Funds “here today and gone the day after”

Interest from insurance and pension funds in the hotel sector will be fleeting, delegates at Deloitte’s 24th European Hotel Investment Conference in London were told.

The funds were described as offering unsuitable investment options for hotels, with lengthy investment periods combining with a lack of specialised knowledge of the sector.

Panellists acknowledged that the volume of refinancings facing the sector had created demand for new investors. Neal Ledger, managing director, UK property & hotel finance, Crédit Agricole Corporate & Investment Bank, said that the sector faced a “ginormous” funding gap, but added: “I believe that a lot of these funds have set themselves up with a product that the hotel sector does not want”, identifying that 10 to 15 year investment periods with fixed returns were not suitable for the property market.

Tim Helliwell, head of hotel finance, Barclays, said: “Transactions today involve incumbent lenders or 100% equity. The insurers are being courted as filler, but they’re able to make a choice and hotels are one of a number of opportunities available for them.”

Christof Winkelmann, managing director, special property finance, Aareal Bank AG, said: “I’m definitely seeing the funds coming into the hotel market, but I fear most of them will be here today and gone the day after”, adding that, as banks started to strengthen their balance sheets and were able to provide more funding to the sector at a more attractive cost, the new entrants would lose interest in hotels as an asset class.

Josh Wyatt, investment director – hospitality & leisure, Patron Capital Advisers, said: “Insurance companies have a very different view of what a loan is. They will be part of the mix, but not overnight.”

Later in the conference the opportunity for private equity groups already within the sector was examined. Marty Kandrac, managing director, real estate, Blackstone, said: “Performance still isn’t anywhere near the previous peak. There are good opportunities, but fewer. It feels like there’s a lot of capital, but when you cut through it, there isn’t. Not many lenders are competing. There are a lot fewer people in the business than there were 10 years ago.”

Wyatt said: “There is less equity out there, there’s more mezzanine coming into the space. There competitive advantage [for private equity] is not leverage any more, it’s the ability to write a cheque of EUR500m to EUR100m and write it quickly. The whole concept of 20% return, people don’t believe this will happen leveraging at 50%. This is not a bad thing, as long as people know what the returns are likely to be.”

Kandrac commented: “I’m sure a 15% return in today’s environment is unimaginable.”

Wyatt added: “You’ll see a lot of money that will fill the gap in the capital stack and it’s a very smart play. Even 12% on mezzanine is not bad, we should all be happy with that. Any portfolio that has a growth story, private equity is a good choice for that.”

There remained conflict between traditional lenders and private equity, with Wyatt complaining that the banks’ willingness to continue to “extend

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Toasting recovery

Commentary by Andrew Sangster

According to Stephen Richardson, partner at Cushman & Wakefield, we need to accept we are in a new paradigm. "Many in the industry are in denial," he said, speaking at a conference hosted by Berwin Leighton Paisner in London last year.

An inflated opinion on revenue growth meant that values were similarly inflated. And the situation is set to deteriorate as many have failed to take account of the capital expenditure needs of hotels. Overall, it is a failure to mark-to-market the value of hotel property, said Richardson.

Particularly notable was Richardson’s analogy to the UK provincial hotel market and toast. Overall "soggy and under done", he said before citing examples of specific portfolios. Von Essen was burnt badly and had been discarded. The Marriott portfolio was well done "but is cold and limp", he asked.

Some Travelodges had been badly burnt, some were toast, most were edible. Principal Hayley was in the toaster "but is it cooking". Macdonald and De Vere were similarly under the grill.

At the same conference, Kingsley Seevaratnam of Westmont took the view that there would be more activity in the UK. He argued that banks had taken the write-down and values had now reached this write-down level. Elsewhere in Europe less activity could be expected right now but this would change in a few years. "We have hope for more realistic pricing expectations."

The biggest price gap was in Spain. "There’s a huge delta between price expectations and where pricing is." Until pricing comes down to deliver a capitalisation rate above 10, Seevaratnam said this was an issue still.

For Tim Hellwell of Barclays equity was as much an issue as debt. "There are changing views in the market about what is acceptable for equity returns," he said.

But Josh Wyatt of Patron Capital asked: “Who cares about debt? You have to make a profit and you need 10% or higher yield outside of London.” The hangover effect from 2005 to 2007 needs to get blown out, he added.

Patron’s debt financing was priced around 4% and leverage was at 50%. The firm had bought in the UK regions “because we liked the price point”.

The contrast between Europe and the US was highlighted at Hotel Investment Europe, also held in London. According to Doug Kessler of Ashford Hospitality Trust, the US-based group currently seeking investments in Europe, the US is at the half way point in its recovery. "We’re almost at peak demand," he said and he anticipated healthy revpar growth.

But Steve Goldman of Starwood Capital’s Louvre Hotels warned that there was more of a positive outlook in the US than was warranted. "The capital markets are functioning fairly well in an economy that has some serious issues," he said.

Laurence Geller, then current but now former CEO of Strategic Hotels, said that bankers have to decide if we are in a cycle or a long-term trend. If it was a cycle, then it made sense to hold.

Despite the apparent differences between the US and Europe, both continents have similar issues. While the bull spirits have woken up in the US, the underlying weaknesses in parts of the economy may yet dampen this optimism. In Europe, there are few signs of bulls in the real estate markets although the equity markets have been staging a strong rally.

The US has seen far more deals than Europe so far. And Cliff Risman of law firm Gardere Wynne Sewell expects this trend to continue with Europeans continuing to “kick tyres” rather than transact.

What is selling and has transacted, according to Arthur de Haast, also speaking at HotF, are prime assets in gateway cities. “We are beyond the bottom of the cycle in terms of value.” But there was now a two tier market with a lot of hotels not finding buyers as the pricing was still too high. The deals that are coming to market in Europe are being induced by banks.

Christie & Co’s Jeremy Hill agreed that pricing was an issue still. “If assets are brought to market and then not sold it creates uncertainty.” While it was easy for banks to hold assets in a low interest rate environment the lack of capex was an increasing problem. “Once a hotel gets tired, it impacts on trading and this impacts on value,” said Hill.

The fundamental problem, according to Piers Talalla of Avington, is that many of the acquisitions in trouble were bad acquisitions. And he argued that: “Until you get sustainable earnings you won’t get the multiples for portfolio deals.”

The views in the market seem to suggest that there is a real risk that the recovery itself might soon be toast.
and pretend” was causing “constipation” in the market, commenting: “Nothing’s really freeing up. Until there’s some sort of reckoning, nothing will happen”. Wyatt described getting deals done as “challenging”, adding: “I’m exhausted, it’s like there’s a boxing match out there and we’re in round eight or nine”.

The oft-quoted “wall of money” which was heading towards the sector in the heady days of 2007 has been replaced with a wall of debt, as refinancings continue to loom over the hotel market. While deals are getting done, delegates talking to Hotel Analyst complained of negotiations that would previously have taken months taking years, even within established relationships.

HA Perspective: There is no question that hotels offer a significant challenge to big institutional
funds. The size of any investment has to remain comparatively small if funds are not to have a controlling stake – something most avoid. And the hotel industry requires a level of expertise that most funds do not see as worthwhile given the potential amounts they are likely to be able to invest.

Even the wider commercial real estate market remains something of an exotic for the biggest funds, as it requires a disproportionate amount of time to understand it relative to the returns and potential size of investments that can be made. Other industries are simpler and can absorb chunky individual investments without an institution taking control of the business.

So pension and insurance companies will not be investing in hotels, right? Well, not quite. Some already do. But the nature of these investments will reflect the higher cost to the funds in making them. That is, the funds expect to make better margins investing in hotels than in say the oil industry.

Pension funds in particular love investments that pay out healthy dividends on a regular basis. This aligns neatly with the payments they have to make on their annuities. The lumpy returns afforded from investing in hotel property, even on a senior debt basis, do not match so neatly.

Of course there are ways of financially engineering returns that are more suitable but this adds complexity and expense.

The search for yield will no doubt see more and more interest in hotels from institutions. But only those that take the time and trouble to build up appropriately experienced teams are going to be around in the long term.

Accor moves more asset light

Accor’s transformation to an asset light, emerging markets hotelier is on track. And despite the substantial refoocusing taking place, and a major rebrand of the company’s economy offerings, the business continues to deliver growth and good returns.

Further disposals during the third quarter pushed Accor towards its asset light goal. A Novotel and Ibis in Shanghai were sold with a manage back deal.

The sale and leaseback of MGallery hotels in Cologne and Amsterdam yielded EUR23.5m, while the disposal of an interest in the Mirvac Wholesale Fund was also completed.

Reporting on a half year that saw the sale of the Motel 6 chain in the US, chief executive Denis Hennequin said the company was on target to hit all of its corporate objectives.

And he added to a new target, of a 40-40-20 holding model to be achieved by 2016. He pointed to the acquisitions of the Mirvac portfolio in Australia, and the Posadas business in South America, as examples of strategic moves designed to take the business into its declared areas for growth.

Revenues in the first half grew 3.6% like for like as the company pushed through record expansion, adding 20,700 rooms. Ebit was up 10.1% at EUR212m, with a predicted full year target of EUR510-530m. Despite a poor May in the French market, impacted by national holidays, and continuing weakness in southern European markets, chief financial officer Sophie Stabile noted the economy brands had delivered a 9.6% increase in Ebit, while for mid and upscale the figure was 6.6%.

The 40-40-20 ambition was described by Hennequin as a “logical” progression. The aim is to have 40% of the portfolio each in franchise and management contracts, with the remaining 20% in “subsidiaries” – meaning either leased or owned.

He explained that the model depends on the environment: “Franchises are better suited to Europe and to the economy hotels, management is better suited to the upscale and emerging markets.”

The first half growth was working towards both objectives, said Hennequin. Of the 20,700 rooms added, 57% were in the Asia Pacific region, 25% in Europe, 13% in Africa and the Middle East and 5% in Latin America. Of the new deals signed, 85% were under either management contracts or franchise agreements.

There is still some way to go, however, as today 63% of Accor’s open hotels are in Europe, while just 31% are management agreements and 25% are in franchise agreements. However, a pipeline that has 72% in emerging markets and with 64% under management contracts indicates that all the travel is in the right direction.

Alongside the strategic changes, Accor is also pushing through a major rebrand of its economy hotels. Rearranged under Ibis and two sub-brands, Ibis Styles and Ibis Budget, the hotels are undergoing makeovers at the pace of 40 a week. More than 660 are already complete, said Hennequin, and 70% would be transformed by the year end. Edgy interiors and bright new common areas, receptions and breakfast bars are going down well with customers, according to a corporate video played to analysts. An international promotional push has been promised for October, to ensure guests know about the improvements.

Further moves towards asset light included disposals or renegotiated terms at 59 hotels, delivering a net EUR283m positive impact on debt. In June, the company also tapped a strong bond market, securing EUR600m of 5 year debt with a coupon of just 2.875%. This was followed in the third quarter by the issue of an additional EUR100m of bonds, maturing in 2017 with a 2.406% yield.

Subsequently, Accor reported revenues in the third quarter up 1.3%, with the modest improvement blamed on unfavourable comparisons with the equivalent period a year ago. All sectors saw an improvement, led by midscale and upscale, where revenues were up 1.6% like for like. Latin America delivered an 8.5% increase, and Asia Pacific performed strongly with 4.1% growth, while southern Europe continued to decline.

Among Accor’s economy hotels, it was again Latin America that performed best, with an 11.3% increase in revenues, while in Europe also...
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continued the same trend as before with most countries seeing softening demand.

Across Europe, the German market remains a strong performer, delivering a 4.1% increase in midscale & upscale revenues and 3.6% in budget. High end spending by trade show visitors helped push average room rates at the upper end of the company’s brands by 9%.

The UK, too, performed well, with upscale & midscale revenues improving 4.9% and economy rising 6%. Management noted this was not solely the positive effect of the Olympics; losses, too, were experienced with the temporary closure of some venues in the lead-up to the main Olympic events.

During the third quarter, Accor opened more than 5,600 rooms, contributing to the year to date total of 26,400 rooms opened.

HA Perspective: The new 40-40-20 target is a significant move towards becoming an asset light rather than an asset right company.

Previously, variable leases were put into the asset light bucket but now Accor is adopting a more Anglo Saxon interpretation.

Right now, Accor owns 10% of its rooms, has fixed leases on 12% and variable leases on 22%. So this 44% segment has to shrink to just 20%.

Quite how Accor is going to accomplish this move is not at all clear. It puts a question mark against its existing variable lease deals for which it had sought long-term partners such as Fonciere des Murs in France, Moor Park in Germany and Land Securities in the UK.

And this about face by Europe's biggest hotelier also significantly shrinks the opportunities available to those European funds focused on finding hotel property that can be leased, or is leased, to operators.

Despite extremely challenging economic conditions in Southern Europe, Accor looks set to deliver on expectation for trading. System growth has also been reasonable in the circumstances.

With its new found aversion to signing leases, and a desire to switch into predominately a management contract or franchise model, the question arises about how well it can maintain system growth.

Whitbread unaffected by Travelodge woes

Whitbread’s first half figures showed that Premier Inn is performing strongly in a tough UK market for economy hotels.

But chief executive Andy Harrison played down the impact of troubles at competitor Travelodge, insisting Premier Inn’s success was down to other factors.

Harrison said the market remained difficult, with little ability to see clearly ahead. Progress that was ahead of its competitive set was down to success on a number of fronts, but it also had to do with a consistent approach to promotion and growth.

During the first half, which was for the 24 weeks to August 16th, Premier Inn delivered a 12.7% increase in sales, with a 3.8% like for like figure. Revpar was up 2.3% on a 10.2% increase in room nights sold.

Although the Olympics had delivered a modest uplift in performance, the effect was limited by the company’s strategic move to cap its room rates in order to underline its value offering.

“It’s very hard to say what’s behind our outperformance. I think the biggest factor is the widening gap between the strength of the Premier Inn brand and the competition. We’re clearly improving our network, we’re investing significantly in maintaining the quality and consistency of the product.”

There is also the impact of the new two tier pricing model, which delivers a revpar improvement and has been implemented across two thirds of the estate. A premium price offers guests the flexibility of late changes or cancellation, as an alternative to the regular room price, and this will now be added to websites for the London region properties.

“The way we’re going to implement it in London will be slightly different,” said Harrison, “because the booking profile in London is different, there’s generally a much longer booking profile. But we will have rolled it out as we move into the second half.”

Analysts were keen to know of the impact problems at Travelodge were having on the Premier Inn business. “Yes, we are benefitting from the financial woes at Travelodge,” confessed Harrison.

“We have picked up about a half a dozen sites from their development pipeline, and it’s possible that we’ll be able to pick up a few more.”

These were development propositions, and so would feed through into the pipeline over the next year or two. “We’ve probably got 5-600 rooms out of their development pipeline, “and some of these replaced previous alternative project plans, rather than being purely additional to the pipeline.

As to the existing hotels that Travelodge will be disposing of, Harrison added: “We might be able to pick up a very small number, a handful or less, but that depends primarily on the landlords.”

