantly upwards, subject to the odd blip. If you look at any of the projections by the independent research agencies, they all tell the same story, right out to 2040. Against that backdrop, it is then a question of where you pick your markets and locations. Southern Europe, generally, and Portugal specifically, is right in the sweet spot.

Q How important are local operators, or boots on the ground, when entering or expanding in a new market?

MF: Having local teams is a huge benefit. The fact that we have resources on the ground deeply embedded in the local market is hugely beneficial. This local footprint gives us an exceptionally good understanding of local planning, tax, legal and judicial frameworks, not to mention the universe of local contractors and how the local sales market operates.

TR: We have had a presence in Portugal since 2008, and our DNA is to run our investments through our local Portuguese teams with oversight from



Q How are investors catering to the changing demands of modern travelers?

MF: A common theme through most of our investments is they are not just one hotel in one location with a car park and swimming pool, they are multi-site and multi-purpose. That mix of facilities serves two purposes.

First, it helps extend the season, which is vital in Southern Europe as the region still suffers from seasonality. The further you can stretch those shoulder seasons and hopefully make them meet in the middle around December and January, that is when you really start being able to deliver superior returns.

The second advantage of that multi-site, multi-purpose strategy is that we can attract guests from a wider pool of people that perhaps would not otherwise come to our destination if there were no equestrian center, marina or golf course.

JC: Part of the consolidation play in our value-add strategy is taking a step at controlling as much as we can of the destination, so that we can cross-sell and bring the whole location up to a new standard with a synergistic aspect. If you have various people who own the different pieces, nobody owns the ecosystem, and that is where you create real value.

the HQ in London. We have had some interesting value-add plays that have been massively important for our early success, and we have been fortunate in the Algarve to have some unique, large-scale developments that play to our strengths.

Our luxury hotels in Vilamoura and Palmares are positioned for the future because they have scale and an ecosystem including residential, hotels, restaurants, sports facilities and leisure experiences which we can control the

quality and offering. In Europe, these things tend to be a little bit fragmented. I think we can export the best attributes of those developments to our other acquisitions elsewhere in Southern Europe.

JC: Hospitality is one real estate sector that works extremely well across different markets. How you manage a hotel, revenue per available room, the actual asset and so on, is remarkably similar. We have already made investments in

Majorca and Italy where we also have operating platforms. We are now starting to look at things in the south of France and along the Italian coast.

Q What are the challenges facing the hospitality sector in southern Europe and how are they being overcome?

JC: We are doing a lot of renovations, and the supply chain has not been as efficient or effective as we had hoped, especially with the repercussions of covid-19, the war in Ukraine and other destabilizing events in the world. Costs have risen higher than expected.

There is a lot of pent-up demand in many places, and we will probably see a little bit more strain on supply chains in Portugal because the new government has made it a priority to rebuild some infrastructure, including a new airport in Lisbon. It has been more of a challenge ensuring projects are priced correctly, that we have done a good job on the underwrite, that our timings are correct and that we have the right construction capabilities in place.

The second challenge, which is a global phenomenon, is finding enough staff, whether that is for the front desk at a hotel or gardeners for the golf course or builders on the development team. We are feeling that right across the market; there is a shortage of professionals across the board. Again, this is where being local creates an advantage operationally.

TR: One of the key reasons why it is difficult to find staff in southern Europe is the limited availability of attainable housing for the service industry. For that reason, we bought a small hotel in an outlying area and converted it into apartments just for our employees. The local governments have been very receptive to housing initiatives and we are playing a role in that sector as well.

Q What about the opportunities and challenges in northern Europe?

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THOMAS RUBI

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MARTEN FOXON

MF: The opportunity for repositioning and value-add or opportunistic returns are there too, but it is not as prevalent as in Southern Europe. And we certainly cannot replicate the sun, sea and beach thesis everywhere. Northern Europe is also slightly more institutionalized than southern Europe, and the sheer scale of opportunity is not the same. But we will continue looking at the markets there on a case-by-case basis.

Q What does the ESG landscape look like for hospitality assets in southern Europe?

TR: Water and solar are two important areas in Portugal. We have a couple of initiatives, including the creation of a solar community in Vilamoura, where we own several golf courses, and proactively addressing water consumption. Strategies include reducing the grass lines, using modern irrigation design, selecting appropriate grass types, reintroducing native flora and fauna and removing the exotic or decorative plants that require excess water.

Another exciting area of sustainable design in the hospitality sector revolves around treated water. The water authorities are currently producing high-quality treated sewage effluent, and once we connect this system with our own facility we will operate our golf courses from this treated waste water, which will reduce our water usage substantially.

Certification is also important as assets get repositioned. A lot of the hotels we have been purchasing are ageing assets built in the 1970s and 1980s. As we reposition and recapitalize these properties, working with Green Key and other ESG certification programs has been a priority.

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