



Confidence in a recovering market
European Hotel Market Survey 2014



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Our research was carried out in January/ February 2014 and is based on data from over 400 online interviews with a cross-section of hotel industry professionals based in over 20 countries worldwide.

Any unattributed quotes which feature in this report were made by respondents to our survey.



Foreword

“ I am delighted to present the results of our survey of over 400 respondents from the hotel sector – investors, lenders, owners, operators, developers and advisers. ”

Does 2014 herald a new dawn for the hotel sector? Certainly enthusiasm is running high for the majority of our respondents as the caution of the past few years gives way to hope that the improved trading seen in many European locations will stick and that a bankable recovery will set in. Over 97% of our respondents predicted growth in European REVPAR over the next 12 months. This confidence is however measured, with 63% of respondents expressing continuing concern over the stability of the Eurozone. There is also some debate as to whether this recovery will be long-lasting, with a number of our respondents predicting that the present momentum will not be sustained beyond the next 12 to 24 months.

In addition to the current buoyancy in the European market, we are seeing increased optimism and an uptick in development in the wider emerging markets, notably Africa and South East Asia.

As well as setting out the top ten market highlights from our survey, we have included in this report the thoughts of our respondents on some of the customer-facing trends in the sector – namely the drive to provide more of a personal service to hotel guests, the desire to capture the Millennials market and the threat – or otherwise – presented by the upsurge of holiday rental online booking sites.

Finally, I am very pleased to share with you the personal views of four industry leaders in the hotel sector, namely Josh Wyatt of Patron Capital Partners, Philippe Bijaoui of IHG and Diane Scott and Tony Burnell of Lloyds Banking Group, which appear in our feature interviews.

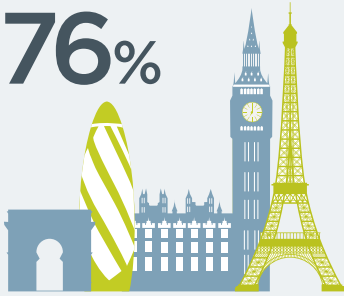
A handwritten signature in red ink that reads "K.E. Friebe". The signature is fluid and cursive.

Karen Friebe
Partner, Hotels Group
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Overview of our European Hotel Market Survey 2014

Top ten highlights

76%



believe that London will see the most M&A activity, followed by Paris at 49% and Berlin at 25%

97%



predict that REVPAR in Europe will grow



51%

expect to see strong inward investment into the European market



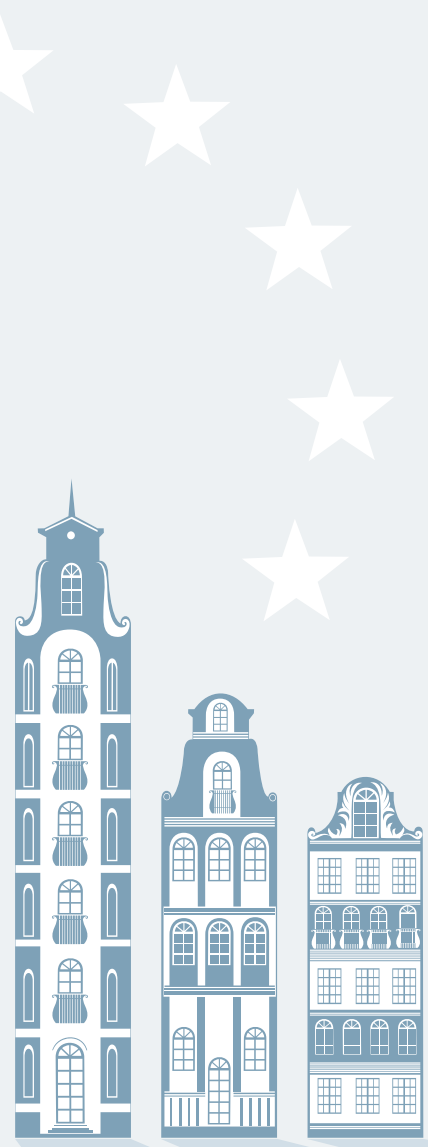
60%

believe investors increasingly value hotels as an "attractive" asset class



54%

think that hotels have outperformed "traditional" commercial property



21%



online comparison sites such as TripAdvisor are not troubling profitability - 21% saw profits increase as a result of appearing on such sites



69%

think that we will see an increase in brands franchising in 2014



69%

believe that investment will be focused on Western Europe



61%

institutional investors increasingly value the benefits of hotel property as an attractive real estate asset class, according to 61% of respondents



64%

expect less traditional forms of lending, such as insurers providing senior debt or engaging in sale and leaseback transactions, to increase this year

Top ten highlights

1 97% predict that REVPAR in Europe will grow

Enthusiasm was running high for the majority of respondents, as the caution of the past few years gives way to hopes that the improved trading seen in many locations in Europe will stick and a bankable recovery will set in. Both the corporate and leisure markets have seen improvements across Europe, with locations including the regional UK market picking up after being hit hard in the downturn.