Despite the refinancing, he noted Travelodge would still remain a relatively highly geared business, in the hands of owners not known for long term interests.

Internationally, there was no progress to report, but a hint of plans to enter new markets. “The focus in international is our capital light approach, and we are making good progress in finding new sites, developing new hotels with the asset light model. It’s a slow burn. We are looking in the Middle East and India and also a couple of adjacent territories.”

Looking forward, Harrison said it was hard to be clear further ahead of the company’s typical six to eight week booking window. “The UK regions continue to be a pretty challenging market, where revpar is declining. That’s been a consistent trend, and in the short term, I don’t see any changes. London is harder to read,” particularly with the effects of the Olympics, and strong comparables in 2011.

HA Perspective: The domestic UK situation looks reasonably robust for Premier Inn. With getting on for half of the branded economy hotel market and the position of being the biggest hotel group in the UK by room numbers, Premier Inn ought to have some pricing power.

But Whitbread still has to address some key strategic issues. Many are betting that the Costa Coffee business, now headed by former finance director Chris Rogers, will be hived-off in the medium-term.

And the restaurants business continues to underwhelm. Given the tie-in with the restaurants and Premier Inn, any demerger of this unit would be more problematic.

The biggest issue remains growth outside the UK for Premier Inn. The company has certainly been more active in the past couple of years but making the right noises will only work for so long. Meaningful delivery is fast becoming due.
Travelodge ready to move on

Travelodge creditors and landlords overwhelmingly backed the company’s rescue plan at the beginning of September, putting the economy hotelier in a position to plan positively for the future.

The deal involved a company voluntary arrangement – a UK legal route enabling Travelodge to reach agreement with creditors that sees debt written off, discounted or extended and new lease terms accepted by landlords.

As a result, Travelodge’s debt costs will be reduced to manageable levels, while there is fresh investment to refurbish the older rooms in the estate.

The new, slimmer Travelodge will be light of 49 hotels, which are to be returned to landlords for reletting to other operators. They will be run as going concerns in the meantime, although Travelodge will pay just 55% of the rent due. The company has not revealed the location of these hotels.

So far, few other operators have publicly stated an interest in taking on the hotels, apart from Premier Inn, which has said it is looking at up to six locations.

Adding to Travelodge’s woes, the Little Chef restaurants adjacent to many of its hotels are also currently being marketed to new owners.

The restructure will also allow for the completion and opening of 52 development sites, where Travelodge has signed leases more recently, but construction has yet to start or may be in progress.

Under the agreement, landlords of a further 109 hotels in the portfolio will receive just 75% of their contracted rent over the next three years, before returning to a market-based rent for the remainder of the term.

Some have been granted extensions to leases, while there will also be a bonus pot to be shared with them, should Travelodge beat pre-set ebitda targets.

There will also be GBP55m of a GBP75m cash injection to fund refurbishments. An 18 month makeover of 11,000 rooms in 175 hotels will start next spring.

HA Perspective: There were only two realistic outcomes for Travelodge once the debt crisis bit in 2008. It could either be sold to a white knight who would restructure or it would force the cost of a restructure onto its creditors.

The scale of Travelodge’s debt and the extent of its over renting meant only the latter course was viable and landlords are the main victims.

The question now is how viable is Travelodge as a company. It can keep trading but it is in no position to grow. Even at its existing development sites, landlords will be scrambling to find alternative tenants who offer a better covenant.

Lawyers will be kept busy finding loopholes in agreements to allow landlords to change horse. And there can be few landlords who will consider signing up for a new lease.

Only the most Pollyanna-ish would believe that trading will recover enough to allow full rents to be paid in three years time. Presumably, the “market-based” rents to be imposed after three years will not be as high as they were.

With a promise that landlords will also be sharing in any upside, there cannot be a huge amount left for the three effective owners of Travelodge – Golden Tree Asset Management, Avenue Capital Group and Goldman Sachs. They will be leaning hard on the group to extract as much cash as possible.

Some are already calling Travelodge a zombie company. Perhaps a better analogy is that of a vampire victim, most of the life force has been sucked out of it but with just enough left for it to keep staggering on. Expect the vampire (squid) to feed regularly.

French economy portfolio sale

French property company ANF Immobilier has accepted a EUR503.5m bid for a portfolio of 160 B&B branded hotels across France.

The deal will see the properties housing France’s third largest economy hotel chain transferred to new ownership in the hands of a consortium of Foncière des Murs and La Française REM.

The price represents a discount of EUR6.5m to a mid year valuation of the portfolio.

ANF will retain seven B&B properties it also owns in the short term, for onward sale to the same buyer at a later date. ANF is planning to recycle the funds from the sale into fresh value-added property acquisitions in its key markets of Lyon and Marseilles.

The property transaction is unlikely to have any impact on the operational business of B&B, which since 2010 has been owned by Carlyle.

The US private equity firm Carlyle paid a reported EUR480m to acquire the chain from Eurazeo, at a point when it extended to 223 hotels with 16,162 rooms. The B&B chain was started in France in 1990 as a high-end economy brand.

All of the French hotels are held on 12 year leases that run until 2019, with a mix of fixed and indexed rents. According to ANF’s accounts, the first half rent bill for the package in 2012 was EUR16.9m.

The deal was Carlyle’s first foray into the hotel business first.

In addition, Fonciere des Murs is a specialised holder of operating businesses and has extensive experience with hotels, notably through its partnership with Accor but also with its 18 existing B&B properties.

Thus FdM (also an SIIC) will have a clear idea of what rent economy hotels can support and should be unlikely to find itself in the unfortunate position of Travelodge’s more diverse group of landlords.

Whether Carlyle has overpaid for B&B to the extent DIC did for Travelodge is also doubtful. Whether it is a money making deal does, however, remain to be seen.

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Banks get granular

Banks have realised the value of real time business information with several institutions in talks with software provider Guestline to use its detailed data to better assess hotel performance. The move promises banks better information on which to base lending decisions, as well as the opportunity to keep a closer eye on the performance of hotels they have funded.

The keen interest from the banks follows Guestline’s formation of a strategic partnership with Jones Lang LaSalle Hotels earlier this year, with the intention of getting the industry to better understand the value of real time data. The company has more than 20 years of experience building web-based reporting systems, usually deployed by client hotel companies purely for operational functions such as handling reservations.

The Guestline initiative will make aggregated hotel performance data available to partners, while those hotels that use the full breadth of Guestline’s web-based reporting systems able to access real time information on the revenue performance of their own properties. This allows benchmark against a locality. “Before lending, banks can take a look at the performance of hotels in, say, Exeter, and that allows them to review actual ADR,” explained Guestline’s Rupert Gutteridge. Then, once funds have been advanced, Guestline can provide all interested parties with live information. “They have access to data in the specific hotel, and can see that the hotel is being run properly.”

For Guestline, which has long been providing web-based reporting systems, and is the UK’s largest provider of PMS systems, the move upstream is symptomatic of a changing market. “Typically in the PMS marketplace, the hotel’s need has been focused on functionality, and measures such as occupancy,” said Gutteridge. “But now, with money tight, everyone is having to look at the bigger picture.”

For those looking to value hotels, Gutteridge said the information requirement has changed too. “With property prices not in a rising market any more, the asset value is changing more to do with what’s happening on the inside, rather than the bricks and mortar.” And by providing partner JLLH with aggregate data on hotel performance city by city, there is the opportunity for a potential investor to compare likely returns from hotels in alternative locations.

Currently, Guestline’s data is UK focused, though its systems are being increasingly used by hotels across Europe and further afield. “We’ve enough of a footprint in the UK to give them good data,” said Gutteridge.

Dutch office deals open up management opportunities

Dutch hotel developer TVHG is promising to redress the Netherland’s economy hotel shortage, having secured backing for a 19-strong pipeline of new hotels.

The hotels, four of which are already open, are all conversions of existing office buildings, and each has a major chain committed to drape its flag over the front door.

With development finance secured, the projects are now all proceeding and will be built out over the coming months. The deal, secured by Colliers International’s hotels team, has brought private equity funders Metric Capital Partners and Hutton Collins Partners into the hotels sector, with a EUR30m equity funding package.

The funds will allow TVHG to build out a contracted pipeline of 19 hotels across the country, which when completed will have a development value of more than EUR120m. Major chains have already committed to take on the hotels, which will be branded as Holiday Inn Express, Hampton by Hilton, Ibis, Aloft and Courtyard by Marriott.

“This sees the successful conclusion of many months of work in what are certainly the most difficult capital markets in my working lifetime,” said Marc Finney, head of International Hotels & Resorts for Colliers International.

“Securing investment from such high quality investors in a deal with so many moving parts was only possible due to the quality of the company for whom we were raising the money and the exceptional business plan which we helped them to formulate.”

As Finney explained, the genesis for the TVHG developments was a perfect storm in the Dutch marketplace. “TVHG identified a shortage of select service hotels, and at the same time, a glut of offices that could convert.”

Having scoped out the office buildings most physically suitable for conversion, and landlords motivated to consider an alternative tenant, Colliers then introduced Interstate Hotels & Resorts as manager, and secured brand partners. Interstate made an equity investment to help deliver the first phase of four hotels.

There is the potential for TVHG to take its concept into other European markets, such as France and Belgium, and these are now being actively explored. While Finney described the situation in Holland as “a no-brainer”, other markets are generally less oversupplied with offices, and less undersupplied with budget hotels.

The deal structure has the new funders coming in as equity partners, but with a preferred return. Building owners are expected to contribute

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towards the cost of the building refits but they will then secure 20 to 25 year lease deals.

Initial results from the first four projects, all trading as Holiday Inn Express and including a hotel at Schiphol airport, have been positive. “They are all performing above their competitive set,” said Finney, and this helped give the new funding partners the assurance that the remaining 15 conversions are likely to deliver good returns.

Finney said that, thanks to judicious building selection, the conversions work very efficiently. “In most cases, you can’t tell the building was ever an office.” Interstate have been able to advise the team on the brand standards of the different chains, in order to assess where any compromises on building layout may be acceptable.

The deal has enabled TVHG to turn a bright idea into reality, said Bart van de Kamp, ceo of TVHG. “We are extremely happy with Metric and Hutton Collins as partners. We required their investment, financial strength and expertise to further expand our business, not only in the Netherlands but also in Belgium, Luxembourg and France.”

HA Perspective: Whenever times get tough in commercial property, people suddenly remember the hotel specialist sitting in the corner.

All of a sudden troubled residential or office schemes are viewed as possible conversion opportunities for hoteliers. Unfortunately for the ambitious agent, it is rare that schemes are viable as hotels.

TVHG, sometimes still known as The Vincent Hotel Group, seems to have hit on a model that works, however. It has been helped by a flexible approach shown by the big brands keen to get into the undersupplied Dutch market with their franchises.

And for Interstate, which is a wholly owned subsidiary of the JV between Thayer Lodging and Jin Jiang, the TVHG deal is an important beach head in Europe. Jointly owning the hotels with TVHG has helped Interstate secure long-term management contracts.

Like many of the best deals, it is opportunistic and will run its course as the excess office supply is mopped up. Longer term, however, it will help establish third-party management as a significant business model for the European hotel industry.

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**UK government flips on tourism**

The UK government has come in for strong criticism from industry bodies for its decision not to directly replace tourism minister John Penrose, following his resignation.

With the role effectively downgraded, there is concern that a lack of commitment to tackle problem issues such as visa applications and high airport passenger taxes will leave the UK missing out on its Olympic tourism legacy.

The British Hospitality Association declared its members “extremely disappointed” at the news. ABTA’s head of public affairs Luke Pollard commented: “The government has said that tourism is a key driver of economic growth. It is vital that we have clear leadership in place at a time when the tourism legacy from the Olympics needs to be secured and the contribution from outbound, inbound and domestic tourism still needs to be properly understood.”

Penrose resigned after a government personnel shuffle that replaced his superior, culture secretary Jeremy Hunt. The replacement for Penrose, Hugh Robertson, has the combined roles of being minister for sport, Olympic legacy and tourism.

In contrast, the US authorities have recently laid out ambitious plans, with supporting actions, to boost tourism. And the UNWTO has underlined the importance of making visits easy, if countries want to maximise the benefit of a growing global tourism industry.

For the US, the target is 100 million visitors in 2021, up from 63 million last year. Alongside the target is a clear strategy to get there, which includes five clearly identified steps to make the USA the most attractive tourist destination in the world.

The first of these, to extend Brand USA’s welcome message, was boosted this week with the signing of British Airways as a founding airline partner; ironically, this will call on the UK carrier to encourage Brits to holiday in the USA.

In addition, federal agencies have committed to improve efficiency and visa procedures. There are plans to link private and public sector better, to create a “world class” visitor experience. And there is a promise to collect and analyse data, in order to make smart, strategic decisions to enhance the country’s growth and leadership in the tourism business.

The UK, which has among the highest flight tax rates in the world, is not alone in seeing the opportunities to tax a growing sector. The European Tour Operators Association this week rounded on the Icelandic government. A proposed 2013 hike in local sales taxes there will hit tourism hard, they claim.

HA Perspective: The resilience of tourism as an industry is remarkable. Despite the woes of the eurozone, Europe saw a 4% rise in visitor numbers in the six months to the end of June, according to UNWTO figures released this week.

Even Southern Europe, which faced difficult comparatives given the bounce from displaced visitors to North Africa last year, saw an increase. Despite this strength, governments are struggling to give the industry the support it needs. The failure is to see that with a little nurturing there can be fantastic returns.

The big problem for tourism and hospitality is the fragmentation in the industry. It makes it hard for it to speak with one voice and this chorus of diverse and weak voices is easy for governments to ignore.

The answer is surely to focus on a handful of important but winnable battles, while laying the propaganda groundwork for bigger asks.

Shooting for the moon just loses the industry credibility with government and the wider public. An area where there seems widespread public disquiet in the UK is Air Passenger Duty. This is now GBP92 per passenger on flights over 6,000 miles for those seated in the lowest class seats. For everyone else this rises to an astronomic GBP184.

The duty is payable by any passenger staying more than 24 hours in the UK, effectively killing the UK as a stop-off destination for many travellers.

The financial services industry in the UK saw off the proposed financial transactions tax, the so-called Tobin tax, by discrete but unified lobbying. The travel and tourism industry, by contrast, has had only limited lobbying success.

And yet travel and tourism is almost as important to the UK economy as financial services. It directly supports nearly as many jobs, for example, according to the World Travel & Tourism Council. While the GDP contribution is smaller than that of financial services it is still significant, and five times more than that of the automotive sector.

These are all facts that can be used to beat government. But the lobbyists need the support and engagement of the key business leaders in travel and tourism. It has yielded results in the US and can do so in the UK and elsewhere in Europe.
Berlin market points to change

Hoteliers in Berlin are up in arms with private apartment owners, accusing them of undercutting regulated tourist accommodation and stealing tourist visitors.

But while the German hotel association Dehoga is calling for new regulation, one major player in the market, A&O Hotels & Hostels is calling on the sector to respond positively to change.

