



Cyprus Hospitality Report

Annual report outlining the
key trends and major drivers
of the Cyprus Hospitality
Market

1st Edition

July 2019





A message from the Managing Director



Christos Vasiliou
Managing Director

Dear Reader,

Over the years, the hospitality sector has played a pivotal role in the Cyprus economy and is a key constituent to the future performance of our economy.

Aside from continuous substantial growth of the tourism industry of Cyprus, the hospitality sector has been further supported with local government incentive schemes which directed local and international investors to the renovation, retrofitting and upgrade of existing hospitality assets and expansion of hospitality offerings. The combined effect of these contributing factors have led to the encouraging growth of the hospitality sector in recent years.

To that effect, we are pleased to present our 1st edition of KPMG Cyprus Hospitality Report, which aims to provide insightful leads into the performance of the Cyprus economy and the local hospitality sector.

Using a holistic approach during our assessment, our objective for this report is to provide an overview of the hospitality sector performance during 2018, while presenting insights of the key market drivers.

Overcoming the challenges of recent years, the Cyprus economy continued to exhibit a solid growth and has maintained its status as one of the fastest growing economies and main tourist destinations in Europe. Given the significance of the industry for the Cyprus economy, we consider it imperative to provide an understanding of the market and offer a report which delves into the key drivers of the sector's growth, the supply and demand characteristics and the notable sectoral developments.

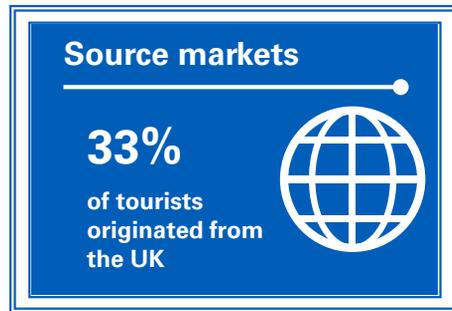
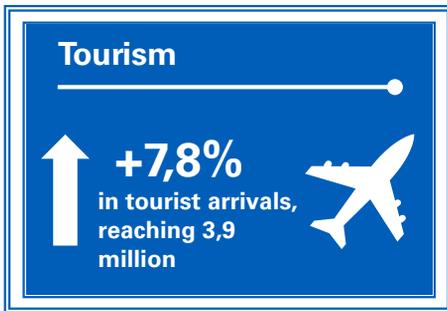
We hope that you will find our report insightful and useful in supporting your future business decisions related to the hospitality sector. Kindly feel free to contact us for further enquiries.

Kind regards,

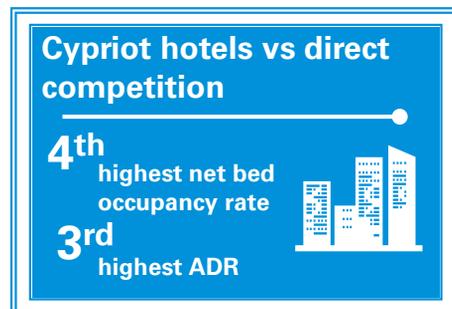
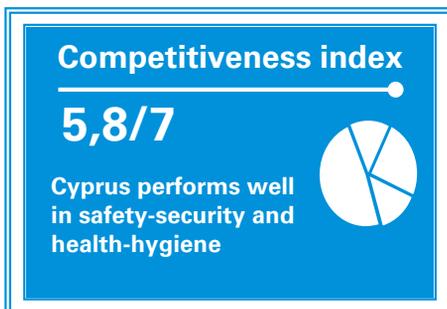
Christos Vasiliou
Managing Director and Head of Advisory Services

Tourist arrivals, competitiveness & hotel supply for 2018

Tourism market overview



Competitive position

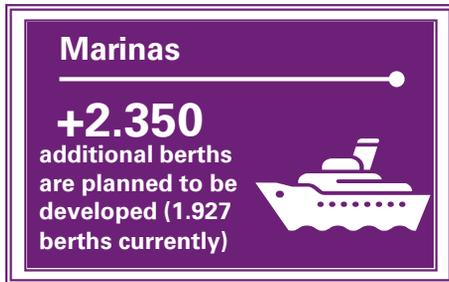


Accommodation supply

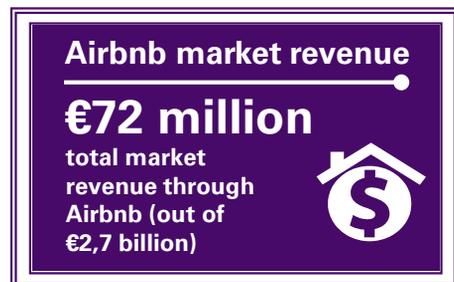
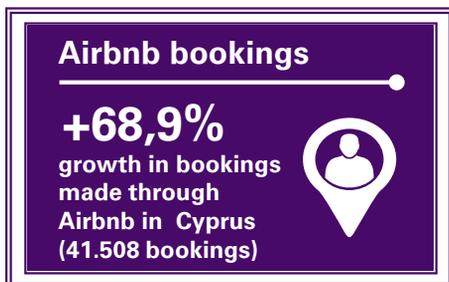


Other developments, peer-to-peer accommodation and financing

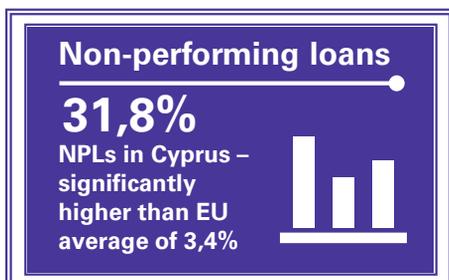
Other touristic developments



Peer-to-peer accommodation



Financing conditions





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Tourism market overview

The tourism sector in Cyprus is considered as the backbone of the island's economy, providing an important lifeline to the economy during the relatively recent economic and financial downturn.

In 2018, the tourism industry has registered another record year with arrivals reaching 3,9 million. Expansion of the high season beyond the June to September period is one of the main targets of the Government for tourism, as part of the 2030 strategic vision.

Demand growth over the last few years seems to be driving capital inflows to new hotel and infrastructure developments, as well as renovation of existing hospitality assets.



Tourist arrivals and revenue growth

Tourist arrivals and associated revenue



Source: CyStat

With a 7,8% year on year increase in tourist arrivals, 2018 is the most successful year recorded for the Cyprus tourism industry, with the number of tourist arrivals reaching 3,9 million.

Since 2014, tourist arrivals have risen for five consecutive years, reaching peak levels in 2018.

In revenue terms, tourism accounted for the equivalent of 13,1% of nominal GDP in 2018, rising by a modest 2,7% to €2,7 billion, compared to the prior year.

Considering the overall growth of the tourism sector, it is evident that despite the economic and financial crisis on the island, the tourism sector provided an important lifeline to the economy, which contracted by approximately 20% in 2012 – 2014. One can appreciate the significance of the tourism sector when further assessing its influence on other main markets such as retail, construction and transport.

Cyprus main source markets

Despite the highly competitive tourism market in the Mediterranean region, the geopolitical instability and perceived security risk in several of Cyprus' competitor markets have benefited the island, especially in 2016 – 2018.

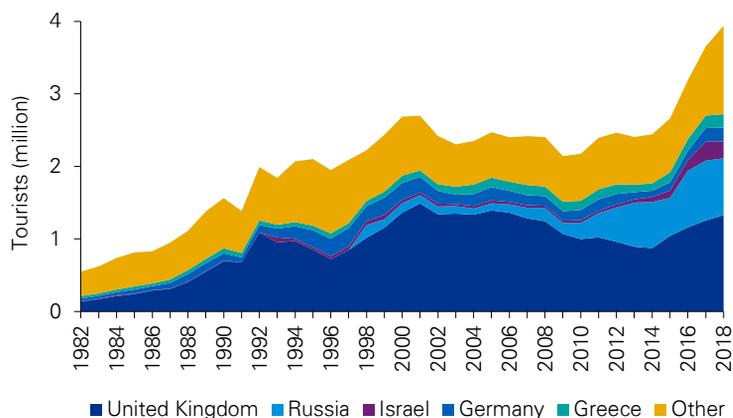
Based on the latest available data, tourist arrivals originate from five main markets: The United Kingdom, Russia, Israel, Germany and Greece, which account for approximately 70% of the island's tourist arrivals.

Tourist arrivals in 2018 have recorded an overall increase of 7,8% compared to 2017, mainly attributed to the growth of alternative markets, indicating visitor diversification and a reduction of the island's main markets dependency.

The combined effect of the depreciation of the Turkish Lira and the lift of the Russian ban on package holiday due to recent political and economic instability, diverted Russian tourists from Cyprus mainly to Turkey, pushing down Russian arrivals by 5% in 2018.

Albeit, such decrease was offset by a strong growth of one of Cyprus' main markets, the UK, as well as increasing inbound tourism from the Scandinavian regions.