There is however continuing concern about the stability of the Eurozone.

2 76% believe that London will see the most M&A activity, followed by Paris at 49% and Berlin at 25%

Both London and Paris saw strong growth over recent years in terms of trading and deal volume. This provides reassurance for those who have invested in the sector in these cities, whether in trophy assets or in budget sites.

A number of respondents also expected to see an increase in private equity and High Net Worth Individuals coming into the sector, drawn in particular to trophy assets in the two capitals. Attendees of the IHIF might also be expected to spend some time shopping for opportunities - with Berlin named by 25% of respondents as a likely investment target in the coming year.

3 51% expect to see strong inward investment into the European market

Respondents were asked for the reasons behind their confidence in the hotel sector in 2014. The leading response was the expected growth of the European economy, alongside strong inward investment into the European market.

With Western Europe the focus of investment, respondents were asked from which region they believed the majority of investment would come in 2014. The Middle East and North Africa were the most popular choices. Political unrest in the region has seen many investors looking to protect their capital by acquiring trophy assets in cities such as London and Paris. Sovereign Wealth Funds in the Middle East have shown a particular appetite for the hotel sector in Western Europe.

China was also a popular choice as a likely source of investment, which has already been borne out in deals over the past year in London. Dalian Wanda was just one of the companies to announce that it was investing in the capital, with a new luxury hotel as part of a £700m investment on the South Bank. China's consistent economic growth has allowed Chinese companies to take advantage of the economic downturn elsewhere around the globe to start realising their global ambitions.

4 60% believe investors increasingly value hotels as an "attractive" asset class

Many years of low interest rates and depressed economies have led investors to step out of their traditional markets and look for higher returns in unfamiliar locations. For the hotel sector, which has found itself out of favour in recent years, this has meant some new entrants. Our survey revealed that 37% of respondents found hotels 'highly attractive', with 59% rating them "attractive", ahead of residential or office assets.

As REVPAR increases across Europe, this is expected to translate into even more heady asset deals, fueled by the belief that the key European capitals can do no wrong. The US REITS have shown themselves to be particularly acquisitive during the downturn, with the likes of Host Hotels and Resorts looking for properties in gateway cities with strong brands attached. The increase in models which allow investment into the sector without expertise in hotel operation is expected to act as a further attraction for return-hungry money.

“It is market dependent but I believe that hotels which are performing regularly outclass traditional commercial property.”

- 5** Hotels have outperformed “traditional” commercial property, according to 54% Respondents were confident that investors would realise that the hotel sector offers potential rewards, with 54% asserting that hotels in Europe had outperformed “traditional” commercial property over the last five years.

Some were defensive, pointing out that hotel performance had suffered disproportionately during the financial crisis due to corporate and private spending cutbacks. The European hotel sector’s resilience and ability to generate cash makes it attractive, with its increased popularity to visitors from China and the Middle East making its long-term potential ever more convincing.

“ Given the tailwind, we are currently seeing an uptick of demand which is leading to a nice growth in RevPar across almost all segments. ”

Josh Wyatt
Director, Hospitality and Leisure,
Patron Capital Partners

“ The buoyancy of the hotel market both in terms of hotel operations and deal activity demonstrates the ability of hotels as an asset class to weather economic downturns. ”

Andrew Little
Partner, BLP Hotels Group

- 6** 69% believe that investment will be focused on Western Europe

Our research indicated that most investment in the coming year would be concentrated in Western Europe - so 69% of respondents forecast. Second in line was China, closely followed by Asia-Pacific, indicating how far these regions have come in recent years in terms of development potential.

Whilst the mature market of Western Europe attracts both commercial and leisure travellers, with the penetration of brands lagging behind the US, it is still seen as ripe for development by the global operators. As travel becomes the norm, rather than the exception for many around the globe, the need for quality hotels across the price points will drive further expansion in the sector.

The BLP perspective



John Sipling
Partner, BLP Hotels Group,
Abu Dhabi Office

“ We have seen a surge of capital flows between Europe and the Middle East in the last year or so, both in terms of sovereign wealth fund investment in European hospitality assets and in Middle East hotels raising funds, including through IPO, from the UK. ”

Top ten highlights continued

7 Institutional investors increasingly value the benefits of hotel property as an attractive real estate asset class, according to 61% of respondents

The message that the hotel sector is a worthy asset class was felt to be spreading outside the sector. 61% of replies supported the statement that institutional investors increasingly valued the benefits of hotel property as an attractive real estate asset class.

