

HOTEL yearbook 2010

What to expect in the year ahead

**Sir David Michels on the shape
of the coming recovery**

**The outlook for 20 key markets,
from China and the USA
to Germany, Brazil and Libya**

**Is it time to change in-room
technology standards?**

**How the crisis
will affect luxury in 2010**

**Editorial input from 25 hotel
industry CEOs**

This excerpt from the Hotel Yearbook 2010 is brought to you by :



Ecole hôtelière de Lausanne

The Ecole hôtelière de Lausanne (EHL) is the co-publisher of The Hotel Yearbook. As the oldest Hotel School in the world, EHL provides university education to students with talent and ambition, who are aiming for careers at the forefront of the international hospitality industry. Dedicated to preparing tomorrow's executives to the highest possible level, EHL regularly adapts the contents of its three academic programs to reflect the latest technologies and trends in the marketplace. Since its founding in 1893, the Ecole hôtelière de Lausanne has developed more than 25'000 executives for the hospitality industry, providing it today with an invaluable network of contacts for all the members of the EHL community. Some 1'800 students from over 90 different countries are currently enjoying the unique and enriching environment of the Ecole hôtelière de Lausanne.



Boutique DESIGN New York

Boutique DESIGN New York, a new hospitality interiors trade fair, will coincide with the 94-year-old International Hotel/Motel & Restaurant Show (IH/M&RS). Designers, architects, purchasers and developers will join the hotel owners/operators already attending IH/M&RS to view the best hospitality design offerings as well as explore a model room, exciting trend pavilion and an uplifting illy® networking café.



Hospitality Financial and Technology Professionals (HFTP)

HFTP provides first-class educational opportunities, research and publications to more than 4'800 members around the world. Over the years, HFTP has grown into the global professional association for financial and technology personnel working in hotels, clubs and other hospitality-related businesses.



Bench Events

Bench Events host premier hotel investment conferences including the International Hotel Investment Forum; the Arabian Hotel Investment Conference and the Russia & CIS Hotel Investment Conference. Bench Event's sister company, JW Bench, is a benchmarking company that has launched the Conference Bench and the Productivity Bench. An industry first, the Conference Bench, measures performance data for conference space in hotels throughout Europe.



Cornell University School of Hotel Administration

Founded in 1922, Cornell University's School of Hotel Administration was the first collegiate program in hospitality management. Today it is regarded as one of the world's leaders in its field. The school's highly talented and motivated students learn from 60 full-time faculty members – all experts in their chosen disciplines, and all dedicated to teaching, research and service. Learning takes place in state-of-the-art classrooms, in the on-campus Statler hotel, and in varied industry settings around the world. The result: a supremely accomplished alumni group-corporate executives and entrepreneurs who advance the industry and share their wisdom and experience with our students and faculty.



Hsyndicate

With an exclusive focus on global hospitality and tourism, Hsyndicate.org (the Hospitality Syndicate) provides electronic news publication, syndication and distribution on behalf of some 750 organizations in the hospitality vertical. Hsyndicate helps its members to reach highly targeted audience-segments in the exploding new-media landscape within hospitality. With the central idea 'ONE Industry, ONE Network', Hsyndicate merges historically fragmented industry intelligence into a single online information and knowledge resource serving the information-needs of targeted audience-groups throughout the hospitality, travel & tourism industries... serving professionals relying on Hsyndicate's specific and context-relevant intelligence delivered to them when they need it and how they need it.



WATG

Over the course of the last six decades, WATG has become the world's leading design consultant for the hospitality industry. Having worked in 160 countries and territories across six continents, WATG has designed more great hotels and resorts than any other firm on the planet. Many of WATG's projects have become international landmarks, renowned not only for their design and sense of place but also for their bottom-line success.

elevation



WATG re-invented the resort to reflect the magic of Kauai by paying homage to the unique island and its culture.

[READ MORE ►](#)

VISIONARY CLIENT



Ismail Haluk Kaya
Üçgen Construction and Trade Co. Inc.
Should a client invest in a monument to the architect's ego?

[READ MORE ►](#)



PROJECT SPOTLIGHT



St. Mary's Mixed-Use Residential and Retail

New luxury towers currently under construction in Kuala Lumpur set the bar high for metropolitan living.

[READ MORE ►](#)

THOUGHT LEADER



Shaun Hannah
WATG's director of sustainability talks about how the recession has impacted green design.

[READ MORE ►](#)



[facebook](#) [LinkedIn](#) [twitter](#) [flickr](#) [YouTube](#)



2010 : Hitting the bottom and beginning to recover ?

