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HOTEL INVESTMENT SENTIMENT IN FRANCE

CONSERVATIVELY OPTIMISTIC EXPECTATIONS

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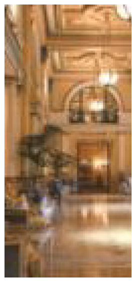

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Introduction

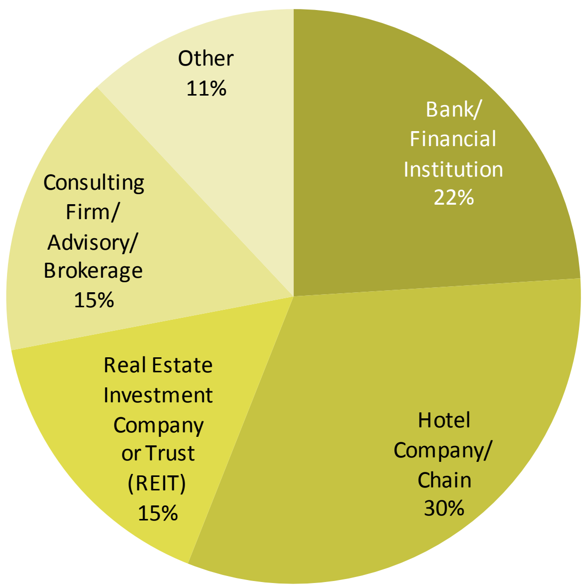
HVS and ESSEC Business School partnered to survey the French hotel investment community. The survey assessed expectations about the French hotel market and gauged investment and lending parameters used. This article reports the results of the participants' expectations. Lending and investment parameters will be reported in a forthcoming article.

The Survey

The overall survey consisted of 53 questions, of which 18 were used for this initial article. These questions related to the parameters used in the past three years, future expectations and the respondents' profiles. Some 68 potential respondents were contacted and 28 full responses were received, representing an encouraging response rate of 41%. The respondents were strongly representative of the French hotel investment community, with a good balance of investors, lenders, operators and advisors, as illustrated in Figure 1. This helps to confirm the validity of the conclusions reached.

All respondents were from firms active internationally (most globally) and have been engaged in multiple transactions (15 to over 100 in the past three years), including hotel sale/purchase, financing/refinancing, development/construction or valuation/appraisal. The remainder of the respondents ('Others'), consisted mainly of private equity investors (when mentioned).

FIGURE 1: PARTICIPANTS' PROFILE



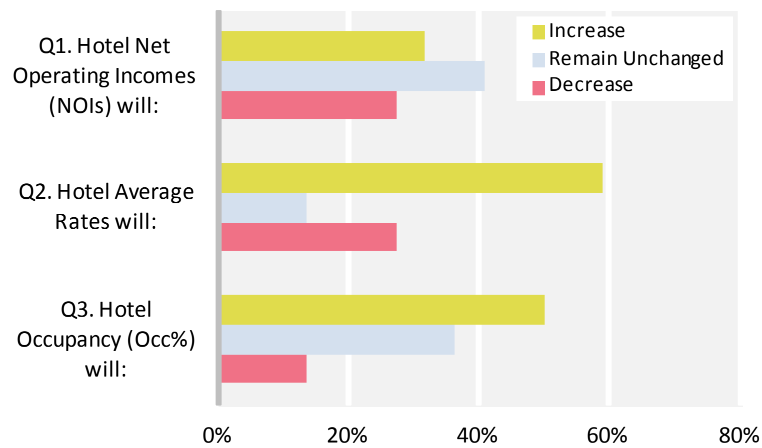
Summary of Findings

The following paragraphs discuss the results of the various questions.