Institutional investors who may in the past have been solely driven by asset value are, it is felt, starting to realise that where the hotel operation is of good quality, the potential for better cashflow can be highly valuable.

There was work still to be done, with investors viewed as struggling to understand the concept of operational risk and how to balance this risk/ reward dilemma. 80% of respondents felt that hotel property is perceived by real estate investors as more risky than traditional commercial property, such as retail and offices.

Respondents also felt that institutional investors still focus on fixed leases and would not risk the benefit of variable income through owning a hotel with a management contract/ franchise.

Operators came under attack from one respondent, who said that investors would be reassured by such a fixed income structure and criticised operators for being “reluctant to smooth the cycle in this way”.

“

Since co-founding IHIF with Questex Media Group in 1998, we have seen a considerable shift in attitudes towards hotel investment. Investors today are much more likely to have hotel assets as part of their property portfolio and this has been brought about by, not only the economic fundamentals, but greater knowledge, transparency and growth of the brands. The industry is far more professional than when we first launched IHIF 17 years ago. ”

Jonathan Worsley
Chairman, Bench Events

“

Hotel funding should not be viewed as corporate real estate transactions and can't be funded as such.... some of the more traditional investors are beginning to realise that the managed hotel can represent a good opportunity, subject to getting the debt levels right. ”

Tony Burnell,
Relationship Director, Hotels, Lloyds Banking Group





“The hotel investment finance market is fully functioning again. It’s great to see that at all levels of the capital stack there is competition, at reducing margins, to finance good hotels for good sponsors in good locations.”

Andrew Flemming
Partner, BLP Hotels Group

Top ten highlights continued

- 8 64% expect less traditional forms of lending, such as insurers providing senior debt or engaging in sale and leaseback transactions, to increase this year

Whilst banks are still wary of the sector and Basel rules are forcing them to hold onto capital, the majority of survey respondents (64%) believed that there would be an increase in less traditional forms of lending over the next 12 months, such as insurers providing senior debt or a move back towards sale and leaseback transactions.

This has already been seen to be the case with Marriott International's sale and manageback of three Edition hotels, a deal which also served to underline the importance of operators taking on some of the risk in their expansion strategies.

- 9 69% think that we will see an increase in brands franchising in 2014

With demand rising from both the corporate and leisure markets, operators are eager to plant their flags in as many locations as possible, with franchising one of the fastest methods of staking their claim. 69% of respondents felt that 2014 was likely to see an increase in franchising.

As owners continue to seek comfort in the brands, several operators have reported seeing a rise in conversions, often to their franchise brands, as a quick and easy switch is sought. Several respondents commented that the large chains were risk-averse and would look instead to franchisees to face the potential hazards of growth.

While the returns may be smaller than those they would see through ownership, and the ability to control standards is more limited, getting the brand out there and having a consistent revenue stream remained important to the global brands.

Wariness seen in lenders was also felt to be contributing to the growth in franchising, with the reassurance of a recognised flag over the door still required by many. For those with limited funding, franchising remains the inexpensive choice.

“For us, the fact that there will be more debt and equity available means that there will be more bidders. This will be a challenge for us!”

Philippe Bijaoui
VP, Development Europe, IHG

The BLP perspective



Nick Skea-Strachan
Partner, BLP Hotels Group

“Generally, owners want a brand, but increasingly not a brand running hotel operations. This is driving franchising with both owners and white label operators.”

“ Private equity is chasing opportunities to invest at discounted prices, often below replacement costs where banks are de-leveraging. ”

“ Banks are leaving the market and there is opportunity for refinancing with new lenders. ”

10 Online comparison sites such as TripAdvisor are not troubling profitability - 21% saw profits increase as a result of appearing on such sites

It is now crucial for a hotel to be on TripAdvisor and for the operator to manage how comments from customers are monitored, increasingly so since the social media site moved into hotel metasearch. The sector has realised this and now sees TripAdvisor as a potential ally rather than enemy.

When asked to what extent online comparison sites such as TripAdvisor impacted on profitability in 2013, 63% of respondents said that they were not affected at all, with 21% seeing profits increase as a result.

Comments were mixed on the issue, with one respondent saying that “as much as brand reputation management is key and we take it very seriously, I believe profitability is much more influenced by other factors”. Respondents appreciate, however, that customer feedback is important to their businesses and that TripAdvisor and other social media are important sources for this. What this means for comment cards and post-stay surveys will remain to be seen, as hotels work to decide how to use the information TripAdvisor gives them. As one respondent commented: “Quality will out”.

