Overview

Members of the ULI Europe Hotel and Resort Development Council met in June 2015 at the Ace Hotel in London ahead of the ULI Europe Real Estate Trends Conference.

Presentations and discussions touched on a variety of topics, including the current banking environment for the hotel industry (with an emphasis on Spain), comparisons between the hotel investment segment and other property investment categories in Europe, and hotel landscaping trends.
The Deerbrook Group recently acquired the Ace Hotel. Billy Skelli-Cohen, the Deerbrook Group’s Director of Hotel Acquisitions and Development welcomed the Council, introduced the Ace, and discussed why the Deerbrook Group found it a compelling opportunity.

The Area

- Shoreditch is an up-and-coming area in London, a place where people want to live, work, eat, drink and shop.

- There is about 1 million square feet of office space within a stone’s throw of the hotel, which will soon grow as Amazon’s UK headquarters plans to move down the street.

- Nobu and Gansevoort are coming to Shoreditch, which will set a new rate barrier for the area.

The Brand

- Ace is in the new generation of hotels; it comes with no legacy so the brand has to write its own story.

- The brand pulls from all markets, from young professionals to older customers who want a different hotel experience. Ace hotels are effortless, natural, and do not feel engineered. The lobby doubles as a social hub and a communal workspace.

- The Ace Hotel in Shoreditch has a neighbourhood concept and competes with other lifestyle hotels in London.

The Bottom Line

- The hotel will have a projected 193-194 ADR this year and profit margins are quite healthy.

- Food and beverage do very well, particularly in the winter.

- There is rate compression going on in London at the moment. The market is doing very well. Hotels that are in real trouble are the ones that are just selling a hotel room. Hotels that are able to deliver an experience over all star categories will perform the best.

- Financing: Most lenders post crisis and in this bullish market are struggling to price assets like this hotel in London.
Helena Burstedt, Partner at EY in Madrid, reviewed the current banking environment for the European hotel industry, with a particular emphasis on the revival of the lending market in Spain.

**Background: Effects of the crisis on banking in Europe.**

- **Spain:** Before the crisis, there were approximately 60 banking entities in Spain. As a result of the crisis, the banking sector consolidated—seven of the most feasible entities absorbed the non-feasible entities and many remaining non-feasible entities merged to create feasible ones.

- **SAREB** - a Spanish management and divestment company for assets - arose from the banking sector reorganisation. 45% of SAREB is owned by the Spanish government, the rest by national and international banks and insurance companies. After 2 years, SAREB has sold 24,000 assets, repaid 5.7 billion euros in debt, made 25 wholesale transactions, received 2.4 billion euros in interest, and generated 9 billion euros in revenue.

- **UK:** The UK banking sector was already quite consolidated but was strongly affected by the crisis and some banks were absorbed by other entities.

- **Germany:** The German government injected quite a lot of capital into the banking sector (30 billion euros) and provided deposit guarantees of 150 billion euros.

**Current state of the Spanish banking sector:**

- Rescued entities are just as keen to finance as non-rescued entities. New mortgages increased by 23% in Spain last year and the economy as a whole grew by 1.4%, making it one of the fastest-growing economies in Europe. Spanish banks pass the stress test. The tourism sector is extremely strong and there is a strong appetite for financing Spanish hotels. However, banks are currently focused on selling property assets and they continue to inflate balance sheets with distressed real estate.

**Hotel investment in Spain:**

- Hotel investment in Spain has become very strong in recent years: 2014 reached almost 1 billion euros and 2015 is expected to exceed 1 billion euros. There has been an onslaught of large deals, investor interest, and international investors daring to move into Spanish resort hotels. Investor confidence is strong due to excellent tourism results and an improved macro-economic situation in Spain. Banks are solvent and starting to finance.

- **Deals:** Project Amazonia, Project Meridian, Project Castle, Project Formentera (ongoing), Project Otelo (ongoing)

- **Single asset deals:** Senator G Via 21, La Quinta, Dolce Sitges, Project Corona, Hotel Ritz, Villa Magna (ongoing), Barceló (ongoing).
International vs Spanish Banks:

- International banks have had a decreased market share in Spain since the crisis; national banks have increased market share. International banks not that keen on hotels and have much tighter conditions than national banks. International banks are more short-sighted and quicker to sell bad debts when things turn sour, while national banks create relationships and try to solve problems.

Markets:

- The urban market has suffered most in the crisis.
- Banks don’t want to finance land purchase - if you buy a mixed use resort, you buy it because of the capacity to build residential.
- Holiday homes in Spain in good locations and high quality modern buildings are doing very well.
- Barcelona has been booming during the crisis and there is a consensus among Barcelona citizens that there are too many tourists. Banning further hotel development would be great for existing hotel owners but bad for investors and developers.

Lessons learnt:

Hotel context: In terms of lease management agreements, banks regarded hotels as real estate investments and used lease agreements. Now national banks are open to management agreements and keen to finance management as well. Banks now analyse in detail the business plan that any hotelier puts in front of them. Banks must understand the business of hotels. This will make the sector more rational when it comes to financing.

Costs and term: In 2014 and 2015, margins and fees have been at 200-250 basis points and deals have closed with less than 2% (200 basis points). Rates have dropped considerably since the crisis. The term of the debt varies and depends on the bank - between 5 and 15 years. Some banks prefer to finance longer than the lease or management agreement while other banks are more flexible. With regards to amortisation and bullets, every bank has its own view. Some banks are against bullets and want everything to be amortised; others welcome bullets and want amortisation of 2-2.5% during the life of the loan. Margins are narrow and if the global economy changes, hotels could suffer.