Increase in Revenue but no Conversion into Operating Profit

When asked about their expectations for occupancy and average rates in the next two years, the respondents exhibited some measured optimism, with the majority expecting to see an increase in both indicators for the major French urban markets. About 50% indicated that occupancy would increase, whilst the remainder felt it would either stay flat or decrease. For average rates, almost 60% pointed towards an increase, against the about 40% that thought there would be no growth in rate, or even a decline. Figure 2 clearly shows this optimism for average rates, which is more tempered for occupancy. The intriguing part of the results is for net operating income (NOI) where most

FIGURE 2: EXPECTATIONS FOR THE PERFORMANCE OF PRIMARY FRENCH HOTEL MARKETS (MAJOR URBAN MARKETS)

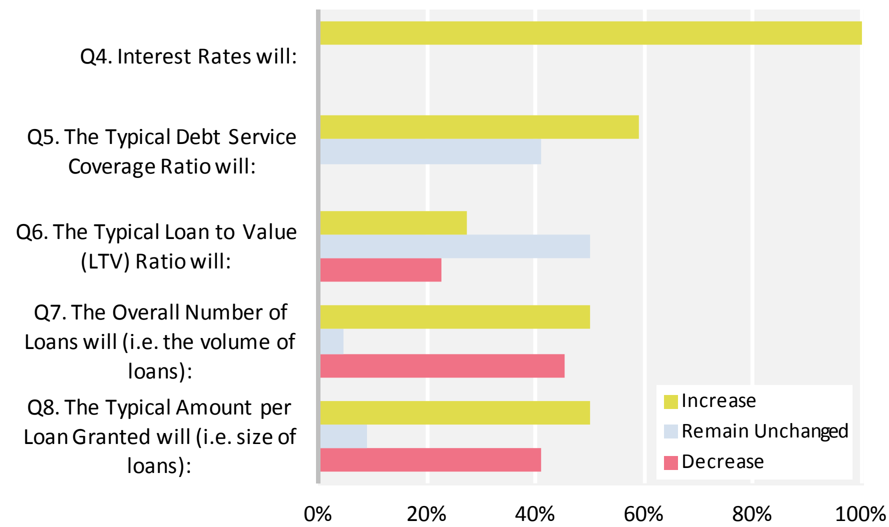


respondents felt it would remain unchanged. This difference suggests that few were confident in the ability of hotels to ensure a good flow-through or conversion of the increase in revenue into operating profit.

Conservative Lending and Slow Increase in Transactions

When asked for lending terms and their expectations about loan amounts and parameters, respondents rarely shared similar views, with the exception of interest rates, which can apparently only go up (see Figure 3). While no decrease was expected given that base interest rates are at or close to historical lows, the unanimous view on the increase is a clear indication that rates won't remain there for much longer, although this is likely to be highly dependent on the unravelling of the current situation within the Eurozone.