“ In one of our properties TripAdvisor is more than likely generating 40% to 70% of our revenue. Customer comments are the only true believable source of information at this time. ”

“ Due to recent competition law developments in the UK, Germany and other countries we may very well start to see a fundamental reshaping of the relationship between OTAs and operators in 2014, with “best rate guarantee” policies becoming meaningless and an increased investment by operators with a view to shifting business to cheaper brand.com distribution channels. ”

Jonathon Grech
SVP, Group General Counsel and Company Secretary, Millennium & Copthorne Hotels plc



Current trends in the hotel sector

The Personal Experience

The demands of global travellers have changed more in the past decade than at any time in the hotel sector's history, with brands struggling to keep up with what the consumer wants in the room and how that room is booked.

We asked respondents what they believed was essential to win future guests and the majority named the delivery of the "personal experience" followed by increased availability of technology to guests, then constant innovation and effective management of interaction with social media sites.

Respondents reiterated the frequent cry of "free WiFi", with one describing it as "massively important" and another calling for it to be easy to connect and at a reasonable rate. With recent studies suggesting that it is more important than a good night's sleep to some guests, WiFi will continue to dominate debate in 2014.

“ Guest loyalty is absolutely critical as is providing a guest with a stay on his/ her terms. The importance of a robust e-commerce platform and the explosion in 'mobile' will dominate the industry going forward. ”

“ It's said that the Millennials make up 50% of hotel bookings, so we can expect to see more brands squarely aimed at that group. ”

David Battiscombe
Partner, BLP Hotels Group

The Millennial Bug

Respondents were also asked whether they believed they needed to adapt business to appeal to the Millennials (generation born from 1980's to the early 2000's), with many feeling this to be true.

Our survey asked what steps were being taken to attract the Millennials, with the majority (60%) taking no specific steps and only 7% of respondents saying that their brands were specifically geared towards the Millennials.

32% stated that they were taking steps to appeal to the Millennials. These steps have included implementing social media strategies and positioning themselves in responsible destinations, combined with technologically advanced travel information and experiences.



Home from Home

Last year saw a rise in prominence of websites which allow any individual the opportunity to rent his or her home out to travellers, for a fee. We asked respondents whether they considered holiday rental online booking sites such as HouseTrip, Homeaway, Couchsurfing! and Airbnb to be a threat to their businesses.

The majority of respondents dismissed the threat, with 59% replying 'no', 22% saying 'yes' and the remainder voting for 'I don't know'. Although Airbnb and its like were not viewed with concern, some respondents did concede that these sites were having an impact on the sector, with one respondent describing them as a "short-term

threat to certain categories of hotels - especially in leisure destinations" and another warning that they appealed to the coveted Millennial guest. One respondent commented "not that the threat is zero but we operate full service hotels and HouseTrip and Airbnb are not truly substitute products in my view".

Airbnb has found itself coming under increasing attack from legislators around the world in the cities it has launched in, amid concerns over health and safety in unregulated properties, as well as income bypassing the tax authorities. Cities including Amsterdam and Paris have acted to clarify the position of home rentals and, at the time of going to press, New York was investigating the tax implications for renters in its city.

“

As an exemplar of Collaborative Consumption Airbnb challenges the entire business model of the hospitality sector. Users are eschewing traditional hotel "service" for a more personal, adventurous, and social experience as they seek greater meaning in their travel. This explosive new trend is valid not just for leisure travelers but business travel too, as new technology and office services make it easier to be on the go without access to the traditional hotel "office suite". ”

Roo Rogers

Co-author with Rachel Botsman of "What's mine is Yours: How Collaborative Consumption is Changing the Way We Live"

“

Whilst most hotel operators who responded to our survey didn't feel that these sites posed any significant threat to their business, they were very vocal about the need for them to be properly regulated - and without delay. ”

Karen Friebe

Partner, BLP Hotels Group



Industry leader's insights

Josh Wyatt



Josh Wyatt

Director, Hospitality and Leisure,
Patron Capital Partners

Josh Wyatt leads all aspects of origination, acquisition and management of hospitality sector investments for Patron, and is a founder of Generator Hostels, the world's largest designer hostel brand.

His main responsibilities include origination, underwriting, execution and asset management for his portfolio companies as well as new business deals.

Josh currently manages approximately €500m of equity with the primary focus being Generator Hostels - he completed the MBO of the business in 2007 and subsequently set about to refashion the business into a global platform.

Q What is your prediction for the European hotel industry over the next 12 months - do you believe that we will see an increase in REVPAR across the board?