A&O ceo Oliver Winter believes the situation is shining a light on the shortcomings of mainstream hotel operators, and is calling on them to adapt to a changing world. "We should not try to build walls, we need to see what we can do to change our offer," he suggested this week.

Berlin is the most acute example of private accommodation making inroads into the tourist market, aided by new websites including Airbnb, Wimdu and 9flats. Their community feel, combined with the promise of a variety of budget accommodation, appears a highly attractive alternative for those seeking lower priced places to stay in an increasing number of global locations.

The situation is particularly acute in Berlin, due to depressed local real estate prices. "It still has quite a cheap property situation," said Winter.

His company has hotels and hostels in German and Austrian cities, and has witnessed first hand the impact on trade at his four Berlin locations. City centre flats are available for medium term rental at EUR600-700 per month, making subletting by the day, if even at relatively low occupancy rates, highly profitable.

As a result, they contend there is substantial expansion potential. In the case of the hotel sector this requires a shift in the mindset of independent hotel operators, and in the view of landlords.

Of the models available, FFW suggests that the "franchise light" style adopted by Best Western Aloft have made conscious efforts to create a point in asking the hotel industry to respond positively to the threat from the informal accommodation market. The extended stay segment in particular has begun to recognise the fact that guests want a social experience.

Even more conventional hotel brands understand this. Hyatt Place is probably the pick of the bunch from the global majors in terms of understanding this but others such as Starwood's Aloft have made conscious efforts to create an atmosphere that is more convivial than the conventional hotel bar or restaurant.

The regulatory issue will – and should – come up and keep the interlopers in check, as much for guest safety as any unfair competition issues. In the meantime, brand owners and operators can learn what guests are seeking.

Franchising under represented

New research by law firm Field Fisher Waterhouse suggests the reach of the franchised hotel brands in Europe is far lower than previously thought.

With only around 3-4% of hotels sitting under a franchise umbrella, the format offers great potential for expansion, with the right model.

"I was surprised to find figures for hotel franchising in Europe were so low," said Babette Märzheuser-Wood of law firm FFW. "This suggests that hotel franchising presents a real growth opportunity for hotel brands in Europe."

According to the information collated by FFW, franchising (across all industries not just hotels) accounts for just 2% of GDP in the UK. This compares with close to 6% in the USA, and 10% in Australia.

As a result, they contend there is substantial expansion potential. In the case of the hotel sector this requires a shift in the mindset of independent hotel operators, and in the view of landlords.

While for the brands, franchising is a fast, low cost way of growing in a market, owner-operators have concerns. FFW says European owners justify their preference for independence by thinking of the fees they will need to earn, and the perception that they will be tied up in a complex legal agreement.

Best Western claims top spot for franchised hotels in Europe, says the research, with 1,300 properties, followed by French brands Accor and Louvre, with 750 and 600 respectively. Behind them come InterContinental and Choice with 500 franchised hotels each. Global brands Marriott and Starwood have less than 100 franchised hotels across the continent, preferring management agreements.

Of the models available, FFW suggests that the "franchise light" style adopted by Best Western and Choice is most suited to the European market. While other US franchise brands maintain strict brand standards, these two offer more flexibility when considering adding properties.

In the UK, Germany and Spain, local markets have traditionally preferred a leased property model. Brands such as Premier Inn, Travelodge, NH and Barcelo have almost no franchised properties, but have instead suffered recently from the inflexibility of rents under the leased model.

However, well-constructed lease models
continue to be attractive for some landlords, compared with the alternative of a management contract. Speaking at July’s IPD conference on the European hotel investment market, Gael Le Lay of AXA Real Estate noted that the choice of lease versus management contract was fundamental, leaving the investor either as a benign landlord, or with an interest in the hotel's success. For the investors, yields on hotels with management contracts are up to 1% better than those leased. “The crisis has demonstrated the resilience of hotels under lease contracts, and thus their use as long term holds delivering a secure income stream. Conversely, those hotels under management type contracts have been more volatile, which may suit the opportunistic strategies of short to medium term investors.”

“Franchising can be a very cost effective way for hotel brands to put flags on maps,” said Märzheuser-Wood. “Many European owners dislike management agreements which do not guarantee a minimum revenue in the same way as a lease. In a franchise model the franchisee will take the lease from the owner and enter into a franchise agreement with the brand so this satisfies the lease-driven owner base.”

There are substantial marketing reasons for joining a franchise, insisted Märzheuser-Wood. “For potential franchisees it gives their hotels access to the added reach that the marketing expertise and loyalty programmes of big brands can bring. In some cases room rate can also be increased significantly by adding a major brand. This is not guaranteed however. As increasing numbers of guests look for value options, we are also seeing the franchising model used more and more at the budget end of the spectrum where it is easier to replicate the customer experience.”

HA Perspective: Given that less than a third of European hotel stock is branded, and that much of this branding is done by hotel companies that either own outright or manage directly their hotels, then 3% or 4% of hotels being franchised across Europe is not unexpected.

Nonetheless, the logic for franchising growth is certainly there and at first sight it is indeed surprising that more has not occurred. The problem is that outside of a handful of territories where they have critical mass such as France for Accor or the UK for IHG, there is sensible concern among independent owner-operators about what they will receive for their fees.

The traditional appeal of franchising for the franchisee is that it is an easier way to own and start your own business. Clearly, for an independent hotelier, they are already in business and the issue then becomes how much incremental business will have a brand above the door actually bring in. For many, it is indeed often not enough to warrant the fees.

This log jam will only be broken when the big brands have the power and reach to offer a compelling proposition. There have a number of stumbles along the way.

One is the confusion between brands and consortia. Best Western, for example, despite being widely distributed as a brand, does not have the income level to invest sufficiently to drive customers into its hotels.

Up against the television advertising of Premier Inn or Holiday Inn in the UK market, for instance, Best Western struggles to create demand for its members / franchisees.

Brands need to offer more. As yet, in the European marketplace, many are still struggling to deliver.

Rezidor reinforces Regent

Rezidor and Regent Hotels have signed a strategic agreement that will have the two working together to develop the Regent brand further.

The deal is the latest twist in a tale that has seen Carlson, and then Rezidor, connected with Regent since 1997.

The pair will jointly develop and operate Regent brand hotels in EMEA, with the territory being split. In Russia, the CIS, Baltics, Middle East and Africa, Rezidor will develop and operate Regent hotels alone. In other parts of Europe, the pair will work in joint venture. Regent will continue to operate its existing hotels within Europe.

Today, the Regent brand is owned by Taiwanese owner-operator Formosa International Hotels. Formosa bought the brand from Carlson and Rezidor in mid 2010, paying a reported USD56m. The deal included back to back support agreements with Carlson continuing to support Regent hotels with reservation services, and Rezidor providing management in EMEA.

At the time, FIH chairman Steven Pan expressed the desire to grow Regent into one of the most admired luxury brands in the world.

Under Formosa’s ownership, the brand, according to its own publicity, has been refined to combine an Asian approach to hospitality, with modern luxury interiors designed to position Regent firmly in the five-star space. The company prefers to take on mixed use projects, combining a hotel with branded residences.

The brand currently has five hotels, in Beijing, Taipei, Turks & Caicos, Berlin and Zagreb. Later this year new hotels will open in Phuket and Bali, while further ahead the committed pipeline includes Abu Dhabi, Doha, Montenegro and Kuala Lumpur.

“We are honoured to partner with Mr. Kurt Ritter and his team at Regent,” said Steven Pan. “Our cooperation will further strengthen our growth strategy while RHR continues to focus on unique hotel residential and mixed use projects in the region. Together we hope to significantly increase the Regent hotel portfolio and international network.”

“We would like to thank Steven Pan and his team for their trust in Regent,” said Rezidor ceo Kurt Ritter.

“The acquisition of the Regent brand and business by Formosa in 2010 allowed us to focus on our core brands Radisson Blu and Park Inn by Radisson, and to strengthen our network in 70 countries across EMEA. A luxury brand was however never off our agenda, and we are delighted to complement our portfolio with Regent now.”

The Regent brand was created in 1970 by a trio of legendary hoteliers: Robert Burns, Adrian Zecha and Georg Raphael. During the 1980s and 1990s, Regent expanded to 17 hotels around the world, placing it as one of the leading luxury brands in the hotel sector. Following its acquisition by Four Seasons in 1992, many hotels in the portfolio were rebranded. The slimmed down Regent was acquired by Carlson in 1997.

More recently, Formosa’s positive influence has been evident as every one of the hotels in the portfolio was listed in the 2011 Conde Nast Traveler readers’ choice awards.

HA Perspective: When Carlson sold Regent back in 2010 it said it was doing so to focus on its core assets. But now, two years later, its upstart European franchise holder Rezidor has struck an opportunistic deal to manage the hotels.

Regent is not set to be a significant venture for Rezidor but it does give it another string to the brand bow. In markets like Russia and the Middle East, having another luxury brand to sit alongside the fashion-focused Missoni is a plus.
Puma lies low as debt dominates

Puma Hotels has had the disappointment of having its half year figures qualified by auditors.

Deloitte added a warning note to the accounts, noting Puma’s high “net current liability” which sees debts outstripping current asset values.

Puma’s problems date from April, when Spanish operator Barcelo decided to exit leases it had signed in better times, to manage the Puma portfolio of hotels in the UK regions. As a result of Barcelo’s departure, Puma was obliged to write down the value of the rental income stream from the portfolio.

Barcelo’s £20.25m exit penalty was small compensation for the write-down, which saw the Puma portfolio valuation fall from £458.4m to £213.5m. Against this, Puma has debts of £332.3m, predominantly supplied by Irish Bank Resolution Corporation, formerly Anglo Irish Bank.

The debt facility is currently due for renewal at the end of 2013, though maintaining it until then ties Puma to certain conditions.

Puma, which is now managing the hotels with the support of Chardon Management, insists in its accounts that the hotels are profitable and cash generative; but in the current climate, profits are not covering much more than the interest charge on the debt.

The other opportunity which Puma had originally seen, that of improving certain properties with extensions and additional rooms, is also looking an unattractive choice in the short term, with regional UK hotel markets still weak.

The deal with Barcelo was struck in the heady days of 2007, when Puma was known as Dawnay Day hotels, having been created by Shore Capital and Dawnay Day three years previously. The Spanish manager agreed to 45 year leases on the 20 Paramount hotels, which it would rebrand.

At the time, the addition of 20 new hotels, in a new country, was an aggressive expansion step for the Spanish hotelier, and the leased model looked to lighten its portfolio in a way that aligned its activities more with the style of the major international chains.

Under the terms of property leases, rents had fixed uplifts for the first four years, after which they were index linked. According to the formula, the September 2011 rent increase was 5%, taking Barcelo’s outgoings from £31m to £32.55m. The agreement also included the potential for additional payments, subject to improvements in profitability.

In late 2011, Barcelo publicly announced they would withdraw from the UK, if their requests for a reduction in rents were not met. Puma, while it acknowledged it had received a letter from the Spanish manager, requesting a revision in rents, issued a stiff rebuttal saying it would enforce its rights under the leases “to the fullest extent possible”. With such a hard ball attitude, Barcelo decided that buying its way out was the least expensive option.

Puma is 49.9% owned by the AIM listed Hotel Corporation, which as a result of Puma’s troubles, has seen its shares fall to a level where they are virtually worthless.

HA Perspective: Barcelo joins Travelodge in showing that what appears to be a strong covenant can quickly prove the opposite once a recession bites.

But while Puma has clearly burnt its paws on leases it does not prove beyond doubt that hotels and leases should never mix. The problem was paying too much at the peak of the cycle and then attempting to pass that on to the operator via unsustainable rents.

Properly structured leases, that are either variable or at least are structured in such a way that allows a lessee enough room to survive a downturn, can work. Whether they are desirable is another matter.

Marriott under pressure

Marriott hit target with its third quarter results but left analysts downgrading profit forecasts after lowering guidance.

A confident performance – labelled “terrific” by chief financial officer Carl Berquist – saw revpar up over 7% in Marriott’s home market, while markets outside the US saw an average 5% upswing.

The Middle East was the highlight overseas, with a 13% improvement. Europe, buoyed by events such as the Olympics, delivered a 5% uplift while the Caribbean was weakest with just 3% improvement. Revenues exceeded USD2.7bn for the quarter, compared to an adjusted figure of USD2.5bn for the third quarter of 2011.

Growth is still on track, with 5,000 rooms added in the quarter as well as the Gaylord acquisition, which grew the portfolio by 8,100.

“The number of newly signed deals is impressive,” said Sorenson. “In the third quarter we signed nearly 13,000 rooms – half are outside the US and two thirds of those are in Asia.”

The target of around 100,000 new rooms across the portfolio over the period 2012 to 2014 remains in place, promised Sorenson. Currently, conversions account for around half the new rooms added.

With the growth is the confidence to let go of product that does not fit the Marriott standards.

“We continue to think that about 1.5% of the system is the right kind of deletion number for the foreseeable future,” said Sorenson, noting that a departure was not always triggered by Marriott, it could be an owner or franchisee forcing the decision.

“Every hotel that leaves us has its own story. On our side, we’ve gotten a bit more comfortable about saying goodbye to hotels that are in the lower quality tiers of our portfolio.”

It is in the home market where Marriott appears most comfortable – and it is here that the company generates 75% of its revenue. Sorenson talked of the substantial benefits of economies of scale. In the US, figures from Smith Travel Research show the company has 10% market share, and 20% of the development pipeline.

“As measured by rooms, we continue to build market share in the US,” admitted Sorenson. Illustrating the effects of the Marriott sales machine, he talked about the strong initial performance at the recently inducted Essex House in New York, where rate and occupancy is up, driven by new guests delivered from Marriott’s loyalty scheme. “We are bringing a brand, a rewards programme, relationships with clients.”

Looking forward, the home market appears in good shape. “In the US today, the big question is the economy generally, and the fiscal cliff in particular. Let us assume a solution will be found,” said Sorenson.

While government day rate budgets have been frozen, next year will bring a presidential election, promising higher hotel demand in key cities. And bookings for hotels more than a year out are up by 10%. Supply growth is predicted at just 1%: “This positions us to drive room rates higher.”

Quizzed about why the company’s guidance was now a 5-7% revpar growth for the next

continued on page 11
Europe back in the black

European business travel is now looking to be past the bottom of the cycle, and will start to grow again next year.

But figures from a new report by the Global Business Travel Association point to a two speed Europe, with the north in recovery in 2013, while southern nations continue their economic decline.

Overall, Europe will see a 2.2% decline in business travel spending this year, with the total falling to USD177bn, before picking up with a modest 1.3% rise in spending through 2013.

The twice yearly report has downgraded GDP outturns from its spring predictions, now expecting the Eurozone to contract by 0.4% during 2012.

Across Europe, “we are expecting flattish dollar performance from our European hotels. We’re still surprised, on balance, by the numbers that Europe is putting on the books,” with London buoyed by the Olympics and hotels in Germany by an unusually strong trade show programme.

Looking forward, Sorenson warned: “We will face tough comparisons to many 2012 events” while he foresees price pressure in places: “Supply is increasing faster in some markets, such as Amsterdam and Berlin.”