FIGURE 3: LENDING REMAINS UNCERTAIN, YET MORE COSTLY AND SENSIBLE

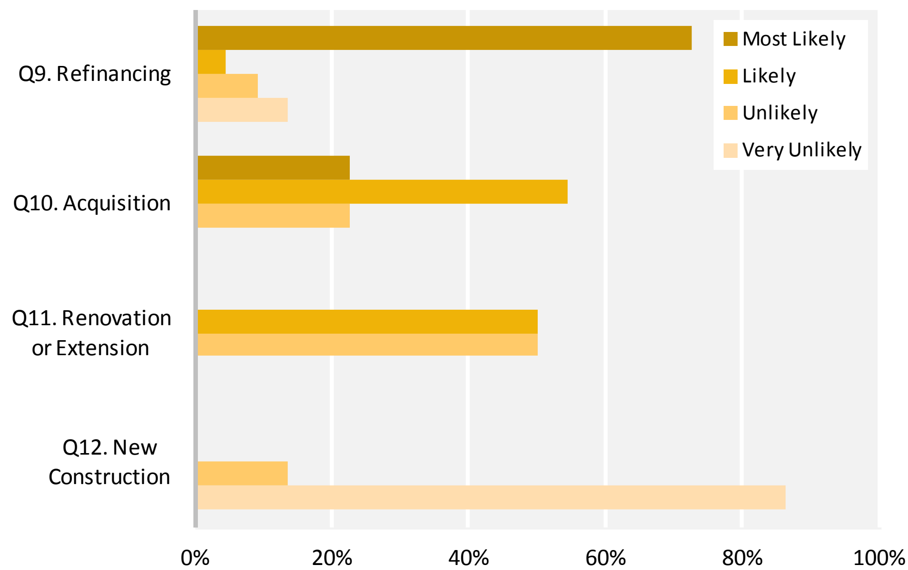


The two questions on Loan to Value ratio (LTV) and Debt Service Coverage Ratio (DSCR) indicate a continuing movement towards more stringent lending terms, with most respondents seeing an increase in DSCR, with LTV increasing or remaining unchanged. From the responses, and given the (tempered) optimism showed on previous questions, it would appear that it is unlikely to see lending terms ease any time soon in France, even once operating performance and the economy have improved.

Answers on the expected number of loans and amounts per loan were for the most part contradictory, with as many expecting an increase as a decrease. As this possibly reflects the uncertainties of our current environment, it may also reveal the unwillingness of lenders to discuss general trends as lending decisions are increasingly driven by the individual characteristics of borrowers.

Most New Loans for Refinancing and Acquisition

FIGURE 4: EXPECT MOST LOANS TO GO TOWARDS REFINANCING OR ACQUISITION



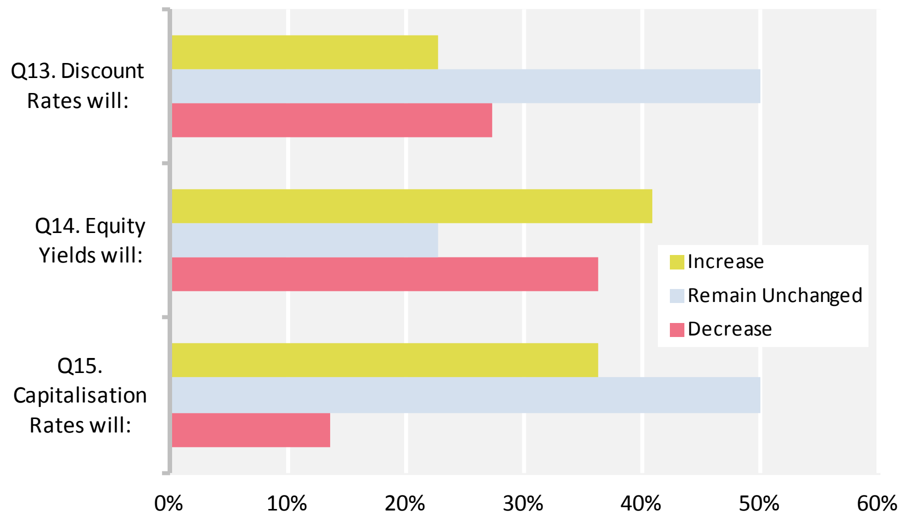
On the question about the expected purpose of new loans, respondents generally agreed that most would be used for refinancing existing loans and some perhaps for acquisitions. These expectations aren't surprising in the current context of conservative lending and uncertain operating performance. In addition, a significant number of loans are reaching maturity and most are seeking to be refinanced[1]. Hence, these major refinancing needs are expected to capture most of the available financing, thereby restricting loan availability for other purposes.

The current turmoil in the Eurozone, with most banks restricting even further their lending activities (as Société Générale announced recently), will most certainly result in further constraints to funding for potential investors.

Higher Capitalisation Rates?

When asked about valuation parameters, respondents provided few clues about what to expect with the exception of capitalisation rates. While half viewed cap rates to remain unchanged, more than 35% suggested they were likely to go up. Considering the pessimistic outlook for NOI, expected to remain stable despite higher anticipated rooms revenue, respondents are indicating that, on average, hotel values are unlikely to improve above their current levels in the next two years.