A The current buzz word in the hotel sector is "tailwind"; there is a macro tailwind with GDP growth - albeit at a 1-2% level. Specific to the hotel sector, we are seeing a "micro" tailwind in the hotel space based on a supply and demand imbalance generated by the lack of development in the past six years (in most markets - exceptions such as Berlin, London, etc exist). This demand imbalance is now in the favour of hotel owners and investors. Given the tailwind, we are currently seeing an uptick of demand which is leading to a nice growth in REVPAR across almost all segments. Hotel operators and investors can ride this tailwind in favour of the supplier for - I would say - the next 12 to 24 months - until supply is delivered into the market.

A number of dead or "zombie" development projects are re-emerging and coming back to life given the more favourable topline dynamics coupled with increasing liquidity in the debt markets. The snag here is that technically, in most markets, we do not need more hotel supply.

Rather, existing hotels need renovation and defensive capex. Accordingly, in most markets (again exceptions apply here for +80% occupancy markets such as London, Paris, etc), Patron's strategy would be to buy under-renovated hotels and refurbish them. This is exactly what we have done in our acquisition of the Luxury Family Hotels Group and also in our acquisition of the Clarion Hotel in Dublin at the beginning of 2014.

From a cyclical perspective, we can look forward to a 12-24 month cycle of positive REVPAR growth as corporate spend recovers, consumer confidence returns, and overall demand increases. However, whereas in the 2003 cycle we saw a good five years of REVPAR growth, the trough to peak, with a return to the median, will be a shorter period, with likely a two year window. The underpinnings of the economic recovery, this time around, appear to have a bit more volatility and uncertainty. Thus whilst we are long term positive, we want to be conservative in our thinking and approach to how we manage our hotels and prepare the hotels for success in a less certain economic environment.

Specific to London, asset values across the board have risen to incredible levels, driven partially by fundamentals, but largely by inbound capital flows chasing security. Accordingly, for many micro areas in London, we view the market as a tad overheated. It is a very competitive landscape, and we cannot see how you can expect opportunistic returns on new build hotels in London. The land cost in itself is prohibitive - £150,000 per key on average. A hotel would need to grow its EBITDA by 5-10% per annum to sustain this, which creates an immense amount of pressure on the operator.

However, if you already own a hotel in London and especially if you bought it in the last 2-3 years with a circa 2012 cost base, I think you will make money in the medium to long term.

Q In which European countries do you think will receive the biggest growth in REVPAR?

A France is interesting, despite the labour and tax issues there. Germany is another interesting market - we would definitely be interested in looking at opportunities there in select markets. We are also looking at Spain, which appears to offer value opportunities, although it

still has a challenge with topline dynamics - i.e. very challenging to drive ADR in most markets. In Madrid for example, asset prices are entering a period where it may make sense to transact if one has a proper business plan and conservative approach. In sum, I would say Spain is interesting but challenging longer term. But we are looking as are many other smart and well capitalized firms.

Q Do you believe there will be more debt/ equity available for investment in Europe in 2014?

A I believe there will be a lot of money available at all levels of the capital structure as the "wall" of capital continues to build and is now making finance available in hotels again. In some ways it feels like 2005 - not the peak, but a lot of action and momentum. If you combine this liquidity with the upcoming 12-24 month cycle, then I think we are going to see a lot of transaction activity during this period.

Q What do you perceive to be the key challenges that hotel operators and investors will face in 2014?

A There is obviously the Eurozone issue, which is still very much with us, along with likely inflationary threats in the Eurozone.

From an operator's point of view, they have the tailwind, REVPAR is growing and inflation is low. However, inflation is robust in certain areas as the cost of labour and food is increasing whereas REVPAR may not grow at the same rate.

In terms of European investors, they will need to run a tight ship in 2014 to keep abreast of market challenges; a focus on strong asset management will be very important. And, be ready for interest rate increases. This will be a defining challenge of 2015 and beyond.

“We are seeing a “micro” tailwind in the hotel space based on a supply and demand imbalance generated by the lack of development in the past six years.”

Q What are your key strategies for growth in respect of the brands you have invested in?

A We will be focussing on refurbishment and running a very tight plan with cost structure discipline. Investment in technology will be important to customer acquisition. We want to work at reducing the impact of the OTAs and push our brands to acquire customers directly. We should also be working with industry colleagues to fight the impact of these agencies.

Q How important do you see the Millennials to be in terms of that strategy and what steps are you taking to attract them?

A Patron has invested €150m on a macro bet with Millennials as we own the Generator Hostel product, which is a very technology driven product. Also, the Clarion in Ireland will be a boutique hotel focused on the working environment yet with a strong leisure angle to the public space. All of our products are differentiated whether it's the Clarion, the Luxury Family Hotels or Generators. There are two mind sets that you need to cater for. The first is the business traveller on a budget who doesn't care about having the experience of being

in a boutique hotel. They are on a budget and want the cheapest, best value accommodation available. They are not looking at TripAdvisor per se, rather going for one of the value brands based on price. The second is the corporate and leisure traveller – the Millennials included – who do use their own data points such as TripAdvisor, broader social media challenges, and real time reviews to assist them in selecting a hotel that provides them with more of an experience.