ALLEN TOMAN, Principal of Como-based **HOTEL REALITY ADVISORS**, once again takes Hotel Yearbook readers on a *tour d'horizon* of the world of hotel finance in the year ahead. Will lenders want to take on additional property exposure when balance sheets have been so badly battered ? Will pressure on operators to meet owners' cost-cutting demands finally ease ? Find out here.

«Every drunken skipper trusts to Providence. But one of the ways of Providence with drunken skippers is to run them on the rocks.»

George Bernard Shaw, « Heartbreak House »

«Fear makes the wolf bigger than he is.»

German Proverb

As this is written, the world economy is showing signs not so much of recovery, but of approaching a real bottom to the current economic downturn. However, reaching the bottom of an economic crisis may be a long way from beginning a sustained recovery. It will take years to repair the damage from the financial earthquake that shook the banking industry and governments with such tremendous force in the 4th quarter of 2007. And since that time there have been several serious aftershocks, with more aftershocks likely to occur in 2010. The depth of problems faced by financial institutions (private and public) as well as the serious economic distortion engendered by emergency government interventions will continue to unfold in the coming year¹.

On a positive economic note, for 2010 China is on track for GDP growth in excess of 8 %, with India forecast to register growth in excess of 6 % and Brazil in excess of 4 %. And, low, but positive, GDP growth is forecast for the US while low, uneven growth is forecast for the EU in 2010. And even Japan's economy is expected to achieve GDP growth only a little below that of the US and EU. However, much of this growth has been « purchased » either by injecting enormous amounts of bank debt into the economy (China); converting private debt to public debt (US, UK and EU); actively (US) or passively (UK) depreciating the national currency; or providing significant government subsidies to induce private consumption and bolster key industries (all of the above). The following chart summarizes the contribution of various economic units to

overall world GDP. The chart illustrates the actual and forecast shift in the contribution from the « developed » countries and the increased role of the « emerging » markets². Overall, GDP growth for 2009 is forecast at approximately 1.5 %, less than 25 % of the annual growth rate prior to the 2007 recession.



The real worry in the developed economies remains the near-critical health of the banking system and the consequent impacts on employment. The banking system in the US, the UK and much of the EU remains illiquid, and without sufficient levels of liquid reserves as the current value of their assets (loans) are worth less than their obligations (demand deposits)³. Despite widely publicized repayments by some major banks

² The « BRIC » countries are viewed as large, emerging markets with significant industrial capacity. They include: Brazil, Russia, India and China.

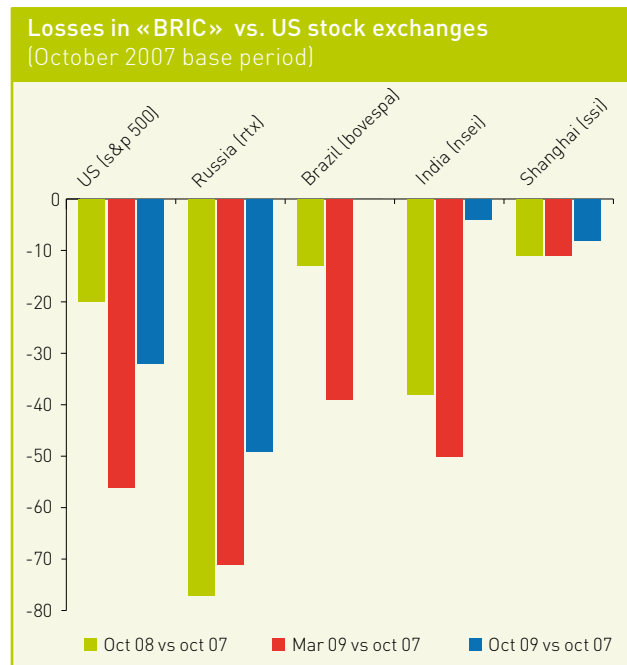
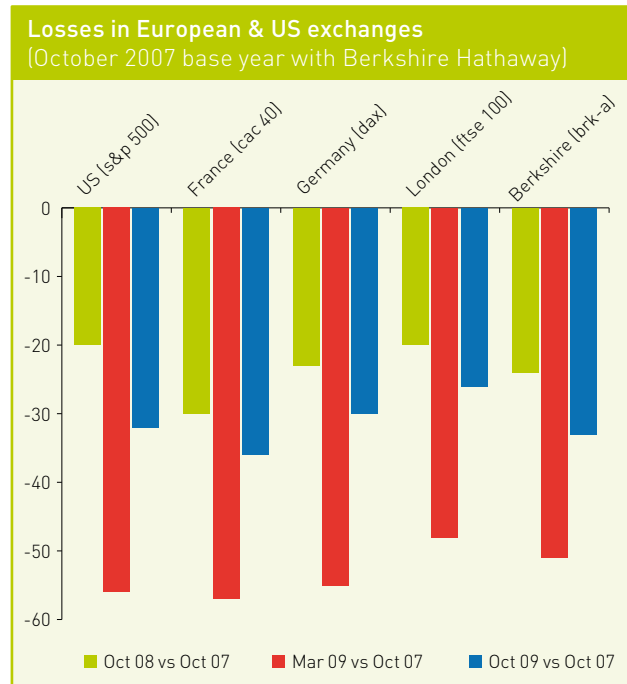
³ Of course, this means that bank reserves are, in effect, negative and many banks are insolvent (or, more directly: technically bankrupt). In fact, in the US regulators have started to seize and sell smaller banks that are not large enough to be considered essential for retaining public confidence in the banking system.