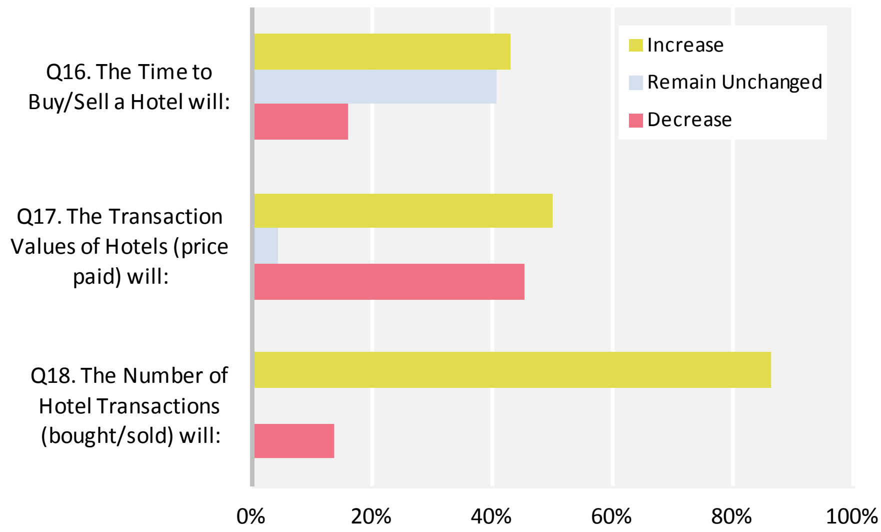
FIGURE 5: CAPITALISATION RATES TO GO UP SLIGHTLY?



More Transactions but no Real Revival Yet

The responses on what to expect from hotel transactions are consistent with more general views. While the number of transactions is widely expected to increase, it is unclear whether this appetite will translate into higher prices. In reality, this expected increase is more likely due to the low levels from which we are coming rather than from true optimism. The time an asset remains on the market to be sold is likely not to decrease, but rather to increase, which is normally a reflection of an illiquid market where buyers and sellers need more time to negotiate prices. This could explain the lack of consensus on how prices will evolve.

FIGURE 6: TRANSACTION NUMBERS UP DESPITE LONGER TIME TO SELL



[1] See HVS Hodges Ward Elliott research report on [Europe: Refinancing a hotel in today's restricted debt markets]

A Few Thoughts on What to Expect

General expectations for hotel investment in France are no different than those witnessed in other markets until the summer of 2011, where the common trait is of conservative optimism. It is likely that the most recent concerns surrounding the Eurozone would have an impact on perceptions in general, at least to some extent. However, the uncertainties around the global and more specifically European economies are, to a great extent, reflected in those expectations. While we see in the responses more positive prospects than negatives, this optimism might be a result of overall conditions improving from a very low point during the recession, rather than a result of expectations of bright prospects for the immediate future. In short, the next two years can't be worse than the past three, but won't look as encouraging as they were pre-crisis.

Key Take Aways

1. Average rates and occupancy likely to increase, but all the improvement won't be converted into operating profit because of rising costs.
2. Although there is practically no lending available at the moment, the view is that, once the current situation improves, sensible lending will return with, eventually, higher interest rates.
3. Most loans will be granted for refinancing, some for acquisition.
4. Expect more hotel transactions to take place but no significant value increase.

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With offices in London since 1990, **HVS London** serves clients with interests in the UK, Europe, the Middle East and Africa (EMEA). We have appraised almost 4,000 hotels or projects in 50 countries in all major markets within the EMEA region for leading hotel companies, hotel owners and developers, investment groups and banks. Known as one of the foremost providers of hotel valuations and feasibility studies, and for our ability, experience and relationships throughout Europe, HVS London is on the valuation panels of numerous top international banks which finance hotels and portfolios.

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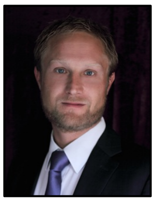

Nicolas Graf, PhD, is on the faculty of ESSEC Business School in Paris, where he teaches strategy and real estate finance in various MBA programmes, including the MBA in Hospitality Management (IMHI). He received his PhD from the Pamplin College of Business of the Virginia Polytechnic Institute and State University, with a concentration in corporate finance and strategic management, and his MBA and bachelor's degree from the Ecole hôtelière de Lausanne in Switzerland. He has published in various academic and applied journals, including the International Journal of Hospitality Management, the Real Estate Finance Journal and the Journal of Retail and Leisure Property, the HVS newsletter and the EHILITE magazine.

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