Covenants: Banks want 50-60% LTV, so anyone buying in Spain needs to be cash rich.

Guarantees: If a hotel is seasonal, the debt service is paid every 3 to 6 months. Hotel assets are what counts for guarantees, which comes back to understanding the business.
Panel Discussion: Hotel Investment
Panel members: Giorgio Manenti, Eastdil Secured; Trish Barrigan, Benson Elliot; Carmen Hui, Host Hotels; Rob Rossman, Deloitte

A panel of industry experts compared hotels with other property investment segments.

Advantages of investment in hotels.
• Hotels generate capital appreciation and have high trading incomes and yields.
• In 2014, global hotel deal volumes rose 10% to $60 billion and European luxury investment is at an all-time high.
• Over the past decade, hotels as an asset class have become increasingly more attractive. It is a good time to be overleveraged in hotels today as there is a sentiment that there will be significant growth in GDP in Europe in particular.

Panel insights
- “Hotels are a good investment because of macroeconomic play.”
- “Hotels tend to generate more cash flow than other forms of real estate.”
- “Hotels are a good asset class if inflation returns.”

Franchises:
• Moving from brand-managed properties to franchises with third-party managers is becoming more prevalent in Europe. This can be an opportunity: there are differences in valuations between brand-managed and franchised properties and 60%-70% of stock in the European region is independently owned. But brand managers can do just as well as franchise operators. Spanish hotels. However, banks are currently focused on selling property assets and they continue to inflate balance sheets with distressed real estate.
• Franchises are mostly popular because they are incredibly flexible and have low fees.

Panel question: where are we in the cycle in the US, UK and continental Europe?
• The US and the UK are in the last part of the cycle and continental Europe is in the mid-to-third quartile of the cycle. Certain places in Europe are in the first inning of recovery.
• Development financing is weak; only in the UK is there development financing available, and only from speciality lenders. On the continent, it is very difficult to get development financing.

Panel insights
- “There is a complete disconnect between cities and countries: the velocities of cities are separate from those of countries as a whole.”
- “The moment you get a flourish of big development; that is the time to sell.”
- “London and New York are great long-term core markets. You just need to figure out the right time to invest. Just because there is new supply coming into New York now does not mean we are shying away.”
Attendees debated the challenges presented by AirBnB and OTAs.

- “Hotels don’t have the capacity to accommodate everyone who is traveling. I think they need to legislate where AirBnB needs to pay its fair share.”

- “The impact of AirBnB is dramatic. The bulk of the business is sub-lets and hotels are trying to find a way to stop the madness.”

- “We don’t see the impact of AirBnB in our figures. Hotel markets are still growing in cities where AirBnB is prominent.”

- “I think AirBnB definitely has a different type of market. It’s early days still. You cannot assess its long-term impact yet; it is only now becoming a more accepted and widely-used tool. As it gets more press and validation, the impact will grow significantly around leisure and not around business.”

- “In Paris, AirBnB represents 20% of room-night stock. I think it is a threat.”

- “OTA commissions will go south of 10% because there will be a major fight for business. These are strong brands but money talks. It’s a free-for-all and it just started this year.”

- “People go to OTAs because they have the perception that OTAs have the lowest prices.”

- “The question is to give the best service, the best product. Everything else to get there is just intermediate. OTAs will have to deal with us, with our operators. The client would ultimately win and the people who suffer will be the people between the client and us. OTAs are unwittingly acting against clients.”

Panel question: You have $250 million and a 10 year investment horizon. Where would you invest?

- The panelists’ answers ranged from Milan, to Spain, to key gateway cities across Europe at either the upscale or the budget end.
John Goldwyn, Vice President and Director of Planning at WATG in London showed examples of recent landscaping trends and discussed how landscaping, although often overlooked, can distinguish a hotel and add value.

*THE VALUABLE GREAT OUTDOORS*

Landscape Architect Frederick Law Olmsted justified New York's Central Park by noting that the increase in the value of adjacent property would produce enough in taxes to pay for it.


The following year the museum received record-breaking numbers.

Bishan-Ang Mo Kio Park, Singapore

The Bird Creation Garden at the Art Science Museum. © John Goldwyn, WATG
Members and Guests of the Council included:

- Algonquin Group
- Benson Elliot
- Crosstree Real Estate Partners LLP
- Deerbrook Group
- Deloitte
- Dexter Moren
- DGA
- Dorchester Collection
- Eastdil Secured
- Ernst & Young
- Four Seasons Hotels and Resorts
- Future54
- Hard Rock Hotels & Casinos
- Host Hotels & Resorts
- HVS
- Hyatt International
- IHG
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- Marriott Hotels International Ltd
- Morgan Stanley Real Estate Investing
- Patron Capital Advisors LLP
- Starwood Hotels
- WATG
- Wyndham Hotel Group

About ULI

The Urban Land Institute is a non-profit research and education organisation representing the entire spectrum of real estate development and investment. ULI was founded in 1936, and now has circa 35,000 members in 95 countries worldwide. In Europe, we have over 2,300 members.

European Councils are forums for industry leaders to meet, exchange ideas, share best practices and foster thought leadership in their specific sector of the real estate market. Consisting of a genuinely international membership, the councils provide a unique platform to learn from peers in the same sector who are operating in different geographical markets, as well as help shape the future of pan-European real estate.

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The success of ULI’s Product Councils relies on the active participation of our senior executive full members. If you would like to share your expertise and be involved in shaping the future of real estate in Europe, please contact the relevant Chair or Clare Game at clare.game@uli.org for information on applying to join a Council.

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