Q Please can you share with us your vision for the successful hotel model of the future. Please can you name three key ingredients of this success?

A 1. Asset Right: hotel companies and the hotel model will increasingly move towards a balanced portfolio. The move to pure Asset Lite has hindered some businesses and brands. Using a balance sheet, in a targeted and smart way, will differentiate the winners from the losers.

2. Experience vs Repetition: brands and owners who devote time to constant innovation, engagement with customers to create a lasting, unique hospitality experience, and those who avoid the clichés of the past will build lasting brands and businesses.
3. Direct Relationships: hotels who work with their customers to create a relationship will lead to gathering data to help them serve their customers better, including weaning the customer from the OTAs.

Q Do you believe there will be an increase in joint venturing between operators and investors?

A I think there will actually be a decrease in this trend. There was a slight increase when the economy was in a more challenging space – for example Ian Schrager becoming Marriott's brand partner. In the current market, operators are offering to put money into the deal and are also more inclined to promote themselves by selling their experience of managing successful hotels or resorts, and this will likely increase in trend as the economy returns.

Q How do you feel about the growth of holiday online booking sites such as HouseTrip, Homeaway, Couchsurfing!, Airbnb and Onefinestay. To what degree do you believe that they pose a threat to more traditional hotel businesses?

A I think OneFineStay is a good product that could achieve considerable success as it fills a need for customers to find more stable, long term stays in a residential environment. This is a complement to the industry, not a threat.

As for the other sites – such as Airbnb – I believe that they do pose a threat right now to the traditional hotel operators. These sites drop their rates to fill beds and often do not understand the strategy of longer term yield management. Additionally,

my primary concern with these sites is that they pay no taxes and they are not regulated – they do not have to comply with health and safety rules. They add no economic benefit to the local community and ultimately are a negative impact on cities as they are a substitute and not an additive, reducing the pot of private and public money that would otherwise be available to fund infrastructure and the like. I hope that public authorities will wake up to this pretty quickly – it is not hard to do the maths and see how much is being lost in terms of public benefit by allowing these businesses to operate tax free and without proper health and safety adherence. It would be naive to say they have no impact on the hotel industry.

“Using a balance sheet, in a targeted and smart way, will differentiate the winners from the losers.”

“My primary concern with these sites is that they pay no taxes and they are not regulated – they do not have to comply with health and safety rules. They add no economic benefit to the local community and ultimately are a negative impact on cities... reducing the pot of private and public money that would otherwise be available to fund infrastructure and the like.”



Industry leader's insights

Philippe Bijaoui



Philippe Bijaoui
VP, Development, Europe
InterContinental Hotels Group

Philippe Bijaoui, Vice President Development Europe, is responsible for development for IHG's six brands in the region. Reporting to IHG's Chief Development Officer Europe, Bijaoui leads a pan-European team of Developers with accountability for growth across the continent.

Philippe has over 20 years unparalleled international experience in hotel development and real estate, and has held senior positions with a number of globally recognised companies. Prior to joining IHG in November 2012, Philippe worked for Carlson Rezidor as Vice President Business Development.

Q Which European countries and cities in the UK will be the main focus for growth for IHG in 2014?

A IHG has a presence in over 100 countries and territories worldwide. Looking specifically at Europe, there are key cities and markets where we believe there is potential for growth. Our focus markets include UK and Ireland, Germany, Russia and the CIS countries.

Q Which European cities do you see as having the most growth potential in 2014?

A Germany is a key focus for us. IHG has the perfect product for Germany in the Holiday Inn Express® Hotels brand. The German market is value driven and the brand offers value for money thanks to the low construction costs and the high quality of the product.

Russia is another key market for us. Our ambition is to be number one in Russia and we believe we can achieve this. Our first Holiday Inn Express hotel is due to open in June, in Voronezh.

Turkey is also growing well and is a very active market with great potential for a range of IHG brands, from Crowne Plaza to Holiday Inn and Holiday Inn Express.

Q Do you believe there will be more debt/ equity available for investment in Europe in 2014?

A My experience tells me there will be. This view is driven by the fact that there are lots of bidders for every property including bidders from the private equity sector.

Q What do you perceive to be the key challenges that IHG's business will face in 2014?

A For us, the fact that there will be more debt and equity available means that there will be more bidders. This will be a challenge for us!

Q What are IHG's key strategies for growth and how important to you perceive the Millennials to be in terms of that strategy?

A We have just published the IHG Trends Report 2014 which highlights how hotel brands must adapt and change to keep pace with the needs of future guests – this is focused on delivering localised and personalised experiences enabled by technology.

