

Shortage of quality stock and consolidation are expected to fuel investment boom

# Hotels nearly booked up

A shortage of stock and income growth expectations sparked a boom in the hotel investment market in 2006. And hospitality industry restructuring will fuel the boom in 2007.

Philip Ward, a director at German bank Eurohypo, says: "Consolidation of the hotel industry on a large scale is still to come in Europe. It will involve property investors. Hotel chains will sell property to finance capital-intensive growth. Experience in the US shows that property-oriented investors can play a major role in the restructuring." Hotel trading performance is expected to be a "top prospect", according to the *Emerging Trends in Real Estate 2006* survey by PricewaterhouseCoopers and the Urban Land Institute.

High net-worth individuals, institutional investors, REITs, property companies and private equity invested a total of €21bn in European hotels last year, a 31% increase on 2005's figure of €16bn. Global transactions were up 38% to €30bn.

"People are just sitting with the cash right now waiting to do these big transactions. A lot of buyers in several locations have put

pressure on prices and compressed yields," says Alexis Delprat, director of European Hotels at Savills.

Throughout Europe, the hunt seems to be for prime assets: trophy buildings with a good brand and in a top location. London, Paris, Moscow and Amsterdam will be the favourites for 2007.

Morgan Stanley Real Estate Funds has begun a major drive into top-end hotels. It plans to build a €2bn European hotel portfolio following its acquisition of seven hotels from InterContinental for €634m in a manage-back contract last July. It now own 14 hotels in Europe.

Invesco recently closed a €700m European Real Estate fund. Geared at 60%, the fund will invest in three- and four-star hotels throughout Germany, France and Spain through a mixture of leases and management contracts and has promised investors a dividend of 7%, which should prove to be attractive.

The UK market has been the most active in Europe and investors there are now looking overseas. London & Regional

has been active in Finland and Sweden – Nordic hotels account for €741m of the €1.9bn portfolio it listed on the UK's Alternative Investment Market. The company owns some of London's most prestigious hotels, including the Hilton on Park Lane, and has plans to develop two four-star hotels in Novosibirsk and St Petersburg.

Daniel Poser, managing director, hotels at London & Regional Properties, says: "The UK market has got very expensive. We take the view that when the underlying interest swap rate plus bank margin is higher than the yield investors are accepting, then you are often paying upfront for growth that may not materialise. Of course we look at special situations in the UK but we also have a network of northern and eastern European offices and most recently a substantial presence in South Africa. This gives us the ability to look at other places that haven't become so crowded."

According to Jones Lang LaSalle's executive director of hotels, Rob Seabrook, some investment deals have now become so competitive that pricing seems out of kilter with the trading fundamentals of

## Portugal seeks investors to fund its fairway future

Portugal's minister for the economy and innovation, Manuel Pinho, wants the country to be Europe's premier golf destination by 2009. The hotel sector is expected to play a large role in achieving this target.

Domestic companies such as Vila Galé and Banco Espirito Santo are involved in hotel investment while new companies, such as Grupo CS, have entered the market.

But the hotel market remains dominated by private companies and families. There are very few transactions compared to other asset classes, and hotel prices remain high. It is difficult for

companies to justify the asking prices with an imbalance between the investment needed and the likely future cash flows.

Although there is growth, profits do not match room occupancy rates. In 2005, while occupancy rates rose by 4.3%, profits only rose by 1.4%, according to Cushman & Wakefield. In the first half of 2006, occupancy rates rose by 5.8% on 2005, with turnover 9.3% greater than the previous year.

"Most key hotel operators are growing organically, buying land, making their own projects and moving on," said Jorge Catarino,

head of hotel advisory services at Cushman & Wakefield Hotels in Lisbon. "There are new entrants, banks, service industries and other real estate investments, groups that are cash-rich and looking for diversification."

The *bête noire* of the Portuguese hotel market is the management contract – although hotel operators like them, hotel investment companies prefer lease contracts.

Lisbon, the Algarve and Madeira remain the sector's hubs, although 50% of new resorts and 85% of the area to be developed will be in the Alentejo and Costa Azul regions.

