

THE HOTEL AND TOURIST INDUSTRY IN FRANCE

Initial results and conclusions for 2009

Since autumn 2008, the hotel industry in France has been in a state of crisis. The first few months of 2009 were very bad, then the outlook was slightly brighter in summer as the rate of decline slowed, a trend that was unfortunately not confirmed in autumn. Thus, during the first 9 months of the year, **the cumulated decline in bookings was 5.2%** compared to the same period in 2008 (source: survey of hotel bookings). Bookings from **foreign guests fell the most**, the number of their hotel nights from January to September 2009 dropping by 11.1% in a year compared to a fall of 1.7% for the French. **Europeans**, who account for three quarters of foreign guests, **were the most affected by the crisis**, their numbers dropping by 12.5%, in particular the British (down 20.6%), the Spanish (down 16.3%) and Russians (down 22.7%). For visitors from more distant countries, the decline was not as sharp, in fact over the summer there was a slight improvement in figures for Americans, Asians and Middle-Eastern visitors.

Consequently, the regions that usually attract high numbers of foreign visitors were the most affected by the downturn: Ile-de-France (a year-on-year fall of 6.9%), Provence-Alpes-Cotes d'Azur (down 6.5%), Midi-Pyrénées

(down 14.8%). Conversely, destinations on the Atlantic coast were spared the worst of the slump because French visitors continued to go there in the summer at a reasonable rate. In fact, **the crisis did not prevent the French going on holiday, but it did make them adjust their spending habits** and they turned their backs on holiday destinations further afield, staying in resorts closer to home in France. This is illustrated by hotel bookings: since the start of the year, bookings fell by less than 1.2% in Basse-Normandie and Poitou-Charentes, 0.6% in Pays de la Loire, 0.9% in Bretagne and 0.8% in Aquitaine.

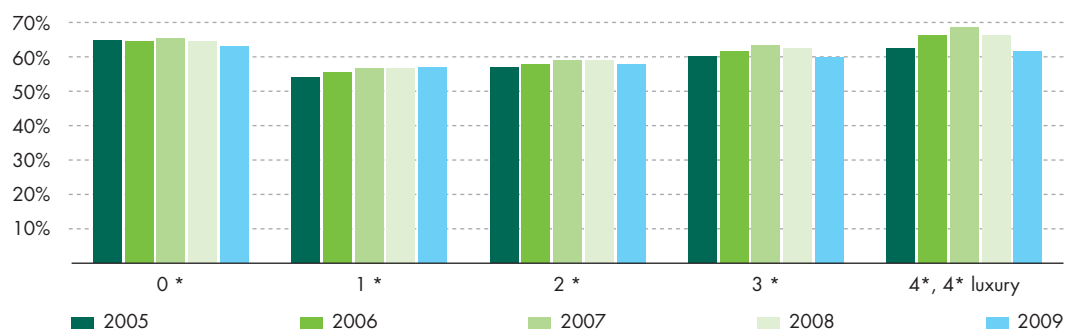
All market segments were affected by the fall in sales. **Budget hotels reacted the most swiftly to the crisis and adjusted their capacity to the new economic climate.** The fall in occupancy rates in this segment was lower than in upper-end establishments, whose supply of rooms continued climbing. Occupancy rates in one-star hotels showed a year-on-year reduction of 1.1% for the first three quarters compared to a 6.3% fall for four-star hotels. **However, the most comfortable categories are the first to benefit from the return of visitors from afar.** After a difficult start to the year, the reduction in occupancy rates for four-star hotels seemed to settle as the year passed, while other market segments, hitherto relatively spared the decline, suffered more.

TRENDS

- Occupation rate ↓
- RevPAR ↓
- Investments ↓
- Prime yields ↑

Trend / 2008

Occupancy rates in tourist hotels by category, from January to September 2009



Source: survey of hotel occupancy - Insee, Tourist Office, regional bodies

More importantly, **although the fall in occupancy rate is not inconsiderable, neither is it a catastrophe for the industry.** Some hotels are taking advantage of the current climate to renovate their assets, which will temporarily affect occupancy rates but will reinforce the attractiveness of their hotels as soon as the industry's business activity really starts picking up. **By contrast, most hotel managers have chosen to sacrifice average room rates to keep occupancy rates high, which has a very negative impact on the RevPAR figures.** Due to the fall in the number of foreign visitors, tighter business travel budgets and fewer corporate and other events, hotel marketing strategies have changed: they are targeting a wider clientele, trying to appeal more to holiday makers and offering special promotional rates.

