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Money glut presents new challenges to hotels as assets

New owners, new contracts, new operators

Augsburg (August 10, 2007). Hotel real estate moves between the hands of different owners more quickly than ever before. According to Jones Lang LaSalle, the sale of a hotel attracts an average of four potential buyers per property. This year, hotel real estate to the tune of 80 billion Euro will change hands - a sum which will again break the record set the previous year. Does such (quick) reselling increase the value of a hotel property? What happens with existing operator contracts? Consultants and asset managers have a whole spectrum of answers up their sleeve.

"For years, possession of hotel real estate was restricted to collection on leases," Stephan Gerhard explains, Chairman of Treugast Solutions Group, Munich, referring to the starting point for today's development. … Now, owners have to get used to the idea of management or even hybrid contracts, of shouldering their share of risk and of having to make their contribution to the optimisation of operations and assets. … "Hotel owners are becoming increasingly entrepreneurial," Hotel Consultant and Asset Manager Harald Muecke from Moenchengladbach adds. Off hand, he's able to name nine varieties of hybrid contract (see definitions at the end of this text). …

Certain is: today, hotel real estate changes hands more quickly. "Two to three years" Martina Fidlschuster from Hotour Consulting in Frankfurt estimates the average length of time a property stays with one owner. "Two to five years" is the observation of Michael Widmann, Managing Director of PKF Hotelexperts in Vienna. "Three to five years," is Gert Prantner's estimate, Managing Director of RIMC International in hamburg. Only institutional investors and traditional funds hold their real estate between five to ten years, Matthias Niemeyer, Managing Partner with STIWA Hotel Valuation & Consulting Ltd in Dusseldorf, adds, quickly receiving confirmation from Harald Muecke.

All consultants and asset managers agree, the resale alone doesn't add to the value of a property. If the value of the property increases, then it's as a result of improvements to cost and marketing structures, Pranter explains, or as Muecke and Widmann stress, through targeted investments for increased yield. "An increase in value is only possible with variable operator contract," Martina Fidlschuster adds, bringing in a new element to the equation. Above all foreign hotel owners are more chance-orientated and less risk-fixated than their German counterparts. … / Maria Puetz Willems

VARIETIES OF HYBRID-CONTRACTS

Fixed Lease Contract: The lessee pays the investor a fixed sum which is mainly dependent on the number of rooms.

Scaled Fixed Lease Contract: To ease the transition through the first 1-2 years of weak operating figures, a scaled lease agreement often comes into play. Here the lease sums payable initially are reduced, in the following years, they then rapidly increase. The lessee thus buys improved liquidity through the initial years at the cost of increased lease payments in later years.

Fixed Lease Turnover Related: In this case, the lessee pays the investor a low fixed lease sum together with a percentage of turnover.

Turnover Lease: The lease fee depends exclusively on turnover. Investor yield is thus directly linked to the economic success of the operator.

Turnover Lease with Guarantee: This type of contract combines the turnover lease with a guarantee of a minimum sum beneath which the lease fee may not fall.
Risk and Profit Sharing: Similar to the fixed lease turnover related, a small fixed lease payment forms the basis of the sum received by the investor. The gross operating profit is reduced by this amount and the remainder shared between lessee and investor in some fixed ratio. On account of

the difficulties in bookkeeping, this type of lease contract is found only seldomly.

Management Contract with Reserve Fund (Cap): In this innovative form of contract, a reserve fund is formed based on a fixed lease. Each year the reserve fund must surpass the lease sum by one percent of turnover. If this is not the case, the remainder is paid from the fund. If the reserve fund is exhausted, the lease fee is fixed at one percent of turnover.

Management Contract with Guarantee: The manager guarantees the investor a minimum sum. This guarantee should, in general, cover all annual finance costs.
Management Contract with Reserve Fund (Cap): For payment of any arising deficits, the manager forms an mostly limited reserve fund from which capital is drawn to cover deficits. Where the reserve is exhausted, the manager no longer stands under a duty to make up the deficit.

(Definitions: Muecke Hotel Consulting, Moenchengladbach)

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