Historic main markets tourists arrivals

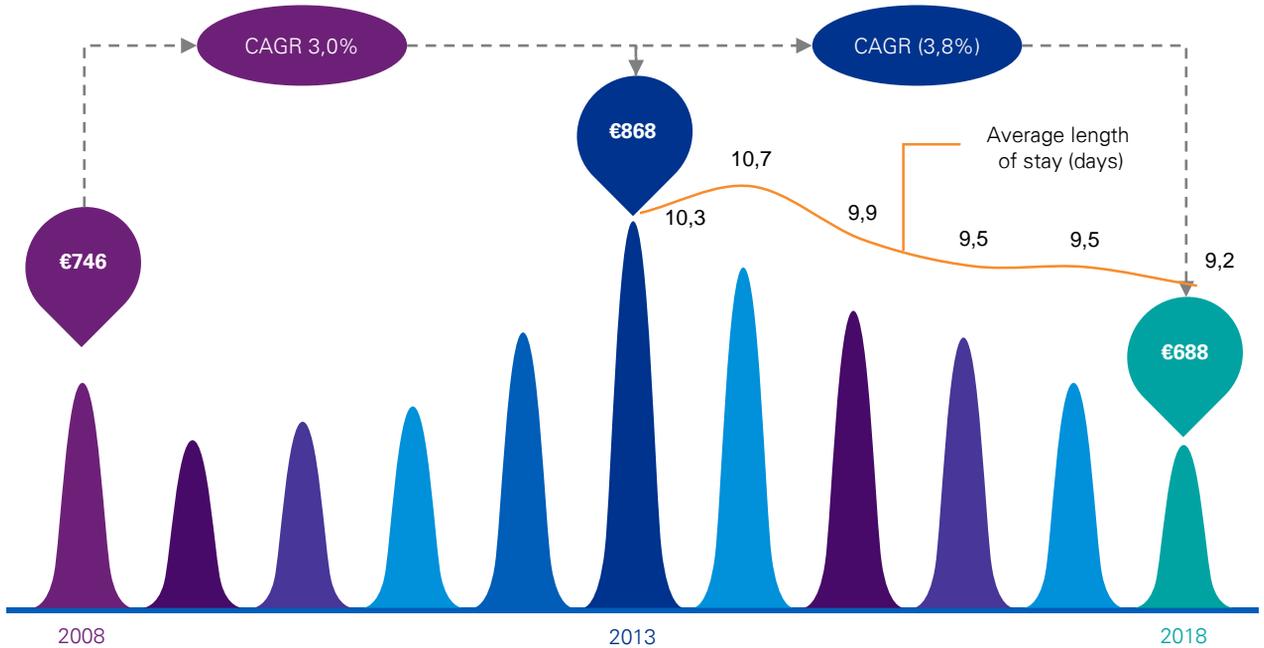


Source: CyStat

Main markets	Share of Arrivals 2018	Change vs 2017
	33%	+6%
	20%	-5%
	6%	-11%
	5%	+1%
	5%	+10%

Tourist expenditure

Expenditure per tourist



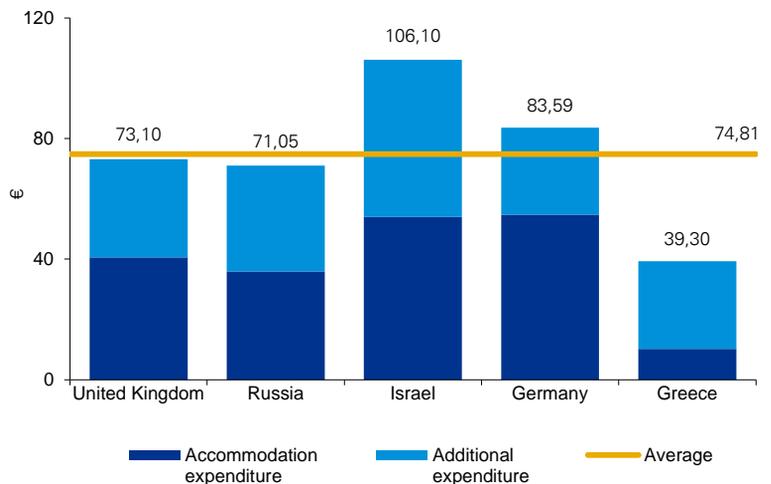
Source: CyStat, KPMG Analysis

Tourist expenditure has been steadily declining from 2013 onwards (in line with a decline of the length of stay), despite the modest increase in tourism revenue in 2018 (2,7%).

€752

Weighted average expenditure per tourist (2008-2018)

Expenditure per tourist per day by country of residence (2018)



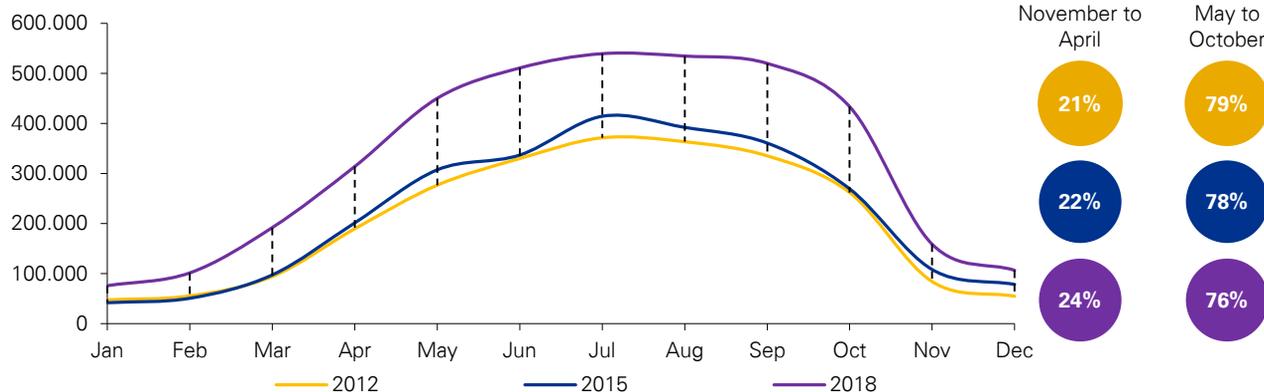
Source: CyStat

The decline in the number of arrivals of Israeli and Russian tourists over the past year – both among the biggest spenders compared to other tourist nationalities – has led to an overall decrease in expenditure. Nonetheless, the decrease was offset by a continued growth in arrivals from major markets, notably Cyprus' biggest market, the UK.

The mismatch between revenue growth and tourist expenditure can be partially attributed to the introduction of the serviced apartments market, which has gained momentum in the past years and for which related information remains limited. This signals a shift to more price-sensitive tourists looking for 'economy hotels' or a shortfall in upscale hotels, thus redirecting such tourists to competitor markets.

Seasonality

Evolution of tourist arrivals



Source: CyStat

The island's hospitality market is characterised by its high seasonal dependence, with the majority of tourist arrivals (75,9%) being in the period between May and October.

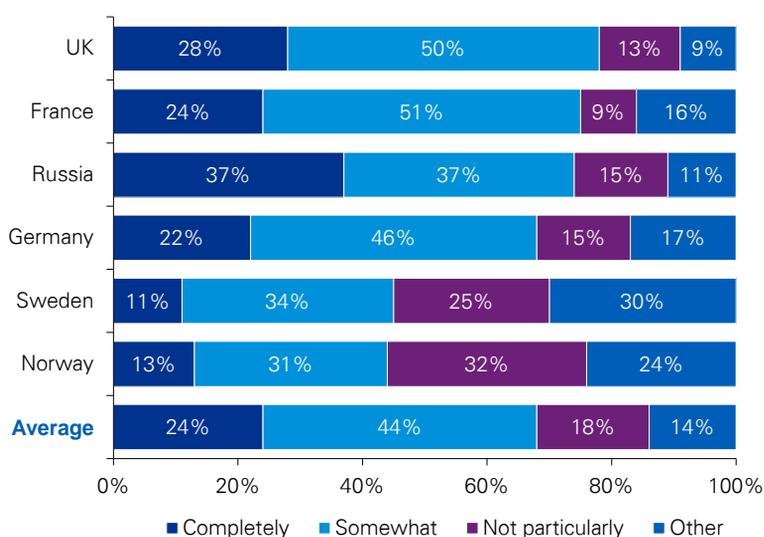
The biggest challenges facing the island's evolution to an all-year round destination remain. These include:

- Lacking air capacity and flight connectivity during the off-peak months;
- Saturation of tourism areas, as hotel operators are congested in island's touristic clusters in beachfront areas;
- Underutilisation of infrastructure, especially during the off-season months; and
- Expansion of the touristic product beyond the traditional "sun & sea"

Percentage of arrivals between November to April showcase that seasonality effect has been marginally subdued but remaining a vital challenge for the future growth of Cyprus' tourism industry.

The increasing tourism demand combined with the extension of the peak season, augers for a strong performance of the hospitality sector, as it can direct capital inflows to new hotel developments, as well as retrofitting and renovation of existing hotels and leisure facilities.

Do you consider Cyprus an all year-round destination?



A recent Brand Adoption Survey, presented as part of the Cyprus tourism strategy report, analysed tourists' perception regarding Cyprus as a year-round destination. Answers were obtained from approximately 1.700 interviewees, in six different source markets.

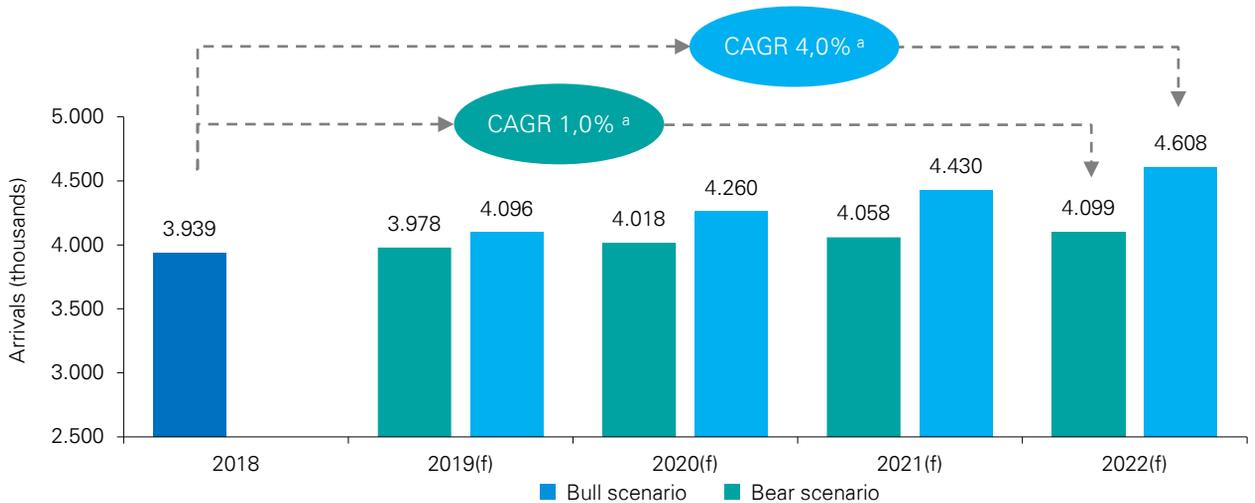
More than 60% of interviewees consider Cyprus as a year-round destination, based on the results of the survey.

As part of the Cyprus tourism strategy, the seasonality effect is envisaged to be alienated by intensive use of online and offline marketing and extending the product offerings, targeting an increase of the share of tourism arrivals generated in period November to April, from 24% to 40% by 2030.