¹ It is always constructive to recall the words of the economist John Maynard Keynes. The following seems an apt characterization of the current « crisis » : «When the capital development of a country becomes a by-product of the activities of a casino, the job is likely to be ill-done.»

(and investment banks) of government injections of capital, the major banks remain moribund with reduced capacity (and little appetite) for taking on new risks or renewing existing lending commitments.

While governments have pumped billions of dollars, euros, yen and pounds into their respective banking systems while maintaining historically low interest rates, the depth and breadth of the banking problem has only become more apparent⁴. A direct consequence of these financial system problems has been a post-WWII record loss of employment throughout the US, EU and UK. While governments remain concerned at the magnitude of jobs already lost and the continuation of employment losses forecast for the first half of 2010, there is a growing unease that appreciable gains in employment will not start until sometime in 2011⁵.

While the financial crisis has been global in scope, the impacts have varied. The two charts shown here illustrate the differences in impact on the US and European markets⁶ and the four BRIC markets in comparison to the US. For the US, there is a pattern of loss in 2008 followed by additional losses in 2009 and a partial recovery in 2010. This pattern is similar for the stock indices for the other developed economies. For Russia, the initial decline is more dramatic with a lagging partial recovery. In the other emerging markets, the initial drop was less dramatic with an almost complete recovery in equity values to 2007 levels.



⁴ A related issue is the increasing level of government debt in the « developed » economies. For example, by 2014, the U.S. is expected to increase its government debt from 63 % of annual GDP to over 100 %; France & Germany are forecast to increase from 70 % to 90 %; and, Japan from 170 % to over 230 %. These levels of debt are likely to: limit additional actions these governments can take to combat future economic downturns; increase interest rates; and, likely, require increases in taxation.

⁵ Current unemployment rates in North and South America are approaching 10 %; in Europe the rate is closer to 8 %; and, in Asia in the rate is in the 5 % range. These are roughly 50 % above the « normal » rates.

⁶ The last column in this chart reflects the trading price of the class-A shares for Warren Buffet’s firm, Berkshire Hathaway, traded on the New York Stock Exchange. Known as one of the best and smartest investors in the world, even Mr. Buffet could not avoid the impacts of the current financial crisis.

Given the impact on the financial institutions and the overall equity markets, it should be no surprise that the impact on the hospitality industry has been both dramatic and widespread. In 2009, many operators came to the realization that maintaining rate integrity was eroding RevPAR⁷ and cash flow at the property level. While the resulting decrease in rates was partially offset by another round of operating cost- ▶

⁷ While not all markets have experienced similar effects, the 2009 year-over-year decrease in RevPAR has been reported at 15 %-20 % in the US, the EU and much of Asia with more dramatic decreases in the resort and luxury segments.

cutting, the results were disastrous for the property owners and management companies⁸. The deteriorating financial performance at the property level, combined with the growing realization that the debt markets will not recover in the near term, reinforced the continuing erosion in property values. And investors, led by the private equity sector, began heading for the exits. While much of the immediate damage has already been realized throughout the industry, the prospects for 2010 are not particularly bright.

Hotel property markets

«In one way, I'm sympathetic to the institutional reluctance to face the music. I'd give a lot to mark my weight to <model> rather than to <market>.»