In emerging markets, there remained challenges. “We do see some incremental slippage in India and Thailand. It’s hard to blame economic factors, as each seems to have its own story.” Projects were not being cancelled, just delayed, he insisted.

“China’s more or less stable,” he reported, adding that projects previously reported as slipping from this year into 2013 delivery had seen no further delays. In the Middle East a combination of political factors make predicting performance very difficult.

Marriott is continuing to repurchase shares, as the best way to invest capital. During the quarter, it spent USD353m on share buying, and has so far this year bought back USD903m of stock. Aside from news of the completion of the Gaylord acquisition, there was no mention of further investment plans.

Sorenson talked of additions to the Autograph and Edition brands and the successful Springhill Suites being those that will fuel growth; but for now, such growth will rely on others delivering suitable properties.

HA Perspective: Despite all the positive talk, the third quarter numbers came in at the bottom end of expectations and the negative sentiments about the final stretch to the end of the year added to the downbeat feel.

But as Sorenson was keen to point out on the conference call, the change is not dramatic: “we’re just a little less bullish”. In effect, the revpar range guidance for 2013 has shrunk by one percentage point and this comes down to expectations of the US economy growing by 2% next year rather than 2.5% it had pencilled in as recently as early summer.

Although Marriott has used its balance sheet for some development and acquisition this year, a bigger pot of money is being returned to shareholders. The guidance for investment spend for 2012 was USD850m to USD950m and Marriott said it would be close to this by the year end, a number that includes the USD210m for the Gaylord acquisition.

An interesting metric that popped out during the conference call was the expectation that 1.5% of the Marriott system would be deleted each year. The company needs to add close to 10,000 rooms just to stand still.

With slowing growth in the US and globally, hitting the 90,000 to 105,000 room openings it has targeted for the next three years may get tougher. A little more direct investment might be needed.

Second in terms of performance is the UK, where the 2012 outturn is expected to be flat at USD40.2bn. For next year, GBTA expects spending to increase by 2.8%. Behind the UK falls France where, despite the expectation that the country will see a very modest GDP growth this year, business travel spend is expected to fall 2.2% to USD17.9bn.

However, the French market is expected to return to positive territory in 2013, posting an expected 1.1% increase in spending.

The other two markets surveyed by GBTA, Italy and Spain, provide little good news for hoteliers, though at least the rate of market decline looks as though it will start to reduce. Spanish business travel is expected to decline 7.8% this year, to USD17.9bn, with a further 1.6% contraction in 2013. Italy looks likely to fair little better.

The GBTA predicts a 6.9% reduction in business travel spend this year, followed by a further 1.2% reduction next year. Both countries are expected to remain technically in recession until 2014.

HA Perspective: Much of the GBTA forecast is pretty much as expected: South bad and North showing limping growth. Although anticipated it still makes for grim reading. Four years after the recession started in earnest, only one of Europe’s big five economies are expected to show any signs of growth.

The International Monetary Fund issued its World Economic Outlook at the start of October and it gives no cause to raise expectations beyond those of the GBTA.

The only country of the big five that is forecast to grow by more than 1% is the UK and then this is only by 1.1% against a fall this year in GDP of 0.4%. Most commentators believe GDP growth risks are on the downside for 2013. And given the hefty negative revision to the UK GDP outlook for this year since the last report six months ago (0.6 percentage points were lopped off growth to take it negative), it would be brave to bet on the new estimate being hit.

And the one area of concern in the GBTA forecast is surely Germany. Given the sluggish growth expected by the IMF, the deteriorating picture for Germany’s main trading partners, the likelihood of German business travel rising at a rate above inflation looks a stretch.
A stake in Starwood?

Starwood Capital has hired corporate finance advisors to review the potential of selling a stake in its empire.

The move comes as Europe moves into the sights of the opportunistic private equity player following a spending spree in the US.

According to the Wall Street Journal, Morgan Stanley has been tasked with making approaches to potential buyers who might be interested in taking a minority stake in Starwood Capital.

The company, one of the world's foremost property investment vehicles, has around USD19bn of assets under management. The company also invests in individual hotel properties, and in portfolio debt, with 43% of its portfolio in the hotel and leisure sector in one way or another.

In Europe, Starwood's interests include buying into Golden Tulip and the Louvre portfolio, the latter chain being the second biggest economy hotel operation in Europe.

Starwood's speciality is in higher risk, potentially higher return property opportunities, of the type frequently more available in a distressed market. The company draws in external funds from private and corporate investors.

The stake sale could provide an opportunity for an existing investor in Starwood's funds to participate in its management fees. The route is also sometimes used as a way to put a value on an asset, ahead of a wider sale opportunity such as a stock market float. It will provide Barry Sternlicht, who heads the operation, with the opportunity to extract cash from the organisation he created in 1991.

HA Perspective: Sternlicht's current investment thesis is to seek high current cash yields to ameliorate the risk factor with investments five, six or seven years into the deal.

He believes we are currently in a subsidised interest rate climate and many opportunistic investors, he cited Blackstone in a Bloomberg television interview this month, are making a bet that interest rates will stay low until they exit the investment.

But he is not so sure. He argues that current government policy of quantitative easing is creating latent inflation.

Real estate investors are covered, however, as the asset class will do well if rates do stay low and should be OK if rates start rising as this is likely to be accompanied by a growing economy.

His caution surrounds the potential for significant economic contraction. And this will no doubt temper his enthusiasm for Europe, given the risk that endures around the eurozone.

Motel One pushes into UK

German designer economy hotel group Motel One is unleashing its brand on the UK market, as it continues to drive aggressive growth in its home market.

The company is shortly to open its first UK hotel in Edinburgh, and has a pipeline of five further sites already under way, with plans to add plenty more.

The growth – and apparent success with customers – comes from a unique approach to both the brand and the business that flies in the face of highly standardised, asset light brands from the major hotel groups.

The company's product, promising high design at a price point not much above budget chains, sets itself apart by designing every hotel lobby uniquely, often with local references: in Edinburgh, even the corporate turquoise has been worked into a tartan design.

Constants are key classic furnishings which feature in common areas, including the Arne Jacobsen egg chair, and Castiglioni's Arco lamp, reminding guests that budget does not have to lack style.

Motel One was established in 2000 in Munich, within the Astron Hotels group. The Astron brand and portfolio of 54 hotels was sold to Spanish hotelier NH in 2002, allowing management to focus on growing and developing the Motel One brand.

In 2007, a Morgan Stanley investment fund took a minority stake in the business. The following year, it grew to 3,000 rooms open and received the first of three annual “Most Wanted Investment Partner” awards from hospitality consultancy Treugast.

In 2011, the company reported turnover up 48% to EUR134.8m, as it grew its portfolio from 31 to 38 hotels. The group achieved an average occupancy of 70%, and declared pre-tax profits of EUR23.4m. With openings in Salzburg and Vienna, the company also took its first steps outside Germany.

Last month, the company announced plans to build its largest hotel yet, an 18 floor, 530 room block adjacent to Vienna’s central station, that will be the fourth Motel One to open in the city.

This year, there will be four more hotels opened, as the company presses towards a target of 60 hotels and 14,000 rooms by 2014. The 208 room Edinburgh hotel, scheduled for a December opening, will be in a converted historic building in Market Street in the city centre, previously occupied by the council. Rooms in Edinburgh will start from GBP69 a night, while in some European locations Motel One rack rates start at EUR49.

The UK confirmed pipeline extends to 1,500 rooms with a second Edinburgh site at Princes Street; central London hotels at the Minories and Commercial Road; at Piccadilly in Manchester and High Bridge in Newcastle. A London office has been established to focus on growing the portfolio fast.

Dieter Muller, CEO of Motel One, recently commented: "We see as much if not more potential in London for our brand as in Berlin, where we have eight hotels, with over 2,000 rooms. Our product is young and stylish and focuses on three qualities, namely excellent location, affordable prices and high quality design and service. We are convinced Motel One will be popular with guests in the UK."

Similar to the flexibility in design is Motel One’s approach to new sites. The company mixes leases with owned and forward funded developments; and works with both new sites and conversions of older buildings, in a bid to get what it wants, where it wants it, fast.

“For us, it's all about getting the best sites and delivering quality,” explained Motel One’s deputy head of legal Stefan Lenze. By being flexible, “you find it easier to get the sites you want. We put a strong emphasis on design and quality – leasing or owning gives us a much better control over our mix. There remains strong competition for city centre sites, “so we do whatever works – and it must look good.”

Asked to compare Motel One with rivals, continued on page 13
changes in the way property lending is regulated threaten to have major negative impacts on the ability of investors and developers to obtain bank lending.

A new practice called slotting, which will require lenders based out of the UK to set funds aside to cover potential lending losses, could actually work against the efficient understanding of risk, and make banks even less interested in lending against real estate.

The concerns are raised by the respected Investment Property Databank, which has researched the likely impact of new rules, in a bid to encourage further debate ahead of implementation.

"Based on our findings, slotting could cause serious harm if the impact on the property market and its relationship to the wider economy are not fully understood," warned Phil Tily, managing director of IPD in the UK.

IPD tracks real world property performance, and in 2010 expanded its database to include the hotel sector. It currently records the performance of more than 475 hotels across Europe, with a value of EUR10.2bn. The data showed properties within the IPD hotels database delivered a 6% overall return to investors in 2011.

Slotting will require banks to classify each of their income-producing property loans into one of five categories, or slots: strong, satisfactory, good, weak or default. Against each one, capital will need to be set aside to cover the risk of default – the higher the deemed risk, the more capital will need to be allocated.

The concept was introduced in 2011 by the Financial Services Authority, when a suggested framework for the slots was made available for discussion. Following that initial consultation the initial FSA parameters were dropped, but it appears slotting will be introduced in some form into UK banking activities; and it will affect around GBP212bn of outstanding loans.

IPD has modelled the likely effect of the introduction of slotting, using information from its own database to see how risk-weighted capital would react under the slotting regime, if there were a downturn similar to that experienced recently. Taking data on 3,442 commercial property assets across the UK, worth GBP56.6bn at the peak of the market, they ran three models to see whether the proposed capital reserves were appropriate to actual risk.

The findings were not good news for real estate investors and commercial borrowers. Slotting will demand that banks set aside more capital as insurance, so as a result they will have to deleverage their loan books. This has the potential to depress the commercial property market once more, and could have a negative impact on capital values.

IPD also sees a danger that slotting will become a box ticking exercise that will take banks away from a regime of detailed risk analysis. And it is only by analysing actual risk factors, says IPD, that safer property lending will take place.

The slotting route will also encourage banks to hold aside a disproportionately high amount of capital as insurance against low risk property lending. This, predicts IPD, will lead to a situation where banks overprice the cost of high quality, low risk lending, with a consequential negative effect on new development. As a result, investors will need to look to foreign lenders, or unregulated sources, to access the funds they need.

"Tracking underlying property data on the security of income as well as values is vital to being able to gauge the real underlying risks of lending against income producing commercial property and IPD will continue to make data available for further research," said Tily.

"We see potential for a more a more risk sensitive UK regulatory regime that would provide capital cost incentives to lend in an economically efficient and stabilising manner. We hope to do further research using the IPD Databank to inform the debate.”

HA Perspective: Since the start of the banking crisis banks have been asked to do the splits, shore up their balance sheets and at the same time lend more.

Now the Janus-faced approach of the authorities is set to demand an ever more impossible balancing act. And unfortunately hotels are likely to be hit disproportionately hard.

Despite having a relatively good recession when compared against other commercial property sectors, hotels are still seen as exotic by property lending generalists. They will be popped into the lower slots, despite good relative performance, thanks to the higher perceived risk.
Euro Disney calls on parent for finance

Euro Disney, the company that runs the Disneyland Paris theme park created 20 years ago, has refinanced EUR1.3bn of its outstanding debt with a fresh loan from US parent company the Walt Disney Company.

The refinancing promises to reduce the cost of its debt, and provide the theme park with more flexibility going forward on the way it manages and reinvests in the facility.

The EUR1.3bn tranche is now good until 2030, while the interest due falls from 5.2% to 4% annually. Additionally, restrictive covenants under the previous loan, which restricted capital expenditure at the park, have now been removed.

A more relaxed repayment schedule will also allow for EUR225m of additional free cashflow. But there is still EUR217m of principal debt to be generated for repayment over the next five years.

The announcement also allowed Walt Disney to snuff out rumours that it might be interested in a takeover of the company. Currently, it owns 39.8% of Euro Disney stock, and the shares had risen more than 80% during the year, in part on the hopes of a takeover bid. Euro Disney chief executive Philippe Gas dismissed the rumours as “unfounded”.

Euro Disney’s other financial commitments were unaffected by the refinancing. The park has a further EUR400m of debt outstanding, while licensing payments to the parent company for the use of the brand and Disney characters will continue as before.

The Euro Disney portfolio in Paris includes seven themed hotels on site, with around 5,800 rooms, as well as the park, convention centres, golf course and ancillary restaurant and retail spaces.

A further 2,400 hotel rooms on the park are in the hands of third party owners including French investor Verquin, which bought the Explorers Hotel from Thomas Cook in April. The 390 room family oriented three star hotel, built in 2003, is undergoing refurbishment in the hands of its new owners.

Gas said the refinancing provided Euro Disney with a platform to continue to grow: “The Walt Disney Company, with this transaction, reaffirms its continued confidence in Disneyland Paris which has successfully become, over the past 20 years, the number one tourist destination in Europe, a growth driver of French tourism and an important ambassador of the Disney brand across Europe.”

HA Perspective: The difficulties Euro Disney has faced in this refinancing show just how tough the lending climate in Europe is. To be fair, Euro Disney has hardly had the best profile as a borrower given that it has made a net loss for 12 of its past 20 years.

What the deal does do, however, is free up Euro Disney to keep growing and build on its success in becoming Europe’s leading commercial tourist attraction. More hotel development will certainly result.

While Walt Disney has had to step in as the lender of last resort, it will now at least receive the fees and royalties it has often been forced to waive in the past. And when (some might suggest) lending does recover properly in Europe, it can offload the debt again.

Developers return to US market

While revpar growth is moderating in their home US markets, both Wyndham and Choice are seeing developers returning to the sector, helping to create further expansion opportunities.

During the third quarter, Wyndham saw overall revpar advance 2%, split between a 5% improvement in the US and a countering 5% drop in revpar in international markets. Choice saw revpar up 5.5% in the third quarter, with the benefit equally from improved rate and higher occupancy.

“I think RevPAR may be moderating,” said Wyndham CEO Stephen Holmes. “It’s still growing, but it may be moderating a little bit. But we definitely see the growth in room opportunity as improving, and so we will be aggressively pursuing that.”

At Choice, CEO Stephen Joyce commented: “Despite a sluggish economy, we’d anticipated a good summer, and we were right.”

For Wyndham, there was an explanation for the poor international performance. “The decline in the international revpar reflects a mix effect, driven by the growth in Asia, our lowest revpar region,” said CFO Thomas Conforti.