Source: Cyprus Tourism Strategy Report, THR, 2017

Forecast arrivals and scenario analysis

Forecast tourist arrivals 2018 - 2022



Source: World Tourism Organisation, Cyprus Tourism Strategy Report

Note: (a) Forecast growth rates were obtained from the World Tourism Barometer based EU area current tourism trends, economic prospects, UNWTO Confidence Index and the Cyprus Tourism Strategy Report.

A central theme to Cyprus' future tourist arrivals is the impending Brexit event, which could potentially weaken the British Pound and disrupt the UK-Cyprus air traffic.

To date, the market appears more resilient than previously thought, as fears of UK not reaching a withdrawal agreement with the EU and significant depreciation of the British Pound against the Euro has so far failed to materialise.

In addition, hoteling infrastructure is also considered a key factor for sustaining tourism growth as capacity bottlenecks, especially during the peak season, can limit the number of available hospitality units.

Incentivisation measures for the construction of new hotels and renovation of existing ones are key for alleviating constraints in accommodation, especially in the peak season period.

Current pipeline of projects in the accommodation sector, along with the opening of the Cyprus casino resort in 2021, are anticipated to extend capacity and serve tourist demand in the short to medium term.

Bull scenario assumptions

- Russian arrivals are anticipated to remain at the same levels as in 2018, with a potential return to growth in the medium term.
- A Brexit event will not lead to any disruption in the UK-Cyprus air traffic, whereas any foreign exchange effects will be of a short term nature, though the spending power of UK tourists may reduce over the long term.
- A reduction in the seasonality effect, development in the hoteling infrastructure and growth of non-traditional source markets at the same levels as in 2018, may boost tourist arrivals throughout the year and avoid any capacity bottlenecks in the medium term.

Bear scenario assumptions

- Despite the faster growth in the Eurozone's tourism market, tourists' response in regards to uncertainty around Brexit and recovering competitor markets may slow tourist arrivals, thus leading to a moderate growth over the short-to-medium term.
- A Brexit event may lead to short term disruptions in the UK-Cyprus air traffic, albeit recovering in the medium term.
- Any foreign exchange effect due to the depreciation of the British Pound against the Euro may be of medium term nature, whilst UK spending power may reduce over the long term.
- A modest reduction in the seasonality effect, delays in hotel development and stagnant growth of non-traditional source markets, could likely slow down tourism growth in the short-to-medium term.

Competition analysis

Cyprus ranks 3rd worldwide in terms of prioritisation on travel and tourism, with substantial public and private expenditure to touristic assets diverted towards Cyprus' hospitality sector.

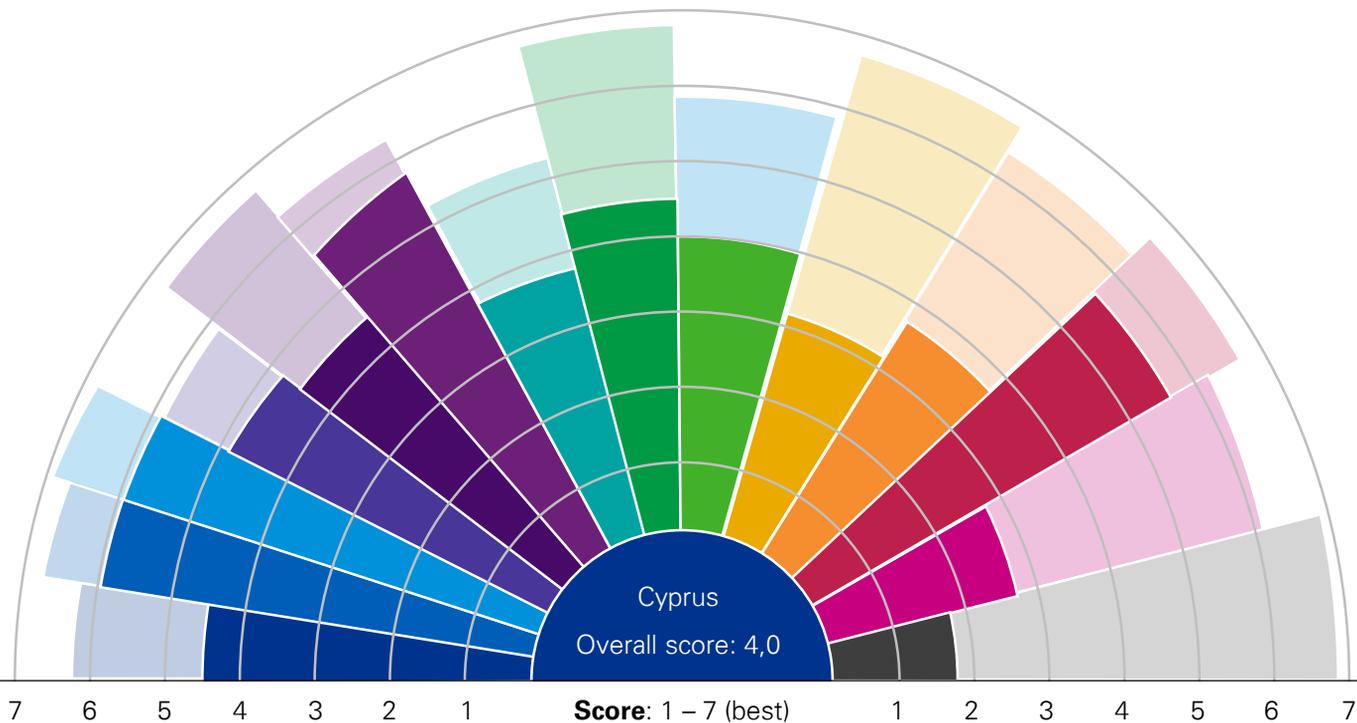
In terms of price competitiveness, Cyprus ranks the lowest among competitor markets whereas airport capacity and ground infrastructure restraints, combined with the lack of cultural resources and business travel, remain the most noticeable challenges for Cyprus competitiveness.

Price-brand discrimination is a key competitive strategy followed by large hotel operators in Cyprus, whilst many local operators have diversified to some extent, by including additional leisure facilities in their operational portfolio.

Access to financing, as well as a cumbersome legal and regulatory framework, have been flagged as the most problematic factors for doing business in Cyprus. These, in turn, limit the investors' capacity to invest in local infrastructure and innovate in the hospitality market.



Travel and tourism competitiveness index



Travel and tourism competitiveness index					
	Performance indicators		Cyprus score (b)	Highest score (b)	Country with top score
	Business environment	●	4,6	6,2	Spain
	Safety and security	●	5,8	6,7	Hong Kong
	Health and hygiene	●	5,8	6,9	Finland
	Labour market	●	4,9	5,8	Iceland
	Information and communications technology	●	4,8	6,5	Hong Kong
	Prioritisation on travel and tourism	●	5,7	6,2	Malta
	International openness	●	3,8	5,2	Singapore
	Price competitiveness	●	4,3	6,7	Iran
	Environmental sustainability	●	4,0	5,8	Switzerland
	Air transport infrastructure	●	3,1	6,8	Canada
	Ground and port infrastructure	●	3,7	6,4	Hong Kong
	Tourist travel infrastructure	●	5,6	6,7	Austria
	Natural resources	●	2,9	6,1	Brazil
	Cultural resources and business travel	●	1,8	6,9	China

Source: World Economic Forum (2018)

Note: (a) The performance indicators are composed of 14 pillars. These 14 pillars are calculated on the basis of data derived from the World economic Forum's Executive Opinion Survey and quantitative data from other source. The results are then derived based on the responses from the survey and range in value from 1 to 7.
 (b) 1 = Incentive to invest is significantly low ; 7 = Incentive to invest is significantly high.

Competition analysis

We have selected to compare the results against Spain, Italy, Greece and Turkey because of their vicinity as well as their comparable touristic product offering, mainly being the 'sun and sea'.

Cyprus' business environment is considered to be performing well against the competitive set. Tax and investment schemes provided by local authorities have proved to incentivise local and international investors.

However, Cyprus' business environment ranking is affected by the time required for construction permits to be issued. Cyprus is ranked amongst the last countries worldwide, requiring on average 507 days to deal with construction permits versus Turkey that leads the competitive set with an average of 103 days.

Cyprus scores amongst the highest among the competitive set in relation to prioritisation on travel a tourism. This is evaluated based on the public and private sector spending on the travel and tourism sector.

Cyprus ranks the second-last (Italy being last) from the competitive set in terms of prices, with tourist products affected by higher prices of travel packages and greater airport charges.

Air connectivity in the island is the lowest compared to the competition, with air access and flight frequency during shoulder seasons being limited. Lack of direct flights to and from countries such as Germany, France and Spain reduces overall flight connectivity and causes spillage to other competitor markets.

Public transport, both in terms of connectivity and accessibility, represents one of the greatest shortfalls in the travel experience, significantly affecting the score of Cyprus among its competitors.

Finally, Cyprus is lagging behind in cultural resources and business travel.

Performance indicators of Cyprus versus competitor markets

	Cyprus	Turkey	Greece	Italy	Spain
Business environment	Yellow	Yellow	Orange	Orange	Yellow
Safety and security	Green	Orange	Green	Light Green	Green
Health and hygiene	Green	Light Green	Green	Green	Green
Information and communications technology	Yellow	Orange	Yellow	Light Green	Light Green
Prioritisation on travel and tourism	Green	Orange	Light Green	Yellow	Green
International openness	Orange	Orange	Orange	Orange	Orange
Price competitiveness	Yellow	Light Green	Yellow	Orange	Yellow
Environmental sustainability	Orange	Orange	Yellow	Yellow	Yellow
Air transport infrastructure	Orange	Yellow	Yellow	Yellow	Light Green
Ground and port infrastructure	Orange	Orange	Orange	Yellow	Light Green
Tourist travel infrastructure	Green	Yellow	Light Green	Green	Green
Cultural resources and business travel	Red	Orange	Orange	Green	Green

Source: World Economic Forum, KPMG Analysis

Note: (a) Colours are determined by the individual relative position of each country's score to the highest scoring country in the tourism competition index

Cyprus competitor destinations



Lisbon



Athens



Madrid



Cyprus



Rome



Istanbul

Net bed occupancy (%)



78%



77%



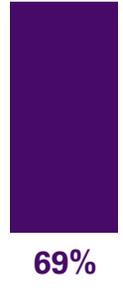
75%



73%



70%



69%

Average Daily Rate (€)



€114



€120



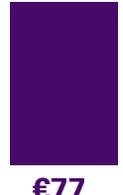
€139



€138



€147



€77

Number of chain hotels



45



28



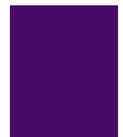
63



51



71



56

Source: Smith Travel research, Horwarth HTL (European Chains and Hotels Report 2019), Instituto Nacional de Estadística, HVS, KPMG online research, DMT

Note: 1. A "chain hotel" is a hotel that is part of a series or of a group of hotels operated by the same company or owner.