Warren Buffet in Forbes Magazine, August 2007

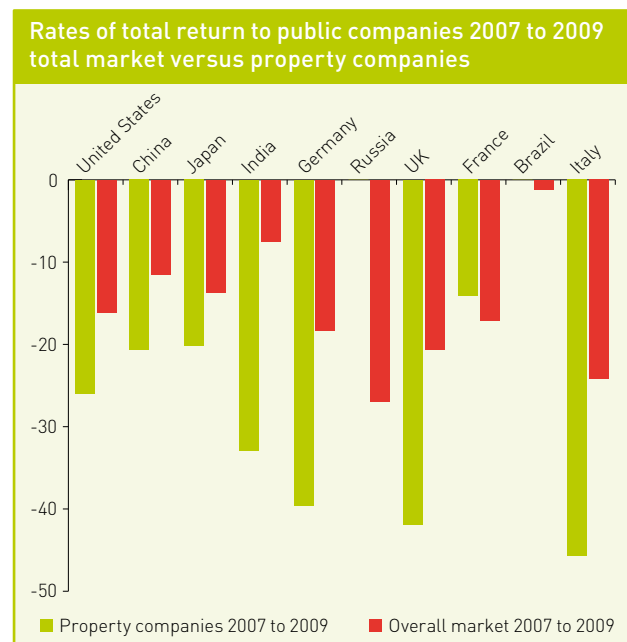
For 2010, the hotel property markets will not remain near their current state of suspended animation. However, there will be little to cheer the majority of owners. Outside of China, hotel lending will remain limited as banks continue to reduce their property portfolios and repair their balance sheets⁹. When available, new debt or refinancing will be provided only for the best properties and to the strongest borrowers who are willing to accept the new, medium term reality: low debt-equity ratios, shorter financing terms and increased lender protections coupled with higher debt spreads.

However, there are two positives for 2010: Additions to supply will be extremely limited, and overall interest rates should remain low. A further, mixed blessing is that transaction activity will increase as the capital markets stabilize and hotel RevPARs reach bottom and begin to improve.

⁸ For example, for 2009 both Starwood and InterContinental are forecast to have net income decrease by over 60% of 2007 levels.

⁹ The rate of debt defaults for commercial property mortgages is forecast to grow from its current level of some 3% to over 5% in 2010 and 2011, not returning to under 5% until sometime in 2012. This means that the banks with property loans will be under on-going pressure to raise the capital necessary to offset increasing loan losses while attempting to rebuild capital reserves. In 2010 they are unlikely to have either the ability or the interest in taking on additional property exposure or to refinance existing loans that mature.

The magnitude of the impact the global recession has had on the property markets is illustrated in the chart comparing the 2007 to 2009 performance of public company share prices for the overall market versus property companies.



In all but Russia, Brazil and France, the property company performance has been dramatically worse than the overall market. The most severely impacted have been property companies located in the EU, where losses are in the 40% range. The bad news for the hotel industry is that hotel property companies tend to significantly under-perform other forms of commercial realty in a down market.

Of even greater concern to investors is the prospect of increased volatility in the property sector and the move out of this asset class by many institutional investors and private equity funds. When returns for the property sector are compared for the period 2002 to 2007 with those of the

period 2007 to 2009, the reasons for dampened investor interest becomes obvious:



While returns over the period are not available for India and Germany, it is clear that returns at the property companies have gone into reverse at a very great rate. While the decline should moderate in 2010, it is unlikely that there will be either a strong recovery in this asset class or a sudden return to profitability. For the property ownership companies that manage to remain solvent during this period, there will be tremendous opportunities as limited liquidity returns to the property markets and weakened owners choose, or are forced, to liquidate their holdings.

An interesting form of liquidation¹⁰ scheduled to begin in 2010 will be by investment funds, such as Blackstone. The plan

¹⁰ Technically, the private equity funds would term this a sale, not a liquidation event. However, as private equity funds are not required to provide independent, arms-length valuations of their assets, what the true values are remains a matter of conjecture. Given Blackstone's 2009 write-down of its Hilton investment by some 49%, whether to characterize these planned transfers of ownership as market motivated or liquidations is a debatable point.

is to package portfolios of properties and form ownership companies. These companies would then be sold to investors through initial public offerings. This move is driven both by the business model of these funds and the expectations of their investors that the funds would recycle their capital within 3 to 5 years. Over the past year, the primary investors in these funds (insurance companies, sovereign wealth and pension funds) have been unable to withdraw and redeploy the investment capital invested in these funds. At the same time, many suspect that the value of their investments has eroded by more than reported amounts. This orderly «liquidation» would allow current insurance company, sovereign wealth funds and pension fund investors to recapture a greater portion of their initial investment than would property-by-property or portfolio sales in a market where debt is difficult to find and existing ownership companies are struggling with their own property and portfolio problems.