“Over the past year, we have increased the number of hotels in our Asia-Pacific region by 26%. This rapid growth has a dilutive impact on systemwide revpar due to Asia Pacific’s relatively low revpar compared to North America and other international regions.”

“Compounding the effect, our lower revpar brands, specifically Super 8, are growing more rapidly than our higher revpar brands in China. This creates an interesting dynamic where system growth can reduce revpar while increasing earnings.”

Both Wyndham and Choice are now seeing developer interest start to return in the US market.

“We believe development opportunities are expanding,” Wyndham’s Holmes told analysts. “This bodes well for room growth as we go forward. With our strong array of brands, we are exceptionally well positioned to capture franchise and management opportunities, giving owners the ability to choose the right flag to best maximize their assets.”

And at Choice, Joyce noted: “Both new construction and conversion franchise sales are higher, and our brands are attracting first rate developers and owners in highly desirable markets.”

In particular, new design formats for Comfort Inn and Comfort Suites have been well received.

“New domestic franchise agreements across-the-board are up 27% year-to-date through September, including new construction and conversions. Quality Inn continues to attract substantial conversion interest with 88 executed contracts so far this year compared to 49 last year.”

Wyndham, which recently added Tripadvisor reviews into its own websites, with positive results, is working through a series of other online technology initiatives, under the banner Apollo.

“We continue to make excellent progress on Apollo” said Holmes. “In August, we relaunched the Wyndham Hotel and Resorts website—we have now completely revamped 13 brand websites, significantly enhancing features, functionality and content for over 7,000 properties. Room nights resulting from brand.com initiative are up 17% versus prior year on both a year-to-date and a quarterly basis. In another phase of Apollo, we are embracing the significant shift to mobile devices by improving our click-to-chat functionality, which simplifies the booking process and enhances the consumer experience.”

Conforti warned that expansion in lower revpar Asia will have less of an impact in the future, as Wyndham starts to head upmarket. “Our pipeline in Asia Pacific, while heavily influenced by our lower revpar brands, will start to be influenced over the next 12 to 24 months by Wyndham branded hotels, which will be much higher revpar impact than what our Super 8 produces in China.”

continued on page 15
Ireland’s long haul

Property prices in Ireland could take up to 22 years to recover to the peak levels seen in the last real estate boom, a new report predicts.

An analysis in the Central Bank of Ireland’s latest quarterly report, comparing the Irish situation with that of other countries that have worked through financial crises, warns the Irish economy will be slow to recover.

One solution, proposed by the Irish Hotels Federation, is for more direct government intervention in the market. The federation has published the findings of an analysis by independent economist Alan Ahearne, which proposes a range of steps to help the sector recover and become an engine for economic growth and job creation.

The proposals for action came as a Dublin court wound up one of the country’s highest profile property casualties, Treasury Holdings. The company has debts of EUR2.7bn, of which EUR1.7bn is owed to Ireland’s toxic debt bank, NAMA. Treasury’s investments included a hotel in Moscow, and the iconic Battersea power station development site in London. Liquidators are to be appointed by the court in the coming days.

The bank paper compares Ireland’s position with the crises endured by Sweden, Finland, Norway and Japan over the last quarter of a century. It concludes that the Irish crisis “now ranks as one of the most expensive banking crises in an advanced economy since the 1970s.”

“The evolution of a property-related crisis depends on the scale of the inter-linkages between the financial system and the real economy,” the report says. “In Ireland, these inter-linkages are quite acute given the prevalence of bank debt as a key source of financing for the resident private sector.”

Against some measures, Ireland tops the lot: “The scale of the loan losses experienced by the Irish banking sector exceeds that of the other systemic crisis episodes. Loan losses as a percentage of GDP are highest for Ireland using 2010 data and are almost double those of Finland. In terms of understanding the adjustment, total assets of the Irish banking sector (circa EUR447bn) were almost three times nominal GDP (EUR156.5bn) in 2010.”

Specifically in the hotel sector, debt is estimated to total EUR6.7bn, and Ahearne’s report for the IHF proposes a restructure to write off more than a third of the aggregate debt. With a 38% write-down, he estimates over-debted hotels could then pay their way and trade forward profitably.

“Now is the time for the Government to take decisive action to help improve access to equity finance and restore financial stability to the sector,” said IHF president Tim Fenn. “This issue cannot be allowed to fester and jeopardise future growth and job creation in the wider tourism industry. If we don’t act now, we’ll be picking up the pieces of a failed tourism industry in five years time.”

Irish tourism is reckoned to provide 11% of the country’s jobs and to deliver EUR1.3bn of tax revenues a year. Average room rates in Ireland are now EUR72, down from a 2007 peak of EUR97, while occupancy last year averaged 61.4%.

Alongside the debt restructure, Ahearne also recommends an existing employment and investment incentive scheme to cover hotels; a hotel restructuring fund supported by national pension reserves and state asset sales; and the establishment of a fund allowing foreign equity investors access to the market without the need to own single assets.

On a positive note, the bank reports notes some losses have already been booked, as banks were obliged to sell bad loans to NAMA. “This transfer of assets to NAMA meant that the participating institutions were forced to crystallise credit losses at an earlier stage than perhaps otherwise would have been the case. As noted from other crises, loss recognition is one of the key actions needed to resolve banking crises.”

“Irish banks entered the crisis with a concentrated exposure to property-related lending funded by short-term wholesale funding. Supervisory shortcomings combined with poor internal credit risk management further increased the vulnerability to credit risk.”

As for the future, the bank report believes Ireland is constrained in the actions it can take to resolve the crisis at the macro level. Being part of the eurozone, there is no option to devalue currency, while Ireland relies largely on external trade with its currently depressed European neighbours, in order to generate greater GDP income.

HA Perspective: Ouch. The report’s authors conclude: “Past episodes of systemic distress indicate that Irish real property prices, both residential and commercial, may take a significant number of years (ranging from 11 years to 22 years) to recover fully, although the start of the period of adjustment pre-dates the economic downturn in all cases.”

Back in 2009, the IHF argued that around 15,000 rooms needed removing from the country to reduce supply imbalance. This latest report is a good deal more positive in terms of action it would like but the conclusions of the earlier report still stand. Until demand revives significantly, which looks unlikely in the near term, Ireland’s hotel market looks grim.
Host affirms European interest

Host Hotels has bought five European hotels, through its European joint venture vehicle in a EUR440m deal.

The transaction, conducted via its joint venture vehicle in which the company has a one third interest, was agreed with seller Whitehall, a Goldman Sachs investment fund.

As a result, Host now has an interest in the Renaissance Amsterdam, and four Paris hotels: the Marriott Rive Gauche, Renaissance Paris La Defense, Renaissance Paris Vendome and Courtyard Paris La Defense West – Colombes. The purchase has been part-funded with a EUR250m loan secured against the properties, which has an interest charge of approximately 4.4%.

The company underlined the logic of its purchases in a statement: “Paris has some of the strongest market fundamentals in Europe with high barriers to entry and historically strong revpar growth. Amsterdam is a key commercial hub in Europe that consistently ranks among the highest revpar markets in Europe.” Host says the price represents less than replacement cost.

Whitehall has held the hotels since before the last peak of the market, having bought three of the properties from Marriott in 2006. The purchase was tipped in a recent quarterly results conference call, during which Host president Ed Walter revealed that further judicious investment in Europe was under consideration.

Quizzed by analysts about how he was going to use cash proceeds to deliver value, Walter commented: “I think right now, it’s really going to be driven by what looks to present the best opportunity. We’re still looking in Europe, and our partners are still very interested in buying there. We’re not seeing much competition, and we appear to be one of the few firms there that can access financing.”

A recent issue of loan notes has given Host access to its cheapest ever money, at a 4.75% coupon, while recent loan renewals have been at 2%, giving a weighted average cost of funds of 3.7%. And the company expects to complete around USD300m of sales this year, or by early 2013.

During the most recent quarter, in a preface for its December transaction, Host invested EUR10m into the Le Meridien Grand in Nuremberg. Once again, the investment was through the joint venture fund, in which Host holds a 33.4% stake. Walter said the hotel was well placed to profit from leisure, corporate and convention business. “It represents one of the major trade fair destinations in the country.”

And the company’s current European investments – 14 hotels in which Host has the same minority interest – are largely continuing to deliver good returns. “Our European joint venture operating results continue to exceed our expectations,” said executive vice president Larry Harvey. Revpar was up 4.1% in the quarter in constant euros, with ebitda up over 9% “Inbound travel to the Eurozone continues to be strong and a major source of Euro lodging demand.” Hotels in Barcelona, Warsaw and Brussels saw strong revpar improvements, while Milan suffered. To date this year, European revpar is up 3.8%.

Walter said the company was also keeping a close eye on opportunities in Brazil and Asia, should opportunities arise. Host currently has an interest in one Australian hotel, and a joint venture developing seven hotels in India, of which two are currently open.

Across the Host portfolio, revpar increased 7.6%, thanks to both rate and growth in occupancy to an average 78.4%. While recent revpar figures have been weaker, and the forthcoming quarter will have a number of awkward holiday dates making performance unpredictable, the company has increased its guidance for the year end.

HA Perspective: During its third quarter conference call Host said it had competitive advantage in Europe as it had funding and there was little competition. This latest deal shows how true that is.

Because of its liquidity, Host’s European JV is proving attractive to both vendors and debt financiers. Vendors like the certainty it offers and lenders are, according to Host, offering LTVs in the 50% plus range it wants and at interest rates its finds attractive – sub 4%.

Host remains understandably cautious on Europe given the continent’s economic outlook but now is probably one of the best opportunities to go into the market and acquire good assets as there is likely to be in a generation.

Chinese downturn spooks Hyatt and Starwood

Weaker international demand knocked the froth off third quarter figures from both Hyatt and Starwood, while the modest flattening in home market growth fed through as expected.

While the battle for the US presidency might have been front of mind at home, it is a change in Chinese leadership that is troubling the chief executives at the pair of hotel companies.

“Some things worked well in the quarter and a few areas faced challenges,” said Hyatt president Mark Hoplamazian. While at Starwood, CEO Fritz van Paasschen argued that “the case can be made that the current deceleration is a temporary pause in growth.”

Three factors worked against the third quarter figures, said Hoplamazian. First, awkward holiday timings this year, versus 2011; second, some one-off expenses down to tax and renovations. Thirdly, weaknesses in performance in some international markets were further exacerbated by currency movements.

“Outside of North America, our international owned and leased hotels have been relatively weaker in a number of markets, with the exception of London, which benefited from the summer Olympics,” he advised.

Specifically, Seoul, Zurich and Baku were mentioned. “The market is weaker in India, partly due to new supply and partly due to economic conditions. In China, we’re seeing uneven performance across markets.”

“Revpar performance is expected to be weaker in China given the political changes,” added CFO Gebhard Rainer. “In addition Beijing has seen a drop in corporate business which has been postponed until after the elections. We’ve seen tightening of government spend, particularly in the south of China. Once the election is over we anticipate corporate demand will return to more normalized levels. In India, revpar was also weak due to additional supply and the decrease in demand as a result of slowing economic growth. Most markets are not expected to see rate increases as a result of increased supply near term such as Mumbai and Delhi.”

In its home market, Starwood drove domestic revpar up just over 5%. But abroad, growth is slackening: “During the quarter, the euro situation grew more tenuous. Revpar was up 3%, helped somewhat by the Olympics and an early Ramadan,” said van Paasschen. “In Asia, our revpar growth eased to 4.3%, with business in China held back by weaker exports, uncertainty about the new government and tighter monetary policy.”

One area where van Paasschen believes Starwood has extra traction is in developing new markets.
brands. Alot, he noted, is just four years old but is well on the way to a 100 hotel target by end 2014. Its growth averaging 15 hotels a year contrasts with Hyatt Place, which has an equivalent growth of just four hotels a year.

Starwood has set its full year expectations for a revpar increase of 5-6% for operated hotels, and 3-4% for owned hotels.

HA Perspective: The news at the tail end of 2012 about China has generally been more positive than what came out in the third quarter. A Chinese hard landing, at least in the near term, looks unlikely.

There is further good news in that China’s so-called rebalancing of the economy away from industry and towards consumption is likely to disproportionately favour hotels.

China’s economy should not be the primary cause of worry for either Starwood or Hyatt, rather it is seeing off the challenge from other international rivals such as InterContinental and Marriott who have established a strong presence in what is already the world’s second biggest economy.

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**PPHE eyes up asset split**

Hotel group PPHE is considering sweating its hotel property assets, as a way to help support its growth.

The company, which operates Park Plaza and other brands across Europe, has spent the recent past clearing up its portfolio, branding and ownerships in order to make a strategic move easier to accomplish.

An interim statement released to the London Stock Market, as the company revealed strong Q3 figures, suggested that PPHE management will have more to say about their plans in March, when full year figures are announced.

PPHE runs 25 hotels comprising around 5,500 rooms, across Europe, of which it owns a significant number. These include seven Park Plaza branded UK hotels and five in Holland, where the company bought out its joint owner during the last year. There are also pipeline openings in both London and Amsterdam for the art’otel brand.

Alongside the owned portfolio, PPHE also manages the Park Plaza at County Hall, London, and leased art’otels in Germany and Hungary. And in addition to the pipeline projects, there are also development sites in west London and Thailand, where hotels are in planning. And PPHE also has an interest in Croatian associate Arenaturist.

The representation of the Park Plaza brand is subject to a long term agreement with Carlson Rezidor, the brand’s owner. But in a hint that the company wants to move away from exclusively concentrating on the single brand, there was a corporate name change in March this year from Park Plaza Hotels to PPHE.

Also in March, PPHE bought out its 50% joint venture partner in four Amsterdam hotels, paying Elbit Imaging EUR26.5m to take control and provide greater flexibility for the future.

The issue for PPHE is that its shares are trading at a substantial discount to the company’s net asset value, with the discount recently being around 50%. Edison Investment Research recently pointed out in a paper on the company: “PPHE owns trophy assets in strong gateway cities such as London and Amsterdam, the lure of which is enduring and should not be underestimated.”

The company is running with debts at EUR477m in the first half of 2012. Against this, PPHE has an estimated value of EUR575m, though Edison suggest that the historical valuations of both London and Amsterdam properties may be lower than current market prices for trophy hotels in these popular cities.

Current performance is strong, with the third quarter seeing revpar up 16%, helped by strong numbers particularly from the London hotels. Revenues for full year 2012 are pencilled in at EUR234.7.

HA Perspective: It is slightly over-eggings things to describe PPHE as having trophy assets but they are, largely, high quality upscale properties with a good exposure to London.

The massive Westminster Bridge property, at 1,019 rooms, has helped put the group firmly on the map. This property was financed through a buy-to-let room scheme which has seen 535 rooms sold.

Quite how this innovative approach at Westminster Bridge will work out remains to be seen but more conventional approaches seem likely to be adopted for the owned assets it is looking to divest.

Previously, PPHE has been fond of leases. In the current climate a sale and manage back seems more probable. Given that the company is dealing with 500 or so owners at its Westminster Bridge property, having a few more owners, albeit ones with a somewhat bigger economic interest, should leave it unfazed.