The fall in RevPAR particularly affected high-end establishments which have faced sharp declines in occupancy rates and average prices. Cumulated results from January to October showed year-on-year falls of 16.7% (source: Deloitte). **Conversely, low-end and budget hotels have weathered the downturn well** and managed to maintain, in some cases increase, their RevPAR. **The arrival on the market of recently renovated hotels has helped maintain average prices in this sector.** For two-star hotels the fall in RevPAR over the same period is just 4%. In most provincial cities, the RevPAR rose in the budget category; for instance it was up 7.8% in Montpellier, 7% in Amiens and 3% in Marseille.

Outlook 2010

As the summer season was less catastrophic than feared, many were waiting for more reasons for hope in the autumn. Some encouraging figures were released for the economy, as France and the USA pulled out of the recession and growth continued in China, Brazil and India, which resulted in a rise in world trade. **But French hotel sales saw no improvement at the year end; on the contrary RevPAR fell off more sharply** in September and October than in the summer months.

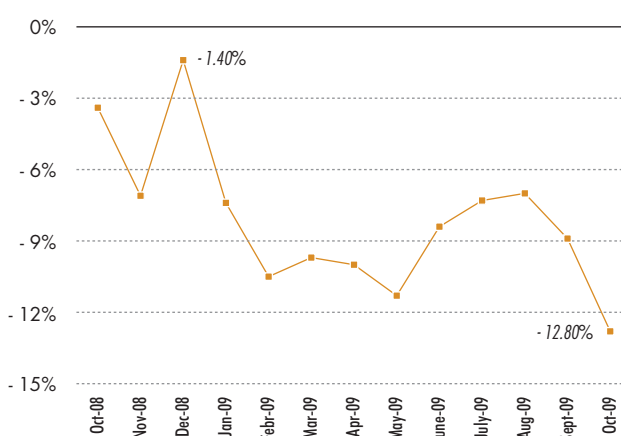
The outlook for the French hotel market is not encouraging. GDP growth is fragile, and a double-dip recession is still a possibility because the upturn in many Western economies is essentially based in the finance industry. **The purchasing power of the French will be weak for a long time** because there is no likelihood of a reduction in unemployment figures and salaries in many companies have been frozen. **On the international scene, we shall have to wait to see if the return of distant visitors stabilises.** The strength of the euro against the US dollar makes it more expensive for Americans, and for people from countries with currencies pegged to the dollar, to visit France. Finally, according to Deloitte, **only 20% of companies are planning to increase their travel budget next year** while sites for business events are still not booked up. These factors point to difficult times in the months ahead.

Performance of French hotels Cumulated results from January to October 2009

	4*	3*	2*
Occupation rate	64.90%	64.60%	64.40%
Trends / Y-1	-7.80 points	-6.70 points	-7.50 points
Average revenue per leased room	€216	€96	€64
Trends / Y-1	-9.10%	-2.90%	3.60%
Average revenue per available room (RevPAR)	€140	€62	€41
Trends / Y-1	-16.20%	-9.50%	-4.20%

Source: Deloitte

Monthly variation in RevPAR in France in a year



Source: MKG Hospitality

ZOOM: HOTEL MANAGEMENT

The management contract

The investor owns the real estate and the hotel business, maintaining full property rights. In order to protect the liquidity of the investment if a sale is envisaged in the future, two distinct holding companies are usually established so that the building and the business concern are separate entities.

To run the establishment, the owner sets up a management contract with a hotel operator for a fixed duration that can be anything from 10 to 25 years.

In this set-up, **the investor is responsible for the whole operation, legally and financially, and directly employs the hotel staff**. The investor is therefore responsible for all risk but enjoys all profit. The hotel operator managing the business generally receives an income that is composed of turnover-based and profit-based fees. The operator is therefore directly interested in making sure the hotel is profitable. To further engage the manager's commitment, the owner can also negotiate financial guarantees in the form of minimum operating revenues.

Lease-management contract

The investor owns the real estate and the hotel business, but transfers responsibility of the hotel operation to a hotel operator by leasing the business. The investor does not directly employ hotel staff and does not benefit directly from the operating income. The investor's unique income from the hotel is a rent paid by the operator, usually based on the hotel's turnover. Nevertheless a lease-management contract can only be established if the business concern has been run directly by the owner for at least two years.

The commercial lease

When investors embark on a hotel development, they have the choice of taking on the operating risks or delegating them and retaining ownership of the bricks-and-mortar alone. In the second case the business concern is sold to a hotel operator (or leased in a lease-management contract). **If, however, the hotel is already a going concern, in some instances the investor can only acquire the building by itself**, either because the former owner did not own the business concern either or because the hotel operator does not want to sell the business concern.