2. The competitor cities were selected based on vicinity and comparable product offerings.

3. The information regarding Cyprus was collected from DMT and online research through various online booking websites

Global trends and challenges

Key trends

Analysis

Increasing use of new age technologies (HotelTech)

End user tastes are changing, particularly where 'Millennial' travellers are concerned. Just having a nice hotel in a good location is no longer enough. The so called 'instagramability' of a location is a factor influencing where millennials wish to travel and so are the facilities that are included within the hotel.

Market trends

Guests use apps, such as Marriott International and Hilton Honors for every core functional service at their properties. Marriot is currently negotiating with Amazon for the use of 'Alexa' in their hotel rooms.

Home sharing concept to gain further prominence

Hotels and resorts throughout Europe are starting to invest in home-sharing companies that are vetted, outfitted and maintained as per hotel standards. Services at the lodgings are provided by company employees rather than homeowners.

Accor was among the first luxury hotel operator to enter the home sharing sector in 2016, with the acquisition of Onefinestay, a luxury vacation rental apartment and homes company.

Key challenges

Analysis

Growing concerns around Online Travel Agencies (OTAs) misleading customers

In 2017, an estimated 70% of consumers compare hotel rooms online via an OTA. However, rooms are apparently sometimes ranked according to the level of commission hotels pay to OTAs.

Therefore, this entails that the rank a hotel achieves, may not always be related to its quality or suitability, making results less relevant for guests.

Market trends

The UK's Competition and Markets Authority (CMA) launched its investigation in October 2017 on the booking practices of OTAs. The CMA found that, in some instances, online accommodation booking sites were presenting consumers with poorly set-out or inaccurate information in their search results, which ultimately restricted consumers' ability to choose the most preferable deal.

Rising cost of customer acquisition

Hotels are devising metrics to gauge the effectiveness of marketing campaigns and distribution platforms to reduce their ancillary spend.

According to Cindy Estis Green, CEO and co-founder of Kalibri Labs, the average cost of customer acquisition in hospitality ranges as much as 35% of guest-paid revenue and includes sales and marketing costs, technological updates, etc.

Peer-to-peer accommodation remains the key competitor to the market

Substitutes that are becoming increasingly threatening are online peer-to-peer accommodation services such as Airbnb, FlipKey and Couchsurfing. Markedly, the Airbnb listings of available accommodation worldwide as of November 2018 reached over 5 million, greater than that of the five largest hotel brands combined.

The average nightly price for Airbnb varies across the region; in Cyprus, for instance, the average price is €70. This represents a significant substitute threat to traditional hotel operators, which are reacting by rolling out brands to attract millennial consumers who typically favour Airbnb.

Internal competition

The Cyprus hospitality market is considered fragmented, whilst rivalry tends to be alleviated in rural regions.

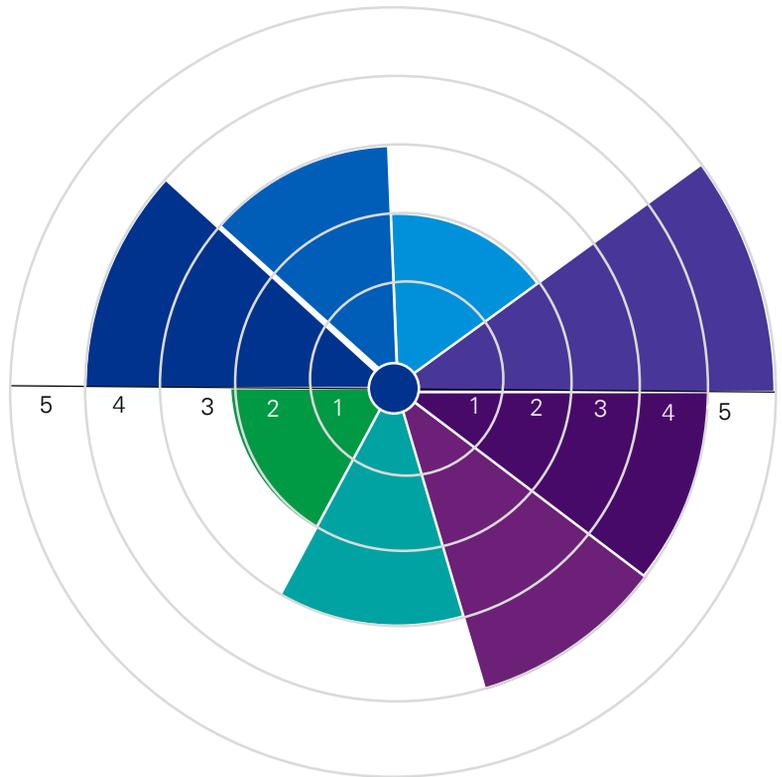
Rivalry tends to be intensified in selected locations where tourist concentration is high.

Price-brand discrimination is a key competitive strategy followed by large hotel operators, based on which they are able to operate in the various industry segments. For example, Radisson in Cyprus engages in the ownership of single-brand independent hotels and operates its upper-scale and luxury proposition.

Competition in the industry has spatial characteristics, as the location plays a crucial role in its success. Players operating closer to an attractive tourism or business location benefit from greater inelastic demand and can command premium rates, whilst operators based further out tend to compete heavily on price, but have fewer associated costs.

Exit barriers in the industry are fairly high, because most of the major tangible assets are industry specific and hard to divest. This is likely the motivator for many of the leaders to pursue expansion plans through franchising and hotel management services.

Forces driving internal competition



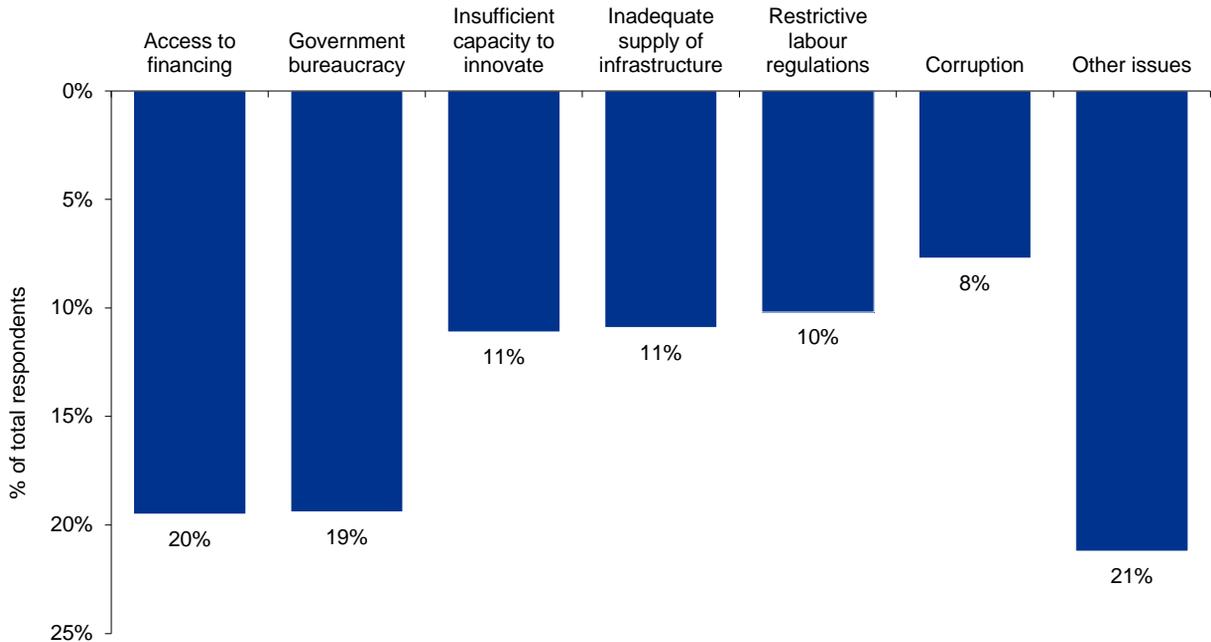
- Competitor size
- Barriers to exit
- Product diversity
- Switching costs
- Costs to Entry
- Number of players
- Similarity of players
- Product differentiation

Source: KPMG Analysis

Note: (a) 1 = Force drives competition marginally
5 = Force drives competition significantly

Drivers of market sustenance

Key weaknesses for doing business in Cyprus



Source: World Economic Forum, Executive Opinion Survey 2017; KPMG Analysis

One of the main weaknesses of doing business in Cyprus is the access to financing, according to a 2017 survey by the World Economic Forum.

Being in the process of unwinding from the aftermaths of the island's economic and financial crisis in 2013, the Cyprus banking sector is currently in the process of restructuring their high NPL portfolios and allow for a sounder footing. To that effect, access to financing has been a significant challenge for investors, as financial institutions have set stricter funding criteria and became more selective in supporting major infrastructure projects.

Government bureaucracy was identified as another main weakness for doing business in Cyprus. This, in turn, hinders the market's need for increased competitiveness and may fall short to meet the needs of a recovering and fast-paced private sector.

Insufficient capacity to innovate, inadequate supply of infrastructure, restrictive labour regulations and corruption were some of the weaknesses that scored high.