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**Fresh start for Malmaison?**

Hotel brands Malmaison and Hotel du Vin are up for sale following the appointment of administrators at parent MWB Group.

The move will put into play a total of 26 hotels under two brands, with 1,900 rooms across the UK. Media reports suggest a private equity buyer may be close to agreeing a deal.

Division chief executive Gary Davis has insisted it is business as usual, talking up expansion plans which include additional Hotel du Vin openings and a refurbishment plan for key Malmaison properties such as its Manchester hotel.

The administration relates to an internal loan between MWB Group and 75% owned subsidiary Business Exchange. A repayment of GBP4.8m was not made as scheduled, bringing internal management issues to the fore and requiring external involvement from Deloitte to resolve the dispute.

With the cash shortfall, and existing lenders appearing to lose patience, a company statement explained: “The company is, or will shortly be, unable to meet its liabilities as they fall due and the board of the company has concluded that the appointment of administrators is the most appropriate course of action.”

Malmaison currently operates from 12 properties, with a thirteenth scheduled to open in summer 2013 after the complete renovation of the Tay Hotel in Dundee. The group specialises in providing a boutique hotel feel exploiting quirky, historic buildings such as its Oxford property, which is converted from a former prison.

The Hotel du Vin brand operates from 14

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properties in provincial British locations, with each hotel also featuring a distinctive food and beverage operation in the form of a French style restaurant and bistro.

The hotel operation has sought to distance itself from problems at the parent, with a November trading statement declaring sales and profits ahead 14% in the most recent quarter.

Said Davis: "The Malmaison and Hotel du Vin businesses have great brands and we continue to invest in the estate. Both businesses have performed well this year, and we continue to see improvements in trading. Occupancy continues to improve with resilient room rates, and recent management initiatives continue to deliver growth and margin improvements.”

Davis also pointed to development plans for Hotel du Vin that could add a further 12 hotels over the next three years. The St Andrews golf hotel is scheduled to join the portfolio, while additional locations being scoped out include London, Stratford on Avon and Oxford. For Malmaison, Davis has Bristol and York in his sights.

In 2011, funding issues within the parent MWB and at Malmaison forced the sale of four Malmaison properties, which were then leased back. The deal released GBP86.8m in cash, selling the London hotel to German fund DEKA, and hotels in Birmingham, Newcastle and Manchester to Legal and General.

HA Perspective: The prediction by Pyrrho Investments, the Hong Kong based investment fund and a near 25% shareholder in MWB Holdings, that MWB would become a forced seller of key assets to pay down expensive debt has not come true. Instead, something worse has happened and all assets are set to go in a fire sale by administrators.

The whole MWB story does not look pretty. Whether Pyrrho's preferred option of it injecting more equity into the business 18 months ago rather than take on an expensive refinancing would have saved the hotels business is a moot point. A point that Pyrrho now hopes the Financial Services Authority will look into alongside its allegations of poor corporate governance.

There is certainly plenty for the FSA to keep busy investigating, given the complexity of the intra-company arrangements between MWB Holdings, the owner of MWB Malmaison, and MWB Exchange, which is also controlled by MWB but has minority shareholders including Pyrrho which has an 11.57% interest.

In the meantime, the Malmaison and Hotel du Vin businesses are looking for new owners. The businesses include attractive assets but the recent sale and leaseback will not help secure a good price.

Observers await Strategic move

Following the sudden announcement of the retirement of Strategic Hotels chief executive Laurence Geller, speculation continues about the future direction of the company.

Shares in Strategic spiked 13% following the news, as speculation about a possible bid excited analysts.

Analysts are suggesting the group could be a target for buyers including Host Hotels & Resorts, or other private equity investors.

And comments during a conference call in early November by incoming CEO Rip Gellein have helped keep the idea alive, as Gellein declined to comment directly on whether Strategic is considering a sale.

The news that Geller, the founder of Strategic, was stepping down was made at the beginning of November. The company announced Gellein as his replacement, adding that Geller will stay on to advise until the year end.

"It has been an immense source of pride over the last 15 years to have founded Strategic Hotels and to have worked with a terrific team to build not only the acknowledged best high-end lodging portfolio, but also the most admired asset management organisation in the industry," said Geller. "We have emerged from the recession a strong company with great assets well positioned for sustained growth in a virtually no-supply environment.”

Geller retains a significant shareholding in Strategic, which is established as a US REIT and owns 18 hotels, mainly large venues that run under major brand flags. The company also has interests in Europe.

The details of Geller’s severance agreement with the company restrict him from making a bid for all or parts of the company for a period of 18 months. While permitted to work for another hotel company, Geller is also prevented for one year from hiring Strategic staff.

In September, Strategic completed the purchase of the JW Marriott Essex House in New York for USD362.3m, joint venturing with KSL Capital Partners to fund the acquisition. Last April, Strategic tapped the market, issuing more shares in a transaction that netted around USD100m of additional cash into the business.

During 2011, Strategic reported total revenues of USD193.9m at its hotels, declaring a net loss of USD23.7m on operations. Debt was reduced to USD1bn from USD1.1bn the previous year, while hotel assets were in the books at a value of USD1.69bn.

One take on Geller’s time steering Strategic came from analyst William Crow at Raymond James & Associates, who commented in a research note: "Geller was hardly perfect as CEO, and the company’s aggressive, debt-fuelled, high multiple acquisition binge prior to the unprecedented 2008-09 industry downturn pushed the company to the very edge of survivability. Today, the company is well-financed and that same portfolio – plus a few more recent additions – has generated some of the best top- and bottom-line growth in the industry.”

Plain-speaking Geller, who was awarded a CBE of the queen’s New Years honours at the beginning of 2012, is set to continue a growing interest as an author. His second novel, titled The Last Resort, is just being published.

HA Perspective: The departure of Geller has firmly tipped Strategic into takeover target territory. The big attraction for buyers is the arbitrage between what the assets are worth privately and what they are worth in the corporate wrapper.

In the case of Strategic the gap is particularly big. On a net asset value basis its shares should be worth around USD10 but currently Strategic’s share price is only just over USD6.

Whether this marks the start of another round of privatisations is doubtful. There may be a few take outs but the difficult debt markets mean that trade buyers are just as well positioned as the traditional private equity acquirers.

But buyers are likely to be deterred by the volatile cash flow issues at Strategic. As the company’s third quarter results showed, it is still making a net loss, albeit smaller than last year at USD8.6m compared to USD11.9m.

Until trading settles down and until the debt markets return to life, big portfolio deals are likely to remain few and far between.
The International Hotel Investment Forum (IHIF) brings the hotel industry together in a first-class location to deliver the very best educational programmes, outstanding networking opportunities and the most senior level professionals from all areas of the industry. It has firmly established it’s reputation as the leading and most important meeting place in the world for the industry.

Over 1700 people now attend. However, it’s not just the number of people that attend that’s important, what sets IHIF apart is the seniority of the delegates. IHIF attracts more world-wide Investors, Owners and Hotel Chain CEOs than any other event.

Whatever section of the hotel industry you are in, the IHIF will introduce you to people who can open up business opportunities and partnerships for you.

“It (IHIF) is a very good way of meeting Investors in the industry... I am looking to continue the expansion of my business and this is one of the main reasons I come here”

SIR ROCCO FORTE
CHAIRMAN, ROCCO FORTE HOTELS

“This is a conference where business gets done. It’s extremely well run and the people who attend are first-rate. I come to this event to get in touch with the industry and to meet with our stakeholders and investors.”

FRITS VAN PAASCHEN
PRESIDENT & CEO, STARWOOD HOTELS & RESORTS WORLDWIDE

IHIF paints a picture of the year ahead

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Quoted hotel brand owners: improving the potential

Are the brands really delivering value? Paul Slattery and Ian Gamse of Otus & Co investigate

Introduction

For 10 years when I was an equity analyst, my colleagues and I produced an annual book on publicly quoted hotel companies, the last of which was published in 1996. At that time there were 51 publicly quoted hotel companies with hotels in the UK alone, today there are only 25. The intervening years have produced substantial changes to the corporate landscape of the hotel business in Europe and elsewhere producing both progress and regression. Here we will examine the patterns of development by the chains in the prime European economies, which is the progress, after which we will examine the wider performance implications, which is where the regression resides.

The UK

At the end of 1995 there were 430,000 hotel rooms in the UK of which 175,000 were affiliated to hotel chains, a concentration of 41%. Among the hotel chains 51 were publicly quoted brand owners with room stock of 125,000. The remaining 50,000 chain rooms were in private companies that generally were smaller than the quoted chains.

Today there are around 530,000 hotel rooms in the UK of which 332,000 are affiliated to hotel chains, a concentration of 63%. Only 25 publicly quoted brand owners now have hotels in the country with room stock of 151,000. Broadly, the number of companies halved, but their room stock increased by 20%.

The quoted major brand owners have materially increased their presence as Table 1 shows. At the end of 1995, Accor had 4,500 rooms and now accounts for 24,600. IHG had 5,000 and now has 38,600. Marriott had only 370 rooms, but now has 11,400 rooms, while Starwood has doubled its room stock to 2,600 and Choice Hotels added 2,500 rooms to reach 2,900. Hilton was taken private when it was acquired by Blackstone in 2007.

Take private, exits from the hotel market and company break-up removed 37 of the 51 quoted hotel brand owners including Four Seasons, Jurys, Queens Moat Houses, Savoy and Societe du Louvre; Granada, Lonrho, Vaux, Greenall and Friendly as well as Ladbroke (Hilton Group) and Stakis.

Only four of the current British quoted companies: Millennium & Copthorne, Peel Hotels, which is listed on the AIM market, Mitchells & Butler, the managed pubs spin-off from Bass, which owns the Innkeepers Lodge brand and JD Wetherspoon the pub company with 600 hotel rooms all came to the market over the period. Additionally, another six quoted brand owners from other countries entered the UK market over the period including: Hyatt, Melia, and Orient Express Hotels.

By far the fastest growth in quoted brand owners was Whitbread, which grew from 9,700 rooms to 45,000 Premier Inn rooms despite the sale of its 8,100 upmarket Marriott franchised rooms in 2007.

Private chains grew from 50,000 rooms to 181,000 boosted by the consolidation of unaffiliated hotels and refugee hotels from quoted chains. The largest boost came from the take private of Travelodge, which grew its UK room stock to 33,000 rooms before its traumas in 2012. The growth in quoted and private company room stock over the period resulted in the decline in unaffiliated rooms from 255,000 to 198,000.

France

At the end of 1995 there were 550,000 hotel rooms in France of which 170,000 were affiliated to hotel chains, a concentration of only 31%. Among the hotel chains 13 were publicly quoted brand owners with room stock of 139,000. The remaining 31,000 chain rooms were in private companies that were smaller than the quoted chains.

Table 1: Quoted Major Brand Owners UK 1995 to 2011

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<tr>
<td>Accor</td>
<td>4,400</td>
<td>24,600</td>
<td>20,200</td>
<td>11%</td>
</tr>
<tr>
<td>Choice</td>
<td>335</td>
<td>2,890</td>
<td>2,555</td>
<td>14%</td>
</tr>
<tr>
<td>Hilton</td>
<td>8,710</td>
<td>0</td>
<td>-8,710</td>
<td>n/a</td>
</tr>
<tr>
<td>Hyatt</td>
<td>0</td>
<td>1,030</td>
<td>1,030</td>
<td>n/a</td>
</tr>
<tr>
<td>IHG</td>
<td>5,000</td>
<td>38,600</td>
<td>33,600</td>
<td>14%</td>
</tr>
<tr>
<td>Marriott</td>
<td>370</td>
<td>11,400</td>
<td>11,030</td>
<td>24%</td>
</tr>
<tr>
<td>Starwood</td>
<td>1,300</td>
<td>2,600</td>
<td>1,300</td>
<td>4%</td>
</tr>
<tr>
<td>Wyndham</td>
<td>0</td>
<td>10,400</td>
<td>10,400</td>
<td>n/a</td>
</tr>
<tr>
<td>Total</td>
<td>20,115</td>
<td>91,520</td>
<td>71,405</td>
<td>10%</td>
</tr>
</tbody>
</table>

Source: Kleinwort Benson and Otus & Co Ltd

Table 2: Quoted Major Brand Owners France 1995 to 2011

<table>
<thead>
<tr>
<th>Chain</th>
<th>1995</th>
<th>2011</th>
<th>Change</th>
<th>CAGR %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accor</td>
<td>82,776</td>
<td>135,500</td>
<td>52,724</td>
<td>3%</td>
</tr>
<tr>
<td>Choice</td>
<td>8,189</td>
<td>7,320</td>
<td>-869</td>
<td>-1%</td>
</tr>
<tr>
<td>Hilton</td>
<td>1,700</td>
<td>0</td>
<td>-1,700</td>
<td>n/a</td>
</tr>
<tr>
<td>Hyatt</td>
<td>0</td>
<td>640</td>
<td>640</td>
<td>n/a</td>
</tr>
<tr>
<td>IHG</td>
<td>2,500</td>
<td>7,540</td>
<td>5,040</td>
<td>7%</td>
</tr>
<tr>
<td>Marriott</td>
<td>0</td>
<td>3,460</td>
<td>3,460</td>
<td>n/a</td>
</tr>
<tr>
<td>Starwood</td>
<td>380</td>
<td>2,203</td>
<td>1,823</td>
<td>12%</td>
</tr>
<tr>
<td>Wyndham</td>
<td>0</td>
<td>230</td>
<td>230</td>
<td>n/a</td>
</tr>
<tr>
<td>Total</td>
<td>95,545</td>
<td>156,893</td>
<td>61,348</td>
<td>3%</td>
</tr>
</tbody>
</table>

Source: Kleinwort Benson and Otus & Co Ltd

Table 3: Quoted Major Brand Owners Germany 1995 to 2011

<table>
<thead>
<tr>
<th>Chain</th>
<th>1995</th>
<th>2011</th>
<th>Change</th>
<th>CAGR %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accor</td>
<td>17,981</td>
<td>43,438</td>
<td>25,457</td>
<td>6%</td>
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<tr>
<td>Choice</td>
<td>2,847</td>
<td>3,207</td>
<td>360</td>
<td>1%</td>
</tr>
<tr>
<td>Hilton</td>
<td>3,014</td>
<td>0</td>
<td>-3,014</td>
<td>n/a</td>
</tr>
<tr>
<td>Hyatt</td>
<td>0</td>
<td>1,471</td>
<td>1,471</td>
<td>n/a</td>
</tr>
<tr>
<td>IHG</td>
<td>7,200</td>
<td>14,467</td>
<td>7,267</td>
<td>4%</td>
</tr>
<tr>
<td>Marriott</td>
<td>1,475</td>
<td>7,115</td>
<td>5,640</td>
<td>10%</td>
</tr>
<tr>
<td>Starwood</td>
<td>1,869</td>
<td>7,404</td>
<td>5,535</td>
<td>9%</td>
</tr>
<tr>
<td>Wyndham</td>
<td>0</td>
<td>55</td>
<td>55</td>
<td>n/a</td>
</tr>
<tr>
<td>Total</td>
<td>34,486</td>
<td>77,157</td>
<td>42,671</td>
<td>5%</td>
</tr>
</tbody>
</table>

Source: Kleinwort Benson and Otus & Co Ltd
Today there are around 612,000 hotel rooms in France of which 288,000 are affiliated to hotel chains, a concentration of 47%. 16 publicly quoted companies have hotels in the country with room stock of 165,000. Broadly the number of publicly quoted brand owners has increased by three and their room stock increased by 20%.