In a word, the hotel property markets have felt the brunt of the economic downturn and, to many, appear to be in a state of suspended animation. Transactions and property values have dropped sharply while debtor in possession seems to be the new growth industry in North America. And unfortunately, this growth industry is likely to spread to Europe and Asia as operating results remain impaired throughout 2010.

Given the growing realization that this is not a short-term economic dislocation and that the property markets are facing a period of serious readjustment, here are four things to expect in 2010:

1. A continued low-level of activity for single-asset, «market» transactions. Sellers will remain reluctant to sell at current values based on distressed levels of income and given the downward pressure on capitalization rates. Buyers will focus on other opportunities, including distressed assets, discounted debt, and other asset classes. ►

2. Smaller ownership companies will explore either privatizing, merging or selling¹¹. This will be driven, in large part, by the debt level on properties and the timing of debt maturity. Those with high levels of maturing debt will be unlikely to replace that debt without substantially increasing their equity contribution.
3. Small and large ownership companies will explore issuing new shares or taking on financial partners in order to raise the capital necessary both to continue operations and to meet the higher levels of equity that banks will require¹².
4. The larger ownership companies will closely watch to see how the initial property company IPOs fare. If the equity markets continue to recover, expect a rash of public offerings involving property portfolios. Also, expect a number of existing public companies to explore using their shares as capital to acquire distressed hotels and hotel companies¹³.

Hotel operations

«It isn't so much that hard times are coming; the change observed is mostly soft times going.»

Groucho Marx

The past two years have not been kind to hotel operations or hotel operators. It is a reminder of two characteristics of the industry that seem to have been neglected during the boom years prior to 2007: The industry is tied directly to the economic cycle (i.e. it is a highly cyclical industry), and hotels generally have high levels of fixed operating costs (i.e. small

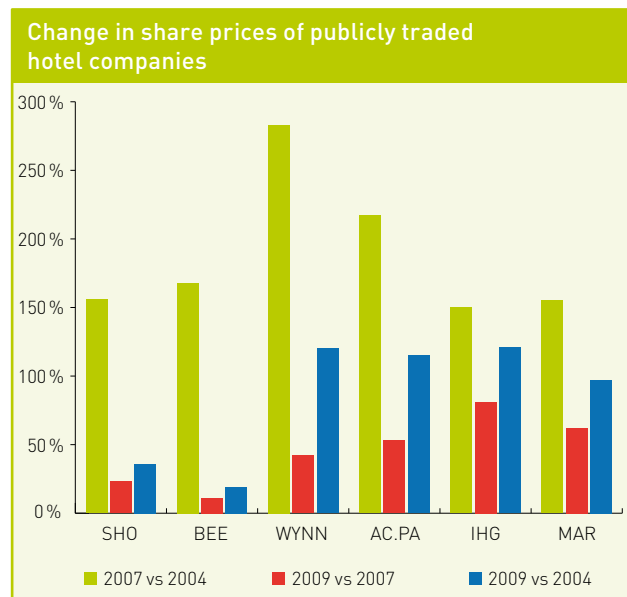
¹¹ In the US, Sunstone (SHO), a public hotel ownership company has already «turned over the keys» to the lender (voluntary foreclosure) for two of its major hotel properties. One of the properties, the W in San Diego, was purchased in 2006 for \$96 million and had a \$65 million first mortgage. This indicates a deterioration in the property value of at least 1/3.

¹² Sunstone is in the process of raising new equity capital through the sale of additional shares. Management has indicated that the proceeds will be used to pay down debt on their remaining properties. The effect on existing shareholders will be to dilute their current ownership position.

¹³ Given the weakness of the dollar and pound relative to other currencies, one would expect many US and UK hotels and hotel companies to be attractive to buyers from other geographies, especially Asia where property investors need to diversify out of the local/regional market.

drops in revenue translate into large drops in net income). These two factors have contributed to the sharp drop in operating revenue and, more importantly, net operating income. This, in turn, has led to the postponement of capital projects along with increased pressure from hotel owners on operations for items ranging from «flowers in the lobby» to brand requirements.

The reaction at the corporate level has been dramatic, as the chains have cut staff, delayed system investments and quietly relaxed some operating (brand) standards¹⁴. The only good news is that the impact on management companies has been less pronounced than the impact on ownership companies. The chart here shows the change in the share price of six publicly traded hotel companies for three periods: mid-October 2004 to 2007; mid-October 2007 to 2009; and mid-October 2004 to 2009.