Hotel supply and future developments

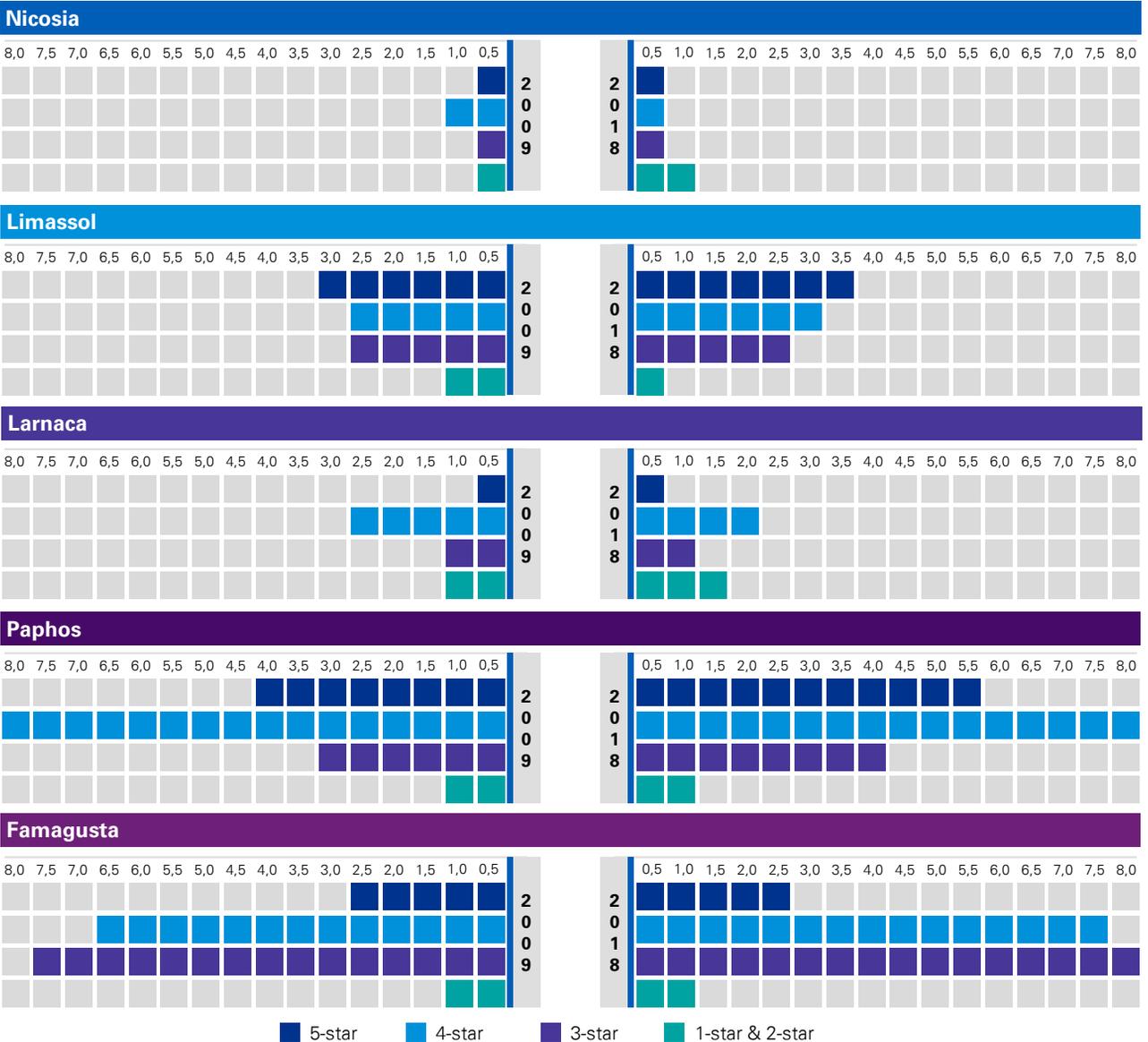
Following 2013 economic crisis, there has been an increase in hotel investments and developments in Cyprus. Along with the revised Cyprus' residency and citizenship scheme through investment for foreigners, this sector continues to be of interest until today.

Cyprus long-term strategy is to become an established all-year destination, while upgrading the quality of its touristic offering.



Evolution of beds of star hotels (2009 vs 2018)

Number of beds by hotel star per district (in thousands)



Source: CTO

Over the past 10 years the stock of star hotels has increased marginally by 7% with additional 13 units, whilst available beds increased by 10%.

Investment in new luxury market hotels (3* and over) had largely benefited Paphos and Famagusta, with number of available beds increasing 11% and 16%, respectively. These districts contributed to over 90% of the total increase in available beds.

Despite the increase in tourism demand and need for additional capacity, Nicosia and Larnaca saw the poorest performance in terms of quality, as budget hotels (1* - 2* hotels) increased by 89% whilst available beds from luxury hotels reduced by 10%. In Limassol there was an increase in high-end 4 and 5-star hotels and a reduction in 1 and 2-star hotels. Thus, Limassol is experiencing an improvement in general stock quality.

Gaps in hotel supply persist despite ongoing hotel investment

Hotel performance indicators for star hotels



Source: Deputy Ministry of Tourism, KPMG Analysis

Note: (*) Net bed occupancy refers to the occupancy rate for the period that the hotel operates, excluding periods that the hotel is closed. Gross occupancy is the all-year round occupancy

Key drivers of hotel occupancy for 2018 are:

Increase in hotel capacity

Eight (8) new star hotels were built in 2018, contributing to an additional bed capacity of 1.591, coupled with existing hotel expansion and renovation.

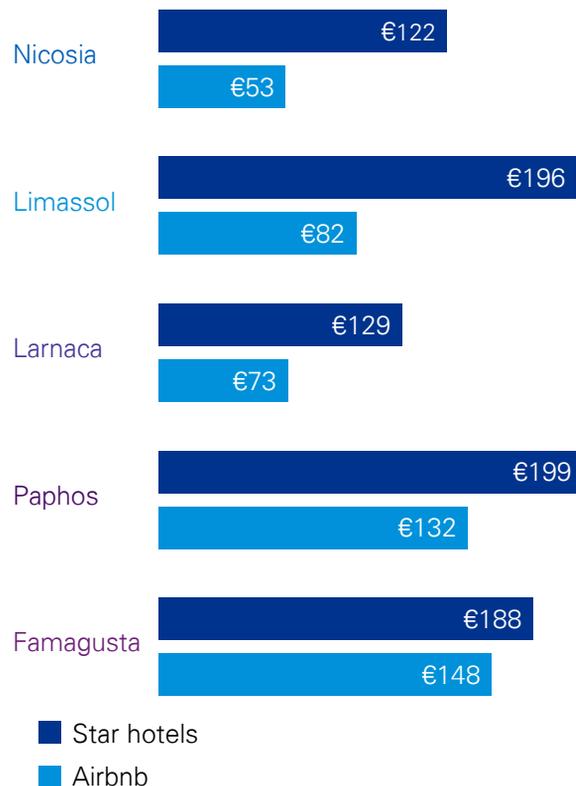
Shift towards short-term stay accommodation

Across all districts, Airbnb ADRs are on average 52% lower compared to ADRs of 3* - 5* hotels and the number of Airbnb bookings in 2018 increased significantly by c.70%, reaching a total of 42 thousand bookings in 2018. Despite its notable growth, the peer-to-peer market is still at its early life cycle and to-date has not led to any major disruption in the hotel market. Conversely, such establishments have filled any supply gaps for luxury up-market hotels during the peak season months.

Based on the above, the existing hotel capacity sufficiently meets tourism demand, with the peer-to-peer accommodation so far filling any supply shortfalls.

Despite the ample supply of hotels in beachfront areas, districts such as Nicosia, Larnaca and the

Hotels vs Airbnb ADRs (for August 2019)

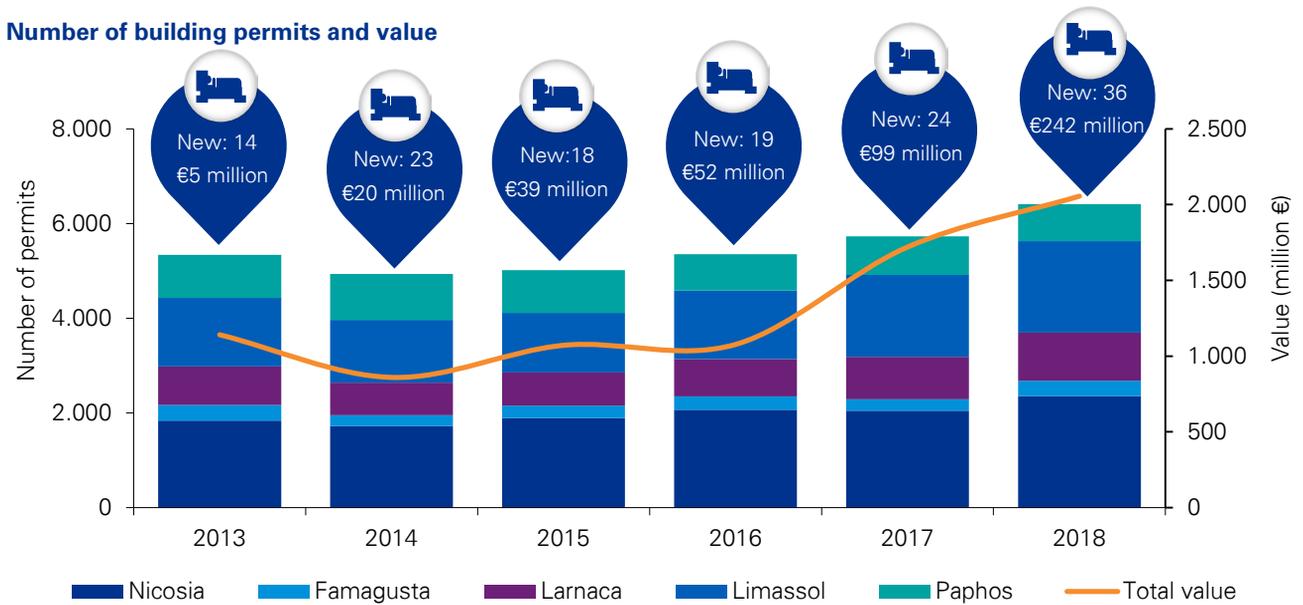


Source: Deputy Ministry of Tourism, AirDNA.co, KPMG Online research
Note: The rates are expected prices, as published online

general Troodos area have experienced a gap in newly developed luxury units. New luxury hotels, resorts and their auxiliary facilities such as conference centres, may have the potential to attract additional leisure and business tourism, prolonging at the same time the duration of the tourism season.

Increasing trend in development activity

Number of building permits and value



Source: CyStat, KPMG Analysis

: Number of building permits for hotels per year and their total value

The continuous growth in the Cyprus tourism industry triggered the interest of various local and international investors for the acquisition, refurbishment and management of luxury hotels, mainly in the coastal areas of the island. Hotels made up the 12% of the total value of building permits issued in 2018 and 20% of the big projects' value.