At the end of 1995, only four of today’s quoted global major brand owners had a presence in France. Accor had 82,800 rooms, 15% of all French rooms and now accounts for 135,500 increasing their dominance to 22% of all rooms. IHG has 2,500 rooms and now has 7,500. Starwood has grown from 380 rooms to 2,200 and Choice Hotels has shrunk by almost 900 rooms.

Seven of the quoted brand owners in 1995 are no longer on the scene: the Japanese owner of Intercontinental Hotels, Seibu Saison; Granada, Ladbroke, Queens Moat Houses, Jolly Hotels, Friendly Hotels and Arcadian Hotels. Over the period, 10 quoted companies entered the French hotel market including: Marriott, Hyatt, Wyndham, Millennium & Copthorne, NH Hotels, Melia, PPHE, Tui, Regent and Mandarin Oriental.

Over the period, private company room stock more than doubled to 134,000 and unaffiliated room stock fell to 289,000.

**Ineffective European portfolio growth**

Portfolio growth achieved by hotel chains and in particular quoted brand owners is a natural progression in the economic ascent of the hotel business worldwide. However, their penetration is patchy. For instance, over the period from 1995, Marriott and Choice Hotels each added six times as many rooms in the US than in Europe to achieve 10% and 8% respective share of all hotel rooms in the US, but only 1% market share each in Europe. After the sale of Motel 6, Accor has been left with only a token presence in the US, but it has 5% share of all hotel rooms in Europe, the highest of any chain. With the exception of Accor in France, where it accounts for 22% of all hotel rooms, the global majors are too small to have power in the market in any European country.

The position of the quoted major brand owners is weak in Europe relative to the US. Assuming no net additions to room stock in Europe and to mirror in Europe their current market share in the US, Choice Hotels would need to add 400,000 rooms in the region, Hyatt would need another 100,000, IHG 350,000, Marriott 480,000, Starwood 130,000 and Wyndham 480,000. On their current strategies these numbers are pipe dreams. More so, their smaller size in Europe narrows the performance differential between the global majors and the other chains in Europe.

**Ineffective demand generation**

It is an article of faith that the larger the hotel chain, the greater the capacity to generate premium demand because larger brands have greater visibility in the market place and greater investment in generating demand. The prime reason why the volume of unaffiliated hotels has declined continually over the past century is their inability to generate premium demand. Conversely, the progressive ability of hotel chains to grow their portfolios has enabled them to achieve higher demand than unaffiliated hotels.

The largest chains, the global majors, have for the past two decades pursued portfolio expansion as a priority through management contracts and franchises. They, like others in the business have used RevPAR as the key metric to illustrate their prowess in demand generation. However, amid all of the problems of defining, managing, comparing and using RevPAR analytically, it is not an effective metric to judge the performance of quoted major hotel brand owners because of the pattern of configuration of their hotels illustrated in table 4.

RevPAR is only concerned with rooms demand yet, as table 4 shows, for the quoted major brand owners, their European rooms are mostly housed in extended feature, full feature and classic feature hotels which are characterised by heavy non-rooms facilities: restaurants, bars, health clubs, conference rooms retailing and other facilities. Broadly, Hyatt, Marriott and Starwood have all of their European rooms in non-rooms heavy hotels. IHG, Wyndham and Choice have three quarters of their European rooms in non-rooms heavy hotels and the pattern elsewhere in the world is not dissimilar. The focus on RevPAR means that shareholders and others have no idea of how well the chains perform in generating non-rooms demand. This is important since the operating margin in non-rooms facilities can range typically from negative to very low double digits. On the other hand, rooms demand typically achieves operating margins north of 50%. The lower the demand for restaurants, bars, health clubs, conference rooms and retailing in non-rooms heavy hotels the more sharply that the return on investment is dragged down.

RevPAR tells only part of the demand story in each European economy because the pattern of hotel demand is different in each case. In the UK, two thirds of all chain rooms are in non-rooms heavy hotels, in Germany there is 79%, but in France only 41%. The congruent demand for non-rooms heavy hotels is packaged conference and packaged leisure demand, however in several countries, notably in the US and the UK, the trend over the past 20 years has been for transient rather than packaged demand, which is why the weight of new hotel development has been in the non-rooms light, limited feature and rooms only hotels. The challenge for many chains is that...
their portfolios do not reflect this trend, which is structural rather than cyclical. Most of the major chains have hotels with extensive non-rooms facilities when the major demand shift is away from non-rooms facilities. In short, the pattern of hotel configuration is out of kilter with the realities of hotel demand.

**Ineffective operating margins**

Generally, the larger the hotel chain, the higher the potential to buy consumables more effectively and to achieve higher labour productivity, but when the mass of rooms in chains are in non-rooms heavy hotels and the demand trend is towards non-rooms light hotels the achievement of high operating margins in the non-rooms heavy hotels becomes a challenge. The poorest demand is into the restaurants, bars, health clubs, conference rooms and retailing, which need higher numbers and cost of employees and higher volumes of consumables than renting bedrooms. When the lower operating margin parts of the business receive sub-optimal demand the return on investment in the hotel is materially impacted.

The focus by the chains on RevPAR alone as the measure of their demand generation has deflected attention from the shift in hotel demand away from non-rooms facilities and the poor delivery of non-rooms demand into hotels. The response by hotel owners to this impasse has been to engage hotel asset managers to police the hotel chains into maintaining demand and cost targets as an attempt to achieve operating margins that can get closer to delivering effective returns on investment for the owners. Chains with management contracts are just not trusted by the hotel owners to deliver effective returns on their own.

**Insufficient access to capital**

There are three prime sources of equity for hotels: the stock market, hotel owners and idiosyncratic sources.

The stock market is the senior source of equity and it is no accident that most of the larger and most maturely managed chains are publicly quoted. The stock market is also a source of capital that has to all intents and purposes been closed to hotel companies. There has not been a rights issue by a quoted hotel chain to make an acquisition for about two decades. Rather than being a source of capital for hotel chains the stock market has becomes a destination for the free cash flow of hotel chains. IHG has returned circa £3 billion to shareholders and has announced another $1 billion to come. Whitbread has returned around £2 billion to its shareholders over the past 15 years. Marriott and Hyatt are among others, which have bought back and cancelled their own shares frequently over the past decade to boost their earnings per share and dividend per share. We have got to the stage that it has become commonplace for equity analysts to estimate how much cash companies might be able to give back to shareholders and how many shares the company might buy back. Essentially, the hotel chains are saying that their main boards cannot think of any investment in the hotel business that will produce an effective return for their shareholders and that it is the best policy to give their capital back to shareholders for them to find better investments in other industries.

Consequently, the focus on capital access by the global majors has turned from the stock market to hotel owners, which is entailed in their almost exclusive concentration on management contracts and franchises rather than owning or leasing hotels. The rush for fast portfolio expansion inevitably raises questions about the fees that hotel chains raise for management contracts and franchises. The suspicion is that the rush for high volume expansion has produced low franchise fees and high hurdles in achieving incentive payments in management contracts. The suspicion is propelled by the reporting of a significant majority of managed hotels whose performance does not reach the hurdle to trigger incentive payments to the brand owners. Thus, the fee potential from these hotels is minimised to around 2% of hotel turnover.

The mass of other hotel chains, more than 900 in Europe alone, are not publicly quoted and have insufficiently strong brands to persuade hotel owners to enter into management contracts for the chain to run their hotels. These short chains typically rely on idiosyncratic equity from their private owners and from hotel owners willing only to lease their hotels to the chains. Not only do these hotel chains have the least access to capital, but also are the slowest growing. Those which have pursued portfolio expansion have done so through leasing, the most problematic affiliation for hotel chains of which the Travelodge debacle in the UK is a stark example. It is the form affiliation to which most of the quoted major chains have minimised their exposure and Accor, which has more leased hotels than its competitors, has committed itself to minimising its leases by 2016. Other large chains such as Carlson Rezidor have also embarked on an initiative to minimise its exposure to leases.

**Conclusions**

At first sight the portfolio growth of the quoted major hotel brand owners looks impressive, but the opaqueness of their total demand generation, the absence of trust by hotel owners in the major brands to produce premium operating margins on their own and in the lack of trust by shareholders in the main boards of quoted companies to manage free cash flow are all examples of impediments resulting from the operating practices of the quoted chains.

The shareholders of quoted hotel chains have been reluctant to rate hotel shares at a premium despite fast portfolio growth, cash returns to shareholders and share buybacks. An insight into the extent of shareholder reluctance can be seen in the relationship between quoted major hotel brand owners and online travel agencies. In real life their relationship about hotel demand generation has often been fractious, but it has been played out differently in the stock market. The online agencies have won hands down. Priceline, the online travel agency established only in 1997 has a market capitalisation of $32.6 billion, 2.7 times that of Marriott International, the hotel chain with the highest market cap.

To make more effective progress the major quoted brand owners will need to be much more creative in their overall approach: in the categories of hotels they develop and where, in their reporting of total hotel demand, in their strategies to improve operating margins and in the performance that will enable them to raise new equity from the stock market to enable them to participate in the inevitable consolidation among hotel chains. It is a tall order, which the winners will not ignore.

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Holmes’ flexible approach to hotel success

Lesley Reynolds, CEO of Portfolio International, meets Charles Holmes, CEO of Four Pillars Hotels

Four Pillars Hotel Group is a collection of six 3 and 4 star hotels in the Cotswolds, Thames Valley, Oxford and Bristol. Whilst many regional hotel companies have reported bumpy results in 2012, Four Pillars is on an upward trajectory, optimistic about the future and looking to expand.

LR: The old adage location, location, location has proven as successful an indicator for hotel performance as any…. How important has this factor been in the performance of Four Pillars Hotels this year?

CH: Yes, of course location is important, but it is not the be all and end all. You still need a great team of people to operate a successful hotel who have a clear understanding of the objectives of the business are incentivised to succeed and really enjoy what they are doing. The growth that we have seen in our business not only this year but for the past three years has been achieved by the people every bit as much as the locations.

LR: What specific strategies have you adopted to drive your success this year?

CH: Nothing that we haven’t done in previous years. I am a great believer in getting back to basics and “sticking to the knitting”. Hotel keeping is just like the banking industry, education or the health service – they are very simple, straightforward businesses, which over the years people have managed to make very complicated, with the end result that they all have confused and frustrated customers. Our strategy, therefore, is to be transparent, to offer our customers great value for money and not to hide all the little add-ons that really annoy and frustrate people. If you book a bedroom at a Four Pillars hotel, your car parking is free, wi-fi is free, there is no charge for using a credit card, breakfast is a full English and our customers consistently tell us that this is what they like – great value and transparency in all that we do. Nothing difficult – just the application of common sense and all delivered with a smile.

LR: Your hotels are strategically located in or on the edge of key provincial cities where there is real potential for corporate, meetings and leisure business. How has this mix changed this year, and how have you adapted to suit this market opportunity?

CH: Over the past twelve months, we have seen a very strong upturn in our corporate business, at the expense of the residential meetings and events market. 40% of our business is leisure and to maintain that level, we have had to work very hard with other third parties. There is no doubt about it, private individuals, spending their own money, are looking for ever greater value and we are finding that a lot of our leisure customers are younger than they were five years ago, with different requirements. The traditional “dinner, bed and breakfast” package for the leisure market is all but dead and buried. So we have certainly had to look at our food and beverage offering to be competitive against other third party operators in the local high street.

LR: From a marketing standpoint, are your properties responsible for their own local marketing and how much are they supported centrally as part of Four Pillars Group?

CH: Each hotel adopts responsibility for its own food and beverage marketing as their target markets do vary quite substantially, whereas the vast majority of our rooms marketing is controlled centrally. This works very well for us, as our F&B management teams have real ownership of their product offering and take great pride in growing their sales year on year.

LR: You have indicated that you would like to expand – what are the issues that will underpin this?

CH: We can buy whatever we want subject to the availability of the necessary funding, but even if we had access to a bottomless pit of money, we would be very picky about what we acquire or, for that matter, build. We are a niche operator in the Cotswolds and Thames Valley and I still believe there are some great opportunities within our traditional marketplace. We are certainly not in the business of paying top prices for other people’s hard work but will, moving forwards, be very interested in acquiring where, through good management, we can create and add value. We will always stick to what we know and what we know we can be successful at.

Charles Holmes – insider information
Favourite gadget: Two, actually – pen and paper
Holiday destination: Again, two – Spain for sunshine and Yorkshire Dales for communing with nature and walking
Website: Two, again – Pistonheads and Rightmove (trying to find a house with a big enough garage for all the cars)
Best book or film: Local Hero
Favourite hotel: Such a difficult question, but ultimately, it would have to be The Chester Grosvenor. It just oozes efficiency and warmth

Lesley Reynolds is chief executive of Portfolio International
lesley.reynolds@portfoliointl.com

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New sources of investment funding are emerging, says Timothy Jones of Colliers International

Alternative sources of finance: filling the gap?

The regulatory pressure faced by European banks has forced them to start rebalancing and reducing assets, especially their exposure to real estate. While this process is likely to remain a protracted one across Europe (a scenario where large volumes of assets are simultaneous dumped on the market is yet to play out) the retrenchment of traditional players in the sector is leaving a large and widening gap.

In the UK, monetary financial institutions’ outstanding sterling loans to the UK real estate sector have fallen by £44bn from Q1 2012 to Q3 2012. This comes at a time when the UK commercial real estate debt maturity profile points to a significant refinancing requirement over the next three years (£112bn, 2012-2014). This situation is replicated across Europe where not only are traditional senior lenders reducing their exposure, but some such as Societe Generale and Eurohypo have left the sector all together.

Borrowers are facing the perfect storm of trying to refinance at a time when traditional sources are deleveraging. Their problems are compounded by falling LTVs, higher margins and the desire of active lenders to focus on a limited number of core assets. In the UK hotel sector the situation is exacerbated by the fact the banks traditionally keen on lending to the sector (particularly Scottish and Irish banks), are amongst those most actively seeking to reduce their exposure. Part of the problem is that there seem to be few takers to step in and fill the gap.