“Our ambition is to be number one in Russia and we believe we can achieve this.”

Millennials – people aged between 18 and 34 – are particularly interested in access to personal content, such as movies or music while travellers over 65 are most interested in healthy food and beverage choices. Also three in four of these Millennial travellers believe that global hotel brands do a better job at being innovative in comparison to local hotel brands.

However a successful global operator has to be able to adapt to meet the needs of all its customers. At IHG there has been a continuous focus on delivering a higher degree of localisation and personalisation across our portfolio of trusted global brands.

Q Do you think that most hotel operators will continue to focus on an asset light strategy and will this remain a key drive for IHG?

A Our asset light strategy has been proven to be the right strategy for IHG. We demonstrated our commitment to this in 2013 with the sale of the InterContinental London Park Lane, one of two remaining hotels owned by IHG in Europe. Having said that, we use capital investment on a strategic basis as required. Being asset light doesn't mean we don't use capital.

IHG will continue to pursue a mixture of franchising and management agreement models. Franchising will always be a key focus area for IHG and we will only propose a management contract where we believe we can truly add value. We believe we are unique in the way we support our franchisees from pre-opening right throughout the life of the agreement. We know and understand the franchising model and know how to make it perform, as well as having the tools in place to improve the bottom line.

Q Do you think we will see more operators prepared to put some "skin in the game"?

A This is a good way of creating a better partnership with an owner, but can't apply to every deal – the operator needs to be strategic.

Q What is your current view on non-disturbance agreements – good or bad?

A You need to find a middle ground whereby the operator is protected but the bank is not stuck with an operator to the detriment of the value of the business. Having said that, we invest long term and we need commensurate protection.

Q Do you think there will be an increase in joint venturing between operators and investors?

A I do not see an increase in joint venturing as a trend. I think that we will see more one-off joint ventures for specific sites.

Q What is your view of TripAdvisor and similar sites?

A It is important that guests are given the opportunity to share their experiences. In 2012, IHG was one of the first hotel companies to launch Guest Ratings and Reviews on our branded websites, giving our guests the opportunity to read authentic customer feedback while booking their stays. In fact, in 2013, we've collected more reviews on our sites from our hotels than TripAdvisor has for all IHG hotels.

“ Our asset light strategy has been proven to be the right strategy for IHG. ”

Industry leaders' insights

Diane Scott and Tony Burnell



Diane Scott
Business Development Director
Hotels, Lloyds Banking Group

Tony Burnell
Relationship Director, Hotels,
Lloyds Banking Group

Diane - Over the past eight years Diane has built up a niche specialism within the Hotel sector and is one of the Lloyds Banking Group's London team members who focuses on this area. Diane has been instrumental in many of their hotel transactions to date, and regularly speaks at Hotel Sector conferences.

Tony - Working closely with Diane since 2004, Tony focuses exclusively on the Hotel Sector for the Bank and is very pleased to have worked with many of the key owner/operators, helping them to complete acquisitions, refinancing and redevelopments.

Q Can you comment on the amount of new lending generated by your team last year?

A DS & TB - Our London Hotel team wrote about £250m in new loans last year. We are effectively the "hub" for hotel lending within Lloyds Bank for mid-market deals - our sweet spot being the upper end of the market in central London. We look at deals with a minimum debt level of £10m and/ or a minimum asset value of £25m. We are also able to provide advice and assistance to our colleagues in other parts of the Bank who are looking at doing hotel deals in the UK regions.

Q How do you believe that level of activity compares to your competitors?

A DS - I really do think that we have benchmarked well against our competitors; and we are doing new lending, as well as some refinancing. Having said that, there has not been a great deal of refinancing/ acquisitions in the marketplace in the last 12-24 months although this is somewhat improving.

TB - I would be surprised if our team had not been one of the best performers in the market last year.

Q Do you believe that you will see a marked increase in new business enquiries in 2014?

A DS - We certainly hope so - the market has started to pick up nicely with London as always leading the way however we are seeing a great deal of interest now in the regional marketplace which has started to perform much better, especially in the "go to" locations such as York, Bath, Edinburgh, Oxford and Cambridge.

TB - There is a definite appetite to lend from the Bank's perspective. Lloyds is committed to lending into the hotel market, particularly the SME market for the right property/ operators.

London is interesting; in a number of cases owners have become comfortable with the operational side of a hotel business and have therefore decided to hang onto the asset. This has arguably cut down the number of transactions in the market.

In respect of the UK regional hotel market, the Bank is keen to be more proactive. Our colleagues in the regions are being encouraged to seek out potential deals in the hotel sector and we are very happy to help where we can.

Q Do you think there will be more competition between banks in 2014 in terms of hotel business?