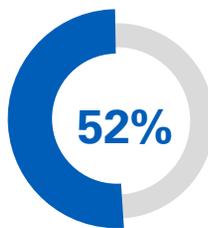
Rising investment interest is being observed for both Limassol and Nicosia, targeting mainly existing luxury hotels and development of new facilities and infrastructure. Such associated interest originated from both local groups, as well of international REITS and investment funds.

Share of big developments



544 Permits
of projects over 900 sqm

Value of big developments



€1,2 billion Big projects
Total value of projects over 900 sqm

Value of hotel developments

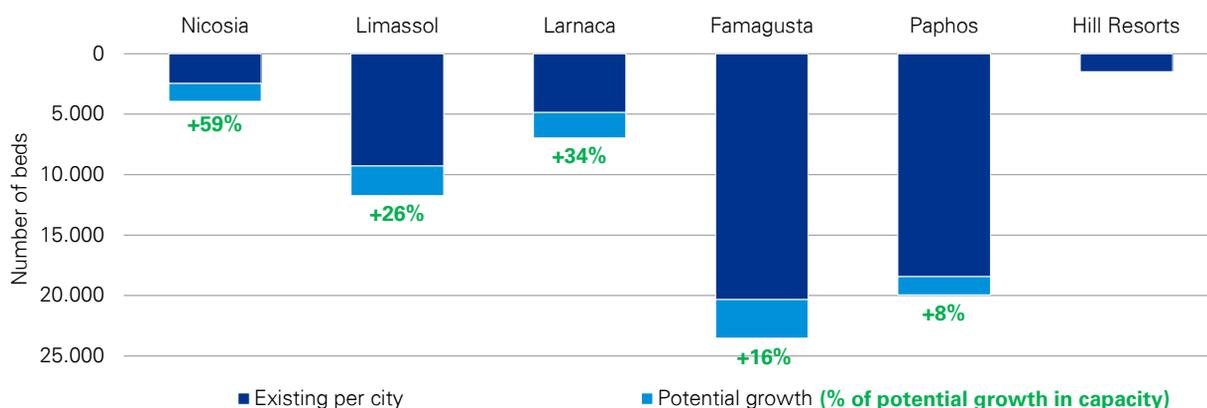


€250 million Hotel developments
Total value of projects relating to hotel developments

Source: CyStat, KPMG Analysis

Upcoming hotel developments

Rooms per city and potential increase (star hotels)



Source: DMT, KPMG Analysis

Following the continuous increase in the tourist arrivals, there has been an increased activity in the development of new hotels. Based on current hotel developments along the pipeline, an 18% increase in the total number of beds is anticipated across Cyprus, coupled with the casino resort, which is

expected to contribute an additional 1.000 rooms by 2021. The consortium, leading the development of the casino resort, anticipates that such development will attract an additional 300.000 of inbound tourists annually.

Top 4 upcoming developments

Name	Expected opening	Number of beds (estimate)	Stars	Location
City of Dreams, Casino Resort	2021	1.000	★★★★★	Limassol
Chrysomare Beach Hotel & Resort	2019	640	★★★★★	Famagusta
Sofitel Cyprus	2022	490	★★★★★	Limassol
Sun City Resort & Residences	2019	460	★★★★★	Famagusta

Potential effects of increase in hotel stock

Based on the expected developments, we have developed various scenarios showcasing how the potential increase in capacity may impact star hotels in the short-to-medium term.

Scenario

1. Gross room occupancy remains at 2018 levels



Impact on star hotels

Tourist arrivals to star hotels should increase by 424 thousand

2. Tourist arrivals remain at 2018 levels



Gross room occupancy of star hotels will reduce to 47,9%

Assumptions

1. Our estimation includes announced developments only; amounting to 10,8 thousand new beds. Any delays/postponement and/or other unanticipated events were not accounted for in our calculations.
2. Our estimation analysis assumes that the average length of stay for star hotels (5,2 days) and room occupancy factor (2,03) remains at 2018 levels.

Source: DMT, KPMG research

Key drivers for future hotel development

Rising demand for citizenship through investment

Rising demand for Cyprus citizenship through investment has to-date boosted private sector investment, as well as having a positive fiscal impact.

Since launching the scheme in 2013, Cyprus has generated €4,8 billion of total investment, most of which has been channelled into construction and real estate.

However, pressure on citizenship and residency scheme grew as a report issued by Transparency International and Organised Crime and Corruption Reporting Project (OCCRP) to the European Commission notified on potential drawbacks in practices and procedures of the said scheme. In turn, the Commission requested the reassessment of such programmes.

A strong opposition and pressure by other EU members for stringent vetting procedures especially for non-EU nationals, could potentially deter the demand and in turn slow investment towards hospitality assets envisaged to be funded by citizenship through investment.

Stricter structural and prudential reforms to ease access to financing

Private debt restructuring framework adopted in 2015 has already translated into improvements in the banking sector, with NPL ratios falling from a peak of 60,0% in crisis peak to 31,8% in the third quarter of 2018, albeit still significantly higher compared to the EU average of 3,4%.

In the face of the highly indebted private sector and the ongoing pressure for balance sheet adjustments by financial institutions, the Government plans to introduce an asset-management scheme in 2019 to further ease the burden of NPLs on local banks' balance sheets.

An improvement in the confidence of local financial institutions to lend has the potential to ease access to financing in the hospitality market, which to-date has been an imperative limiting factor for both local and international investors.

Investor confidence and household spending showing sign of strong recovery

As economic recovery continues, Cyprus' market demand risk is in line with the Western European average. Domestic demand, especially for hospitality offerings, continued to rebound this year as GDP growth persisted.

Household deposits in core domestic banks have stabilised and consumer confidence has improved. Foreign-financed construction projects are gaining momentum and property prices have begun to rise, signals of improving investor confidence.

Growth in GDP in 2018 was mainly driven by increases in private consumption and gross fixed capital formation. Fixed capital formation in relation to building and works has grown by 24,9%, with increasing positioning of capital both in relation to non-residential properties exceeding 25%.

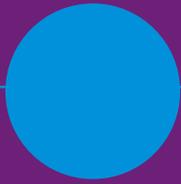
Potential reboot of Chinese incentive to increase connectivity

China's initiative for the Belt and Road Initiative (BRI) in 2013 to improve connectivity and cooperation on a transcontinental scale, was brought to a stalemate in 2018 after international scrutiny, especially after concerns regarding Chinese investment in the EU and the US who labelled China as a "systemic rival".

Despite the challenges, the BRI initiative remains firm with 126 countries having signed bilateral co-operation agreements, as China has been recognised for its rising economic weight and its ability to support large-scale infrastructure projects.

The initiative itself can be an appealing investment proposition, especially in the fields of the hospitality market. To-date, Chinese investments in Cyprus relate to touristic mixed development projects whilst there has been interest for further infrastructure and hospitality projects.

A potential direct air traffic link with China could have a significant impact on tourist arrivals, which could potentially boost the hospitality market growth. As per the World Bank, BRI transport project, if completed, could reduce travel times along economic corridors by 12%, while increasing trade up to 10%.



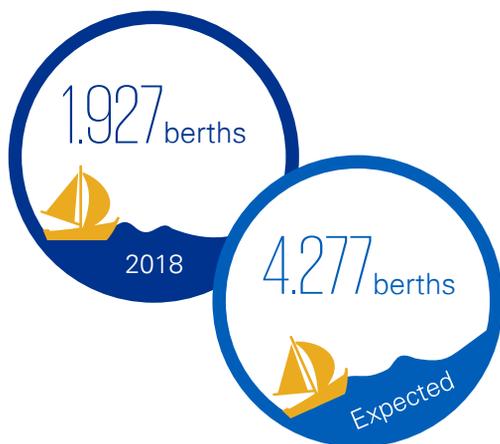
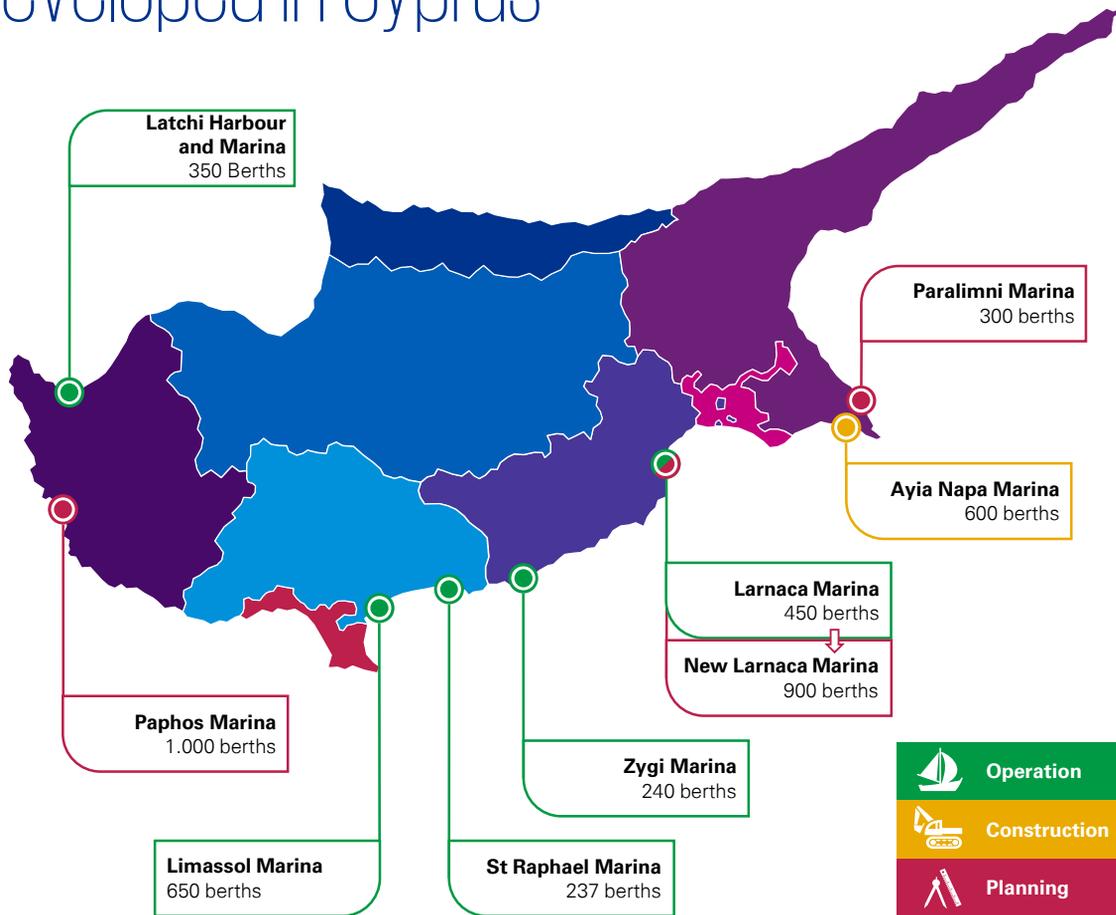
Other touristic offerings

Golfs and Marinas are some of the touristic developments that are aiming to attract high-end tourism and as a result, upgrade the touristic product of the island.