Morgan Stanley estimates that this financing gap left by the banks, is of the order of €400-700bn across European commercial real estate, providing plenty of scope for new entrants and existing non-bank players to increase their exposure to the sector. Given that prior to the

<table>
<thead>
<tr>
<th>Hotel name/brand</th>
<th>Location</th>
<th>Country</th>
<th>Classification</th>
<th>Number rooms</th>
<th>Tenure</th>
<th>Date</th>
<th>Price (local currency)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premier Inn</td>
<td>Woking</td>
<td>UK</td>
<td>Budget</td>
<td>105</td>
<td>Unknown</td>
<td>October 2012</td>
<td>9,790,000</td>
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<tr>
<td>Biebtreustr</td>
<td>Berlin</td>
<td>Germany</td>
<td>Upper Midscale</td>
<td>66</td>
<td>Unknown</td>
<td>October 2012</td>
<td>Undisclosed</td>
</tr>
<tr>
<td>Courtyard by Marriott Seestern</td>
<td>Dusseldorf</td>
<td>Germany</td>
<td>Upscale</td>
<td>221</td>
<td>Unknown</td>
<td>October 2012</td>
<td>Undisclosed</td>
</tr>
<tr>
<td>Cowgate Edinburgh Hotel</td>
<td>Edinburgh</td>
<td>UK</td>
<td>Budget</td>
<td>259</td>
<td>Freehold</td>
<td>October 2012</td>
<td>30,600,000</td>
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<tr>
<td>Ibis Styles Alesia</td>
<td>Paris</td>
<td>France</td>
<td>Midscale</td>
<td>47</td>
<td>Freehold</td>
<td>October 2012</td>
<td>Undisclosed</td>
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<tr>
<td>Hotel Arenella</td>
<td>Sicily</td>
<td>Italy</td>
<td>Upper Midscale</td>
<td>460</td>
<td>Unknown</td>
<td>October 2012</td>
<td>26,000,000</td>
</tr>
<tr>
<td>Tulip Inn Muscat</td>
<td>Muscat</td>
<td>Oman</td>
<td>Upper Midscale</td>
<td>153</td>
<td>Unknown</td>
<td>October 2012</td>
<td>10,000,000</td>
</tr>
<tr>
<td>Riu Playa Cala Millor</td>
<td>Balearic Islands</td>
<td>Spain</td>
<td>Upscale</td>
<td>242</td>
<td>Unknown</td>
<td>October 2012</td>
<td>Undisclosed</td>
</tr>
<tr>
<td>Hotel Polonez</td>
<td>Poznan</td>
<td>Poland</td>
<td>Midscale</td>
<td>369</td>
<td>Unknown</td>
<td>October 2012</td>
<td>Undisclosed</td>
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<tr>
<td>Madison Hamburg</td>
<td>Hamburg</td>
<td>Germany</td>
<td>Upscale</td>
<td>166</td>
<td>Freehold</td>
<td>October 2012</td>
<td>37,500,000</td>
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<tr>
<td>Radisson Blu St. Gallen</td>
<td>St. Gallen</td>
<td>Switzerland</td>
<td>Upper Upscale</td>
<td>123</td>
<td>Freehold</td>
<td>October 2012</td>
<td>58,500,000</td>
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<tr>
<td>Renaissance London Heathrow</td>
<td>Heathrow</td>
<td>UK</td>
<td>Upper Upscale</td>
<td>649</td>
<td>Freehold</td>
<td>October 2012</td>
<td>Undisclosed</td>
</tr>
<tr>
<td>Park Inn Sheffield</td>
<td>Sheffield</td>
<td>UK</td>
<td>Upper Midscale</td>
<td>111</td>
<td>Freehold</td>
<td>October 2012</td>
<td>Undisclosed</td>
</tr>
<tr>
<td>Hyatt Regency Birmingham</td>
<td>Birmingham</td>
<td>UK</td>
<td>Upper Upscale</td>
<td>319</td>
<td>Freehold</td>
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<td>26,800,000</td>
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<tr>
<td>Travelodge Balham</td>
<td>London</td>
<td>UK</td>
<td>Budget</td>
<td>90</td>
<td>Freehold</td>
<td>November 2012</td>
<td>6,900,000</td>
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<tr>
<td>Portfolio of 165 B&amp;B Hotels</td>
<td>Various</td>
<td>France</td>
<td>Budget</td>
<td>Various</td>
<td>Unknown</td>
<td>November 2012</td>
<td>529,000,000</td>
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<td>Budget</td>
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<td>Danderyd</td>
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<td>Upper Midscale</td>
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<td>14,500,000</td>
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<td>Radisson Blu</td>
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<td>UK</td>
<td>Upper Upscale</td>
<td>247</td>
<td>Unknown</td>
<td>November 2012</td>
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<tr>
<td>The Burlington Hotel</td>
<td>Dublin</td>
<td>Ireland</td>
<td>Upper Upscale</td>
<td>524</td>
<td>Unknown</td>
<td>November 2012</td>
<td>67,000,000</td>
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<tr>
<td>University Arms Hotel</td>
<td>Cambridge</td>
<td>UK</td>
<td>Upscale</td>
<td>119</td>
<td>Unknown</td>
<td>November 2012</td>
<td>20,000,000</td>
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<tr>
<td>Tophams Hotel</td>
<td>London</td>
<td>UK</td>
<td>Upscale</td>
<td>48</td>
<td>Leasehold</td>
<td>November 2012</td>
<td>16,000,000</td>
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<tr>
<td>Steigenberger Apartments Hamburg</td>
<td>Hamburg</td>
<td>Germany</td>
<td>Upper Upscale</td>
<td>128</td>
<td>Unknown</td>
<td>November 2012</td>
<td>Undisclosed</td>
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<tr>
<td>Sofitel Paris La Defense</td>
<td>Paris</td>
<td>France</td>
<td>Luxury</td>
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<td>Unknown</td>
<td>December 2012</td>
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<tr>
<td>Portfolio of 5 Hotels</td>
<td>Various</td>
<td>France/Netherlands</td>
<td>Various</td>
<td>1736</td>
<td>Unknown</td>
<td>December 2012</td>
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<td>Steigenberger Europaischer Hof</td>
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<td>Upper Upscale</td>
<td>125</td>
<td>Freehold</td>
<td>December 2012</td>
<td>Undisclosed</td>
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Alternative sources of finance: filling the gap?

Completed deals

Steigenberger Europaischer Hof Baden-Baden Germany Upper Upscale 125 Freehold December

Tophams Hotel London UK Upscale 48 Leasehold November

University Arms Hotel Cambridge UK Upscale 119 Unknown November

Radisson Blu Glasgow UK Upper Upscale 247 Unknown November

Holiday Inn Express North End

Portfolio of 4 Formule 1 Hotels Various Sweden Budget 324 Unknown November

Portfolio of 165 B&B Hotels Various France Budget Various Unknown November

Hyatt Regency Birmingham Birmingham UK Upper Upscale 319 Freehold November

Park Inn Sheffield Sheffield UK Upper Midscale 111 Freehold October 2012 Undisclosed

Renaissance London Heathrow Heathrow UK Upper Upscale 649 Freehold October 2012 Undisclosed

Radisson Blu St. Gallen St. Gallen Switzerland Upper Upscale 123 Freehold October 2012 58,500,000

Madison Hamburg Hamburg Germany Upscale 166 Freehold October 2012 37,500,000

Hotel Polonez Poznan Poland Midscale 369 Unknown October 2012 Undisclosed

Riu Playa Cala Millor Balearic Islands Spain Upscale 242 Unknown October 2012 Undisclosed

Tulip Inn Muscat Muscat Oman Upper Midscale 153 Unknown October 2012 10,000,000

Ibis Styles Alesia Paris France Midscale 47 Freehold October 2012 Undisclosed

Cowgate Edinburgh Hotel Edingburgh UK Budget 259 Freehold October 2012 30,600,000

Courtyard by Marriott Seestern Dusseldorf Germany Upscale 221 Unknown October 2012 Undisclosed

Bliebtreustr Berlin Germany Upper Midscale 60 Unknown October 2012 Undisclosed

Hotel name/brand Location Country Classification Number rooms Tenure Date Price (local currency)

Alternative sources of finance is not limited to office and retail; the hotel sector is also attracting its fair share of attention. We have seen a number of recent deals where specialist funds have replaced at least some portion of the bank lending and a number of large funds are reportedly seeking hotel debt opportunities. Provision of mezzanine financing to the sector has proved slightly more elusive as the more risk averse providers struggle to get comfortable with the inherent operational risk.

Despite the emergence of new lenders, a financing gap still remains and the market will remain challenging. The amount of alternative finance drawn to the hotel sector may well not be sufficient to fill the gap left by the banks. Furthermore, new entrants will have the luxury of being able to cherry pick the best deals, which is likely to result in a larger number of players chasing a small number of deals in core locations.

While these new sources of funding will increase the diversity in the capital structure they will also increase the cost of capital. As low cost senior debt is replaced by more expensive capital, such as junior debt and equity, the weighted average cost of capital will increase. Sellers need to take this into account when considering their valuation expectations; the change in the weighted average cost of capital will go some way to explaining the difference in price expectations between buyers and sellers.

Timothy Jones is a senior consultant at Colliers International

timothy.jones@colliers.com

This table features individual asset and portfolio transactions in excess of €5m in the EMEA region. The exchange rate used on the table was £1 = €1.2300.
How strong is your cyber security?

Hackers are the unseen threat, warns DLA Piper’s Stewart James

Never mind thieves through the front door, it is electronic attacks that have the real potential to disrupt.

In 2011, a central London hotel held a government conference on cyber-security. The event was attended by a range of government ministers and senior security officials, as well as a range of security experts, vendors, media and other professionals.

Perhaps unsurprisingly, the event came under cyber-attack, with the attack perpetrated through the hotel’s free-to-use WiFi internet access. The consequence was that any delegate who used the WiFi network (and presumably any other guest staying in the hotel at the time) had their log-in details compromised and any subsequent communications made using the network were also potentially hacked.

The event reveals the ease with which attackers can gain access to computer systems. In fact, tools are readily available for purchase on the internet that explain how to conduct such attacks, often with step-by-step video instructions published on YouTube and some even include “money-back” guarantees. It also raises the question of whether the hotel would have any liability in the event that a guest incurred a loss as the result of such an attack, and if so who should bare that liability – the operator, brand owner (franchisor) or the owner?

Are you liable?
A preliminary question that would need to be established is the ground on which the guest would bring a claim. It might be founded in negligence, where a successful claim would result in a higher value of recoverable loss. However, negligence can be difficult to establish so it is more likely that the guest would make a claim for breach of contract. The claim would either be for the breach of a term within the general hotel conditions or a term relating to the use of the hotel’s WiFi network (it is quite usual for hotels to require guests to sign up to separate terms for the use of the network as part of the process for logging-on).

In either instance it should be anticipated that the guest will associate his/her loss as being the responsibility of the franchisor as the public face of the hotel. The franchisor may then be able to pass this liability back to the owner through the franchise agreement, but it should be remembered that it is the franchisor’s reputation that is at risk and for which compensation may not always prove an adequate remedy. Additionally, any terms imposed by the hotel’s conditions or terms of use will be subject to the usual test of reasonableness under UCTA, especially in respect of exclusion and/or limitation of liability clauses.

Reasonable steps
Where conditions or terms of use do not contain express relevant provisions then a court will look to imply terms relating to fitness for use, which may include that the network is safe to use or “fit for purpose”. In considering what is reasonable to imply a court will consider the steps that a hotel could take, and by considering what other hotels do, to ensure that guests are not unnecessarily exposed to risk.

Many hotels already use access controlled networks as a means of levying a usage charge on guests, a by-product of which is that the network may already be using encrypted security settings to exclude guests who do not subscribe to the service. In any event, the security settings are readily available and merely require to be set. It is likely, therefore, that a court would be willing to accept that a secure network is the basic standard for a “safe” network.

However, the problems do not stop here. The greatest weakness in any security chain is the human element and staff will have access to both the guest network but more importantly to the hotel’s internal network. Consequently, they will have the opportunity to introduce malicious code, whether innocently as the result of cyber-grooming and phishing attacks (sometimes referred to as advanced persistent threats), or deliberately.

A recent article published in ComputerWorld highlighted the use of Trojan malware which had been developed specifically to access guest credit details and booking information contained within hotel systems, and introduced using cyber-grooming tactics.

Clearly such an attack raises data protection and privacy issues. In particular, has the hotel taken all “technical and organisational” measures necessary to secure the information? Currently a fine would be limited to £550k but the new data protection regulation is proposing fines of up to 2% of turnover (it’s not clear whose turnover or whether that is global, combined, group, etc).

Mitigation of the regulatory consequences of such attacks assumes that the hotel is using a reasonable degree of information security. However, the US Federal Trade Commission recently levelled a complaint against Wyndham Worldwide alleging that the group failed to take any security measures; a complaint which is implicitly accepted according to the response the group is reported to have given. If the complaint is upheld then the group may be required to pay compensation to its customers.

Reputation protection
Cyber-security and cyber-crime are prominent issues in the press – it’s never too late for hotels (owners, franchisors and operators) to consider their respective position and strategies, both to protect their own systems but also to keep their guests secure. Initially, the biggest damage is to the reputation and the goodwill of the brand, but there may be other losses to settle as the cause is investigated. Those losses can be avoided provided by making advance provision and ultimately by making some simple amendments to the network.

Stewart James is a partner in DLA Piper’s Intellectual Property & Technology group, based in the Canberra office
Hotel Analyst (HA), Hotel Analyst Emerging Markets (HAEM) and Hotel Analyst Distribution and Technology (HADT) are key reads for hotel industry professionals. They are different from all other titles in the hospitality sector. They are designed to focus purely on the information needs of the hotel investment and operating communities.

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<th>BEST VALUE PACK</th>
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Serious steps on sustainable agenda

Hotel groups are pushing sustainability up the corporate agenda, as a trio of recent initiatives illustrate.

Marriott’s second annual report puts their progress on record, while Rezidor has announced ambitious plans under its Think Planet! Campaign. And in the UK, IHG is working on plans to create a sustainable legacy off the back of its sponsorship of the London Olympics.

Marriott focuses on a wide range of human interest angles in its report, from empowering more people through employment opportunities, to fighting human trafficking and protecting fresh water supplies in China. The company has improved the transparency of its reporting of resource usage at its hotels; and reports a 12% reduction in water use and 4% cut in energy consumption since 2007.

Marriott places great emphasis on employment as a sustainable way to reduce poverty and help the disadvantaged into work. It is working through a number of initiatives internationally to reduce youth unemployment and help skill the disabled to enable them into work. The company expects its hotels to hire 100,000 people over the next two years, of which two thirds will be outside the US.

Creating a sustainable future includes preserving the environment, but it also means creating more jobs and stronger communities,” said Mari Snyder, vice president of social responsibility. These programmes are equipping disadvantaged youth with employable skills that can hopefully prepare them for jobs with Marriott.”

Chief executive Arne Sorenson described the Marriott mission as being “to provide the opportunity for rewarding travel experiences for our guests, the opportunity for personal and professional growth for our associates, and the opportunity for a better and more sustainable future in the communities where we live and work.”

Rezidor, in contrast – and perhaps unsurprisingly as a Scandinavian company – puts saving resources higher up the agenda. The company has set its hotels tough targets including a 25% reduction in energy use, under its Think Planet! Campaign. The aim is to hit the target by 2016 in all hotels across Europe.

“IHGs commitment.”

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