A **DS** - Over the last 12 months or so we have already seen more variation in terms and a lot more competition, with owners/ acquirers “shopping around”, unfortunately we are also seeing borrowers “pitting” one bank against the other to get the best deal, and this is something that we have not seen for quite some time. Insurance companies and pension funds are now also coming into the hotel lending space potentially structuring loans in slightly different formats.

TB - Even with a decent level of transaction volume in London, if there are more banks pitching to lend than previously – including non-UK banks – this cuts down deal availability. The PE houses are also in the market, as are pension funds; they will look at longer term loans than most banks, particularly in Europe. Some banks are taking higher hold levels than they would have done in the past, which brings them into deals they would not have been in before. You have to be competitive and relationship-driven to get the best deals.

Generally speaking, hotel funding deals should not in our view be viewed as corporate real estate transactions. They can't be funded as such - unless you are looking at the likes of Premier Inn who will take leases on a more traditional and predictable rental pattern.

When you have a hotel with a management agreement, which is the case with many hotels operating in London, you have a variable income stream in spite of relying on a third party to service the payment. That kind of investment is more challenging for an insurance company for example, which is likely to be looking at 20-25 year returns.

However, even these more traditional investors are realising that there is a big demand for hotels, particularly in central London. Also that if the deal is structured at the right level, there are hotels that will be there for – and stay open for - the longer term. In other words, some of the more traditional investors are beginning to realise that the managed hotel can represent a good opportunity, subject to getting the debt levels right.

Q Are you seeing hotel operators more prepared to put money into a deal?

A **TB** - A lot of operators are talking about doing this and about offering minimum income guarantees. However, we see very few of these deals. The key for us is the management ability and track record of the management team – but equally they will need to be backed with equity. Generally, strong managers do not own all of the equity but they have strong backers, predominantly recently from overseas.

DS - We are not seeing operators putting substantial sums of cash into a hotel deal, however its true to say that there has been a shift, along with both overseas and existing UK operators accepting the need to put equity into a transaction.

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Diane Scott

Business Development Director Hotels,
Lloyds Banking Group

Q Do you think the Bank will be prepared to contemplate lending for development in 2014?

A **DS** - The Bank would do so in the right circumstances, though for us it would be via our corporate real estate team. However, both the operator and location would need to be of the highest quality.

TB - The Bank would be more inclined to do this with an existing client with a track record. You need someone who can demonstrate that they can develop, and at the same time can manage the hotel operationally on completion.

Q Have you found yourselves faced with any novel issues in deals you have been handling in the last few months?

A **TB** - Every time we do a deal something different comes up! What is important to one person can be unimportant to someone else.

What we really do find concerning however is that some funders that we know - and have high regard for - are starting to talk about LTV rather than leverage, because of what is happening in the market and the prices that are being achieved. We shouldn't be going back to that mindset.

Q Are non-disturbance agreements (NDA's) - a benefit or a burden to you?

A **DS** - We have not signed an NDA for some time and operators are now much more accepting of this. That's not to say that in the right circumstances we wouldn't, however they can be restricting from a Bank's perspective.

TB - NDA's are certainly not automatic anymore, as they were in the past. It depends who the operator is. The major operators are still looking for these to be signed but in the deals we have done, we have not had to sign an NDA. That's not to say that we wouldn't do so in certain situations if it's right for the parties. Ideally we are likely to want to have the ability to retain the operator if we wish to do so which might on occasion require us to enter into an NDA as part of this negotiation.

“
The market has started to pick up nicely with London as always leading the way.”

Q Are you looking at new types of business or are you focused on historic relationships and more traditional formats?

A **TB** - Both, but with a leaning to the more traditional operation. We have been following the progress of businesses like Airbnb and HouseTrip. I think that some of the traditional hotel businesses are worried by them and I am sure there will be a market for this type of business at the lower end. However it would be difficult for us to lend to that sort of operation using our normal criteria. It is also difficult for us to lend to hotels that might not have an alternative use if a particular concept were to fail - for example capsule hotels where none of the rooms have windows. You would need to factor in the conversion cost if you had to sell the asset and this would impact on the loan size.

DS - As Tony has already alluded to its both. It's definitely more difficult to fund a new hotel concept which is untried in the UK- conversely we would also find it a challenge to fund a non-traditional concept at the same level as we would say a freehold asset - bricks and mortar in an established location.

Getting in touch

When you need a practical legal solution for your next business opportunity or challenge, please get in touch.

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BLP Hotels Group

For 12 consecutive years, Berwin Leighton Paisner has been the top-tier ranked law firm in advising hotel clients. Our international Hotels Team advises on deals in every sector of the market, including management agreements, franchising and licensing and M&A operations.

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