Over the last few years these developments have been in the spotlight, with announced upcoming developments, not all of which materialising yet.



Four new marinas are expected to be developed in Cyprus



In an effort to diversify and enhance the island's tourism infrastructure while attracting the growing nautical tourism, multiple marinas have been constructed or are being planned. Future developments are expected to greatly increase the island's nautical tourism capacity while doubling the number of available berths.

The Ayia Napa Marina with an estimated investment of €220 million, is currently under construction and expected to be fully completed in 2021. Multiple multi-million developments are in the planning stage including the Paralimni, Paphos and New Larnaca Marinas, expected to exceed €1 billion in total investments.

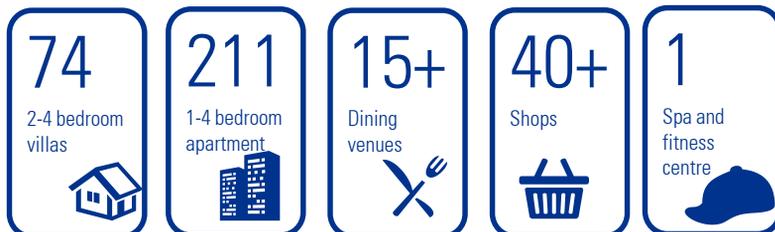


Multi-faceted marina developments

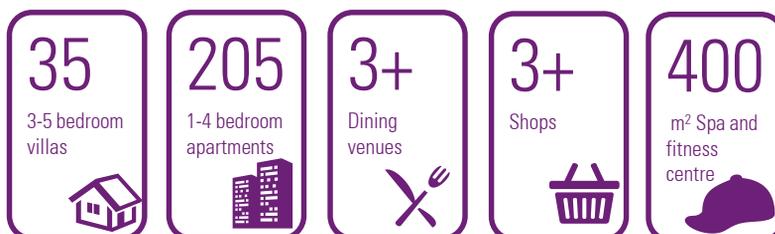
All future proposed marinas as well as the relatively recently completed Limassol Marina, are part of multi-faceted tourism developments which include hotels, apartments, villas and other leisure establishments.

These diversified offerings are expected to increase the island's tourism capacity, while contributing to the enrichment of the island's tourism product.

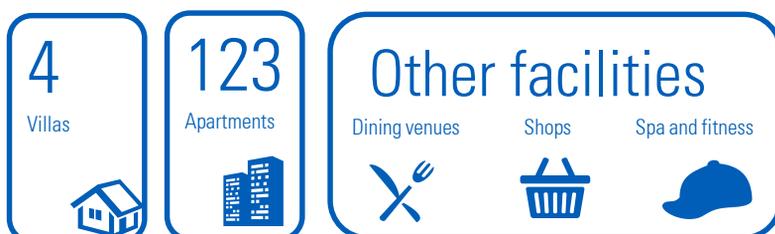
1 Limassol Marina



2 Ayia Napa Marina (under construction)



3 Paralimni Marina (under planning)

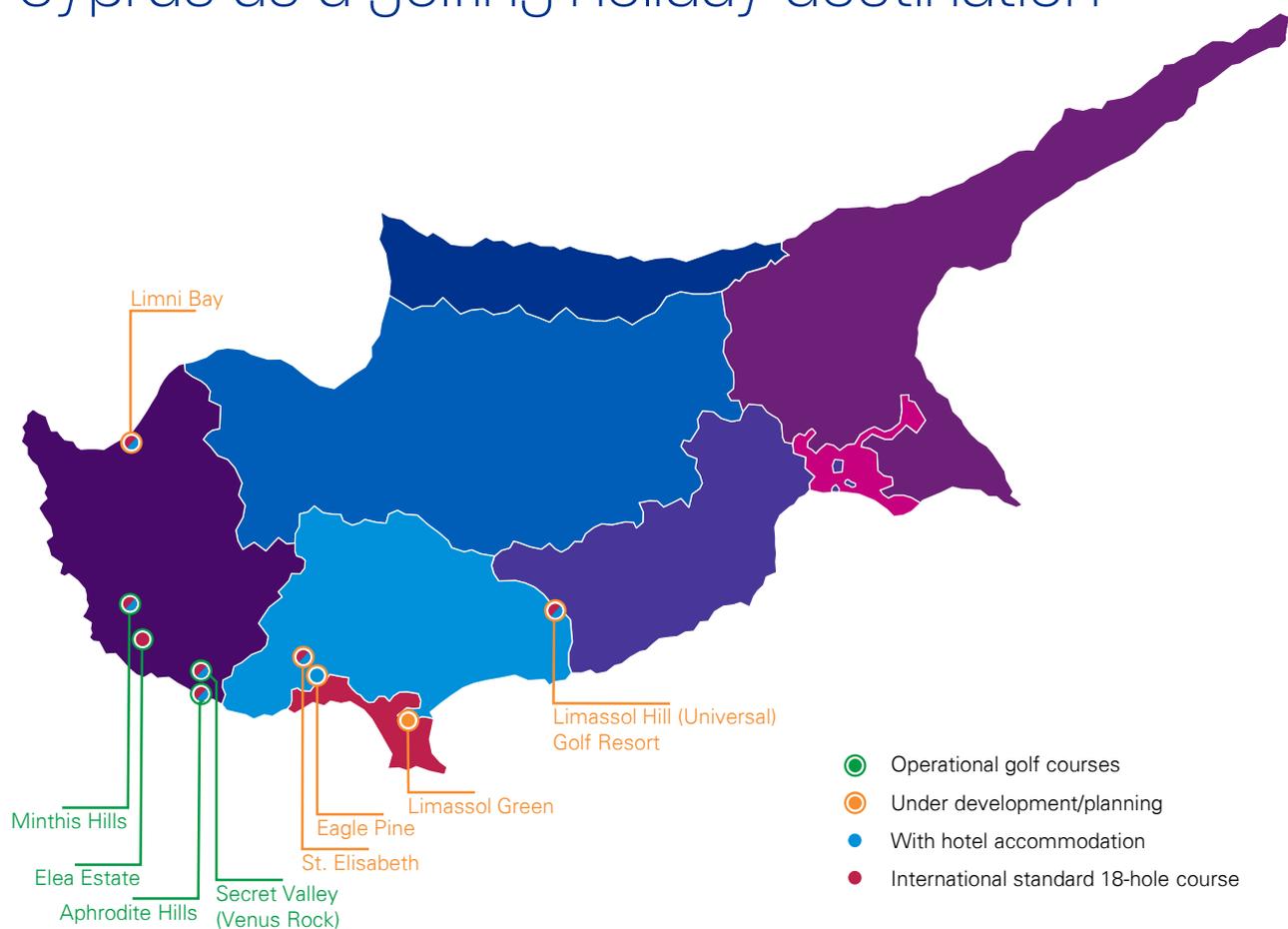


4 Paphos and New Larnaca Marinas

Note: Based on KPMG research, there are no publicly available information in relation to the commercial and residential units to be developed in relation to the Paphos and new Larnaca marinas.

Both envisaged marina developments are still subject to tenders by potential interested parties and approval by local authorities.

Cyprus as a golfing holiday destination



Initially introduced in Cyprus in early 90s and with the introduction of the gold policy in 2004, the golf industry grew in early 21st century to result in four (4) golf courses currently operational, all of which are located in the Paphos district. These 4 golf courses have an international 18-hole standard status. Two of them have an operational resort offering real estate development, hotel accommodation and leisure facilities in addition to golf. The rise of Cyprus as a golf destination may have an impact on both the tourism and hospitality sectors, attracting individuals of higher disposable income level.

Alongside further expansions of existing resorts (Elea Estate is planning to develop residential units), the pipeline includes 4 golf resorts under planning, with the following characteristics:

- A focus on the development of integrated resorts consisting of golf courses, luxury hotels, residential villas and comprehensive leisure facilities; and
- An emphasis on developing golf courses in Limassol district, shifting from the current concentration in Paphos district.

Peer-to-peer accommodation

Peer-to-peer accommodation (with Airbnb being the most prevalent platform in Cyprus) is transforming the tourism and hospitality industry, integrating the travelling and accommodation domain with new age technology.

Through these online platforms, both locals and tourists are given the opportunity to discover and explore various destinations. Among other countries, Cyprus boasts an entire host of properties ranging from rustic retreats getaways to urban city breaks.

In Cyprus, the effects of such platforms on the wider hospitality sector remains to be seen as data to-date are limited and such services are in the early stages of their life-cycle.

In 2018, peer-to-peer accommodation in Cyprus accounted for only 1,3% of the total bookings whilst, as at 31 December 2018, the number of listing in such platforms where 19,0% higher compared to previous year; indicating its potential as a key trend for the future hospitality sector.