¹⁴ In 2009, Four Seasons has been reported as «willing to listen» to owner requests for cost savings through staffing and service changes. However, officially the firm has maintained, «the brand standards are the standards.»

The results are set out for three types of hotel companies: two ownership companies (Sunstone and Strategic Hotels); two owner-operator companies (Wynn Hotels & Resorts and Accor) and, two management companies (InterContinental and Marriott). The owner-operator companies show the greatest share price increase for the period 2004 to 2007, and they have the best results when comparing the starting point, 2004, to the end point, 2009. The property companies have seen the most dramatic fall during the past two years, and their shares remain at a fraction of their 2004 price levels. The management companies experienced less of a fall during the past two years, and their share prices have recovered to 2004 levels.

During 2010, the operating companies should continue to increase in value as income at the property level stabilizes and the overall economic (and industry) prospects comes more into focus. However, various forecasters have estimated that it will be 2013 or 2014 before hotel RevPAR returns to 2007 levels¹⁵.

Given the major adjustments most operators have made during the past two years, there is not a lot to expect that will be different in 2010. However, here are four things to look for related to operations:

1. If possible, even more pressure from property owners and asset managers to control costs while improving top-line (i.e. RevPAR) results. Of course, this will be coupled with minimal capital investment by owners.
2. By the end of the first quarter, an uptick in the business and meetings segments driven both by some stability in the

economy and pent-up demand. This will cause operators to begin to test rate increases.

3. Expect even less help from the airlines. Despite slight increases in capacity, the airlines have significantly cut capacity both to secondary cities and on international routes (other than to South America and within Asia). While the budget airlines have greatly benefited hotels in secondary and tertiary cities, especially in Europe, many are now trying to survive. The surviving companies are focusing their remaining capacity on the most profitable routes (i.e. between major cities).
4. As the year progresses, increasing costs for supplies and energy. Oil prices are already above \$80 per barrel and are forecast to increase 20% or more as industrial and consumer demand increase during the year. The increase in supplies will be driven by three factors: diminished competition (suppliers exiting the market); increasing transportation costs; and the potential strengthen of the Chinese yuan.

Conclusion

«Great investment opportunities come around when excellent companies are surrounded by unusual circumstances that cause the stock to be mis-appraised.»

Warren Buffet

In 2010, the industry will remain «between Scylla and Charybdis» (or, for the less classical reader, «between a rock and a hard place»). Unlike the recessions experienced over the past thirty years, this one will not be over soon, and the markets will not rebound quickly. It is still too early to understand the extent of the damage caused by the near-collapse of the global financial system or the damage that will be caused by the multi-faceted (and largely uncoordinated) rescue packages put in place by various national governments. What is becoming clear is that both the operating and the capital facets of the hotel industry will be hard pressed for the next several years. ►

¹⁵ This makes the timing of the proposed IPO of the Hyatt management company curious. Will investors really pay a premium to share in the future of Hyatt in a period when the economic situation of the industry is, to say the least, grim and uncertain? Even more curious is the proposed split between A and B shares with B shares owned by the family and having 10 votes per share more than the A (public) shares. If this transaction, which involves selling a constrained 20% interest, raises the \$.75 to \$1.0 billion that is currently anticipated, it should open the way for numerous hotel-related public offerings in 2010.

For 2010, the industry, on a global basis, is expected to experience a slight decrease in rate and RevPAR, except in Asia. This means that operations will remain in a cost containment mode and that staffing levels are not likely to return to more normal levels. On the capital side, the reduction of debt remains a necessary condition to sustained economic growth. To date, there has been little progress in achieving meaningful debt reduction by financial institutions, companies or

consumers. This means that in 2010, the industry will still face ongoing capital constraints which will translate into depressed valuations and minimal re-investment into existing hotels.

The bright side of the story is that by the end of 2010 there should be solid signs of improvement throughout the global economy that translates into meaningful improvements for the hotel industry. ■





the leaders in hotel data

want to know
what the future holds?

forecasts

the ultimate resource for anticipating
future hotel industry performance

pipeline

the past, present and future of hotel supply
and projected growth

trends

detailed historical performance reports
on customized hotel samples

(US) +1 615 824 8664
(UK) +44 20 7922 1930
www.str.com
www.strglobal.com

we offer a complete suite of hotel performance
benchmarking reports and market data
contact us today to learn more