So the **investor rents** the hotel building to the operator that owns the business via a **classic commercial lease**. In this scenario the investor does not take on any of the responsibility of the hotel's operation and receives a rent that may be fixed or variable, with or without a minimum guarantee. The leases are usually fairly long, lasting very often at least 12 years.

For more information: Special report "L'investissement hôtelier", Opérations immobilières, July-August 2009, page 16-22.

Specificities of hotel investment

The specificities of hotel investment, compared to standard commercial real estate, are linked to the existence of a business concern and an operator that ensures the day-to-day running of the hotel business. For logistics or offices, the relationship is straightforward: there is no business concern, the investor owns the building and rents it via a commercial lease to another company. In retail, there is a business concern, but the retailer renting the premises is the owner of the business and the investor only owns the real estate.

In the hotel industry, several possibilities exist. The investor can choose to buy the building and the business or just the building. The relationship between the investor and the hotel operator can be packaged legally in several different ways that involve different levels of operating risk: the traditional commercial lease, lease-management contracts and management contracts. In practice, the hotel operator chosen by the investor is usually the party to dictate the modus operandi.

INVESTMENT IN FRANCE IN 2009

Much like the commercial real estate sector in Europe, **the investment market for hotels is going through an unparalleled crisis.** Throughout 2009, **less than 500 million euros were invested in France in hotels**, of which €272 million were for a single sale and leaseback deal with Accor in September for 158 of their F1 hotels. With the transaction volume plummeting by a third, the change was brutal and can largely be attributed to the **total freeze in market activity in the first half.** In the autumn, the market started moving again with, most significantly, the reappearance of a few transactions in upmarket areas of Paris such as the sale of Claridge Bellman and Renaissance Trocadéro.

The reasons the investment market was blocked are obvious. **The credit crisis forced potential buyers to provide considerably more equity for each transaction**, often as much as 45 - 50% of the total investment volume, which reduced the volume of capital that could be invested proportionately. **Above all, the turnaround in hotel trade severely affected investors' confidence in the hospitality sector's prospects.** Office investment enjoys much higher visibility than investment in the hotel sector as income from hotels fluctuates directly in proportion to the hotel's business operating result and, in some cases, there is no guaranteed minimum rent. In addition, while the prospects for capital gains upon resale fuelled the market in recent years, the recent fall in prices has wiped out any short term capital gains potential. Finally, **hotel operators, in a weaker position because of the crisis**, are more reticent to take on new commitments and are now seeking to pass on the operational risk to the owner/investor. The upshot is they much prefer hotel management contracts. This curbs investment in the hotel sector because very few potential real estate investors are also willing to take on the role of employer.

From the buyers' point of view, waiting is the name of the game. **Most sellers have not yet agreed to lower their prices and the gap between the parties' price positions is blocking the market.** Investors in the hotel real estate market are rarely opportunist players, their investments are generally for the long term and at the moment, although the crisis has cut operational results by 20%, this "cut" is on all-time high results. **The sector's profitability is at a decent level, so potential sellers have the leisure to wait for the market to pick up again.** Those investors with sufficient cash flow are even managing to take advantage of the slow period to carry out renovation works, thereby repositioning their asset in anticipation of an improvement in the market. **The investors in difficulty now are those who used heavy leverage to make their acquisitions** because poorer operating performance is making debt reimbursement problematic. Distressed assets are relatively scarce in France compared to other markets, for example Britain.

The few transactions that took place in Paris CBD on quality assets do not show signs of a significant fall in the price per room compared to those seen in recent years. This indicates that despite the current climate, which is particularly difficult for up-market hotels, **investors believe Paris will remain a preferred destination for stays in luxury hotels.** In fact it is worth noting that none of the development projects for luxury palace hotels in Paris that were initiated before the crisis have been abandoned; works have carried on as usual. And more new hotels are even being considered, including one on the former site of the Samaritaine department store in central Paris.

Hotel yields, January 2010

Paris itself	6.50% - 8.00%
City-centre in regional France	8.00% - 9.50%
Outskirts	9.50% - 10.50%

Source: CB Richard Ellis

uncertainty, hotel investment requires a total understanding of the ins and outs of operating a hotel so the investor can track the performance of each group. For this reason **the most financially solvent groups and funds dedicated to hotel investment will probably regain a prominent position.** Such groups will not hesitate to make the most of the specialist know-how to seize any opportunities on the market.

To summarise, **the outlook for 2010 is mixed. The market will not be able to reach an equilibrium as long as sellers are not willing to adjust prices downwards and buyers see no improvement in the operating results in the hotel industry.** Tourist activity is not expected to show any real signs of improvement before the end of 2010. In times of

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