Airbnb: Peer-to-peer rental is on the rise



41.509 ↑ +68,9%
y-o-y

Bookings made
in 2018



5.289 ↑ +19,0%
y-o-y

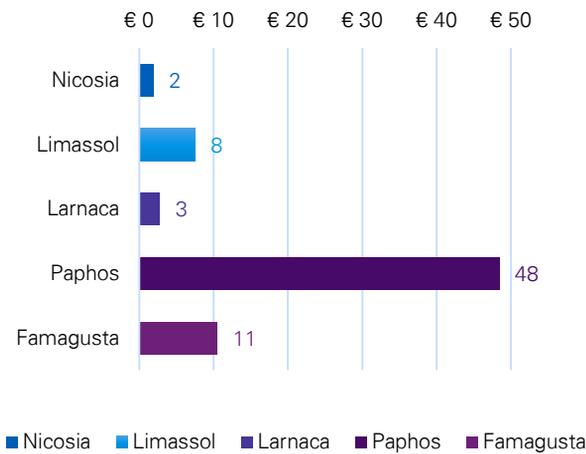
Active property
listings in 2018



54.858 ↑ +40,4%
y-o-y

Guests in 2018
50.999 International
3.859 Domestic

Market revenue 2018 (€ million)



Net Occupancy and Average Daily Rate for homes and apartments that are rented for exclusive use

Region	Net Occupancy Rate	Average Daily Rate
Nicosia	51%	€46
Limassol	52%	€65
Larnaca	50%	€48
Paphos	57%	€117
Famagusta	51%	€76

In recent years, the Airbnb platform has gained momentum, affecting the hospitality sector worldwide.

In Cyprus, individuals select Airbnb accommodation both for leisure and business purposes. Bookings through the platform increased significantly by 68,9% over the past year. Net room occupancy rate in 2018 amounted to 52%; lower compared to the average of 70% of hotels and other hospitality establishments.

Airbnb has emerged as an opportunity for many individuals to commercialise their private property, as in recent years many residential properties were acquired and then converted into short-or-long-term rental properties. This phenomenon has been observed to be prevalent in the coastal fronts of the island.

Peer-to-peer platforms have proven to be an immediate substitute product to traditional hospitality offerings whilst its effect in the Cyprus hospitality sector remains to be seen given the limited information available to date and the fact that such platforms are in the early stage of their life-cycle.

With the change of end user tastes and the rise of 'Millennial' travellers and continuous technological innovation, the growth of peer-to-peer accommodation is anticipated to continue over the medium term.

Source: AirDNA.co, KPMG Analysis

Note: (1) The above are estimated using data for entire homes, private rooms and shared rooms, except for occupancy rates and ADRs which are calculated using data for entire homes only.

(2) Some hoteliers rent their rooms through Airbnb platform, hence the data may include data for hotel rooms as well.

Access to financing

Overcoming the challenges of recent years, Cyprus maintained its strong fiscal performance and has been growing with around double the rate of Eurozone economies average for the last three years.

The banking system in Cyprus focuses on the continuous provision of increased financing to both households and fundamental economic sectors which are key drivers of Cyprus economy, including the tourism, real estate and construction sectors. However, NPLs are still one of the main challenges that the Cyprus banking sector has to overcome in the near future.



Development financing

Cyprus economy is largely dependent on the services sector including tourism, financial services and real estate, accounting for more than 80% of total GDP.

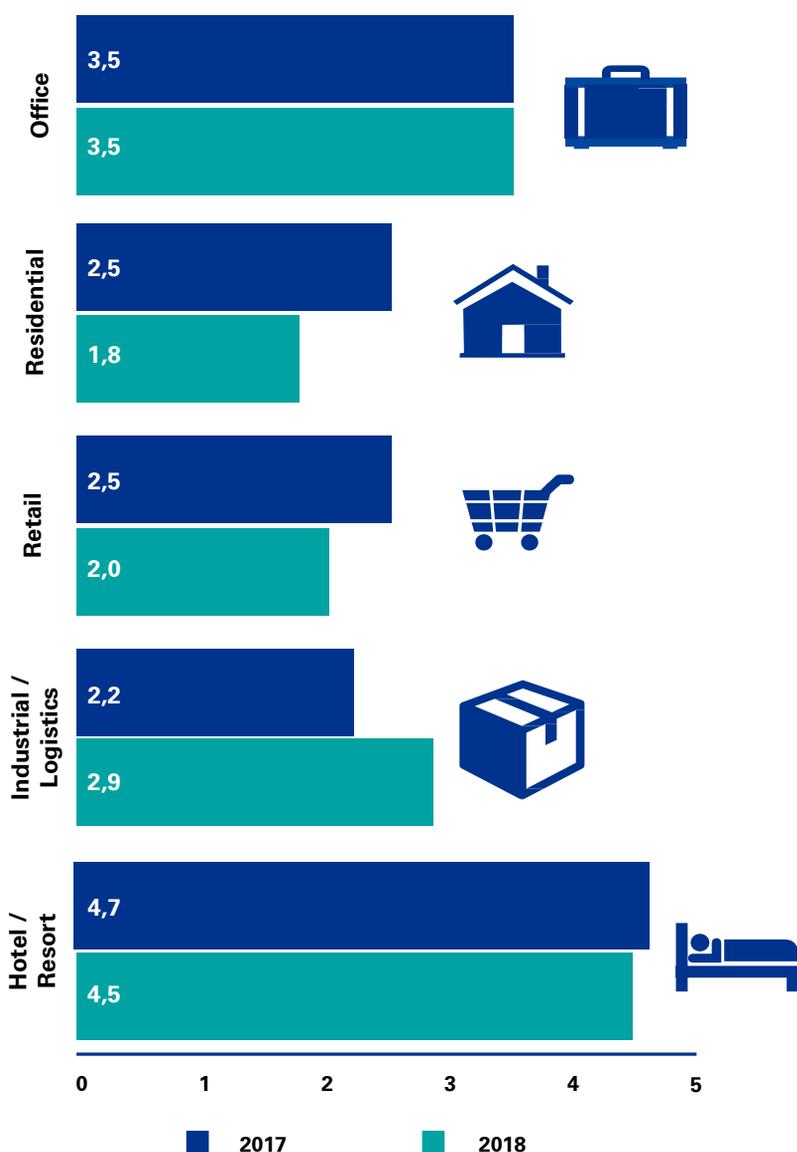
In accordance with the KPMG's Property Lending Barometer 2018 survey - regarding real estate-related corporate lending activities - local banks demonstrate a marked preference in lending to the hotel/resort projects, followed by offices for both 2017 and 2018, as shown by the local banks' average scores.

One of the most important strategic choices of the domestic banking system is to support the tourism sector. Specifically, the total value of loans provided to the hospitality sector as at 31 December 2018 amounted to €1,9 billion (Central Bank of Cyprus).

As per information obtained from the KPMG's Property Lending Barometer, the tourism infrastructure projects are considered lower-risk, viable and income-generating projects and allow significant equity participation and suitable collateralisation.

As at 31 December 2018, the NPL ratio of loans provided to the hospitality sector amounted to 14,1%; significantly lower compared to the market average of 31,8%.

Bank priority in providing development financing in the next 12-18 months



Source: KPMG's Property Lending Barometer (2018)

Note: 0=lowest priority, 5= highest priority

Commercial real estate financing

Loan-to-cost ratios (LTC)

In 2017, Credit Financial Institutions (CFIs) required the highest LTC ratio for hospitality projects, reflecting a capital structure of 54% debt and 46% equity. In 2018, LTC ratio for hospitality projects reduced to 0,69 notably below office and large residential assts.

Loan-to-value ratios (LTV)

Average LTV ratios for the various industries appear to be incremental, as the 2018 ratios experienced a decline compared to previous year.

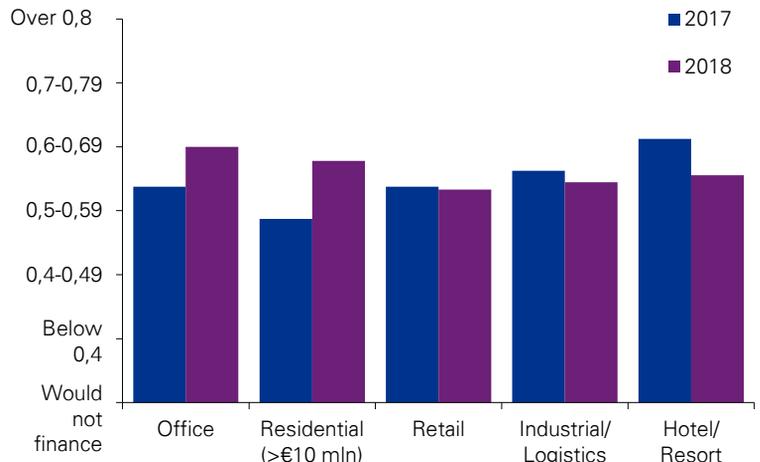
Specifically, for hotel/resort projects, LTV ratio declined by 18,1%, albeit remaining an the upper bound LTV ratios among the alternative asset classes.

Interest premiums

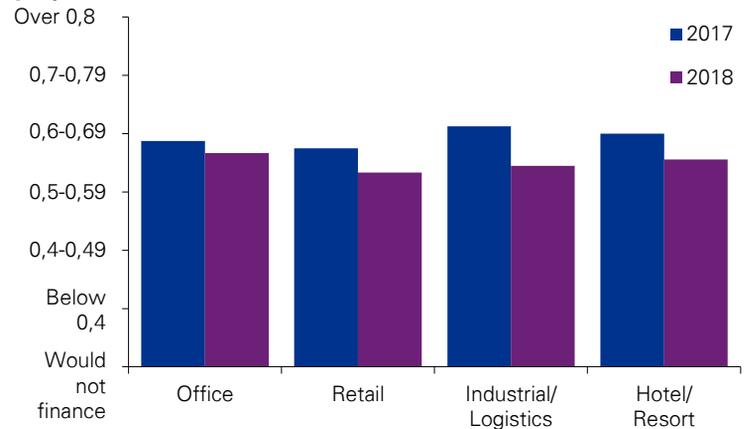
Interest premium provided for hotel/resort developments ranges from 3,28%-4,16%, with an average of 3,72%.

The decrease in both LTCs and LTVs of facilities provided to the hospitality sector – although remaining conservative – entails an increasing appetite of CFIs in providing finance to said assets. With the lowest pricing among the asset classes, this is an indication of CFIs' confidence for the future of the hospitality sector which has showcased continuous growth over the past years.

LTC ratio expectations for financing prime real estate projects in the next 12-18 months



LTV ratio expectations for financing prime real estate projects in the next 12-18 months



Interest premium to be applied on financing of real estate projects

Ranging from		Average per sector
3,25-4,25%		3,75%
3,41-4,35%		3,88%
3,32-4,25%		3,79%
3,31-4,28%		3,80%
3,28-4,16%		3,72%

Source: KPMG's Property Lending Barometer (2018)

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