

In the eye of the storm – or are we already overcoming the crisis ?

The profile of the German hotel market has always been different compared to its counterparts in France and the UK. Sky-high room rates in Paris and London have no parallel in Germany. For exactly this reason, Germany is weathering the '08-'09 economic crisis somewhat less painfully than its two European sisters. But what will 2010 bring ? **MATTHIAS LOWIN**, Managing Director of the Mainz-based **FEURING HOTELCONSULTING GMBH**, and **ANNE MOOSMANN**, Senior Consultant for the firm, walk us through an extensive analysis and prognostication.

We have got a crisis. Everybody is talking about it. But can we also really speak of a « crisis » in the tourism sector? According to the Federal Statistical Office Germany, hotel overnights dropped by 1 % in September 2009 compared to 2008 – does this really mean there is a crisis ?

What does « crisis » mean, anyway? How can we define a crisis? A lot of questions have been raised during this last year with regard to the topic. But there is no denying: yes, we are in the middle of a crisis. What effect on which economies this crisis will have remains to be seen. However, nobody can neglect that this crisis will have a certain impact on the tourism industry any longer and therefore also on the hotel industry. We will try the impossible and give an outlook for the coming year. What will the German hotel market look like in 2010? What will be the direct impacts of the crisis? The indirect? Is there any light on the horizon yet? Let us take a closer look at these things:

1. The first shall be last and the last shall be first

The German hotel market is one of the most modern markets in the world in terms of facilities. However, hotel prices in Germany do not comply with this high quality standard. Germany has always been a « demand-friendly » market in terms of hotel rates. While international capitals such as London, Paris or Rome realize high Average Room Rates (ARR), and single assets easily achieve rates in excess of €500, Berlin occupies the bottom of the list and realizes a constantly low ARR with top performers realizing only up to €250 – even though almost no hotel in Berlin is older than 10 years !

In comparison, Germany achieves much lower results than other European hotel markets. One major factor causing these low prices is the decentralization of the country itself. Where centralized capitals such as London or Paris concentrate the vast majority of demand in other countries, Germany has several capitals. Frankfurt as the country's financial capital, Berlin as its political and Munich as its technological capital lead to a spread of the demand, without any constant high demand in these destinations. Hence these cities cannot achieve comparable rates as other capitals in Europe.

During recent months, however, this huge disadvantage in terms of the price range turned almost into an advantage. What we could observe since September 2008 was that the hotel prices in Germany in relation to other European countries hardly reacted at all, whereas the European hot spots like London or Rome had to face a major decrease in their rates. A decrease in demand is true for all destinations – even for Germany – however the Revenue per Available Room (RevPAR) was not that highly affected and rates remained relatively stable in Germany. Whereas London, Paris and Rome, the top three in Europe, had to face major decreases in RevPAR, German cities remained relatively stable.

Rank (year to May 2009)	City	RevPAR % change (year to May 2009)	RevPAR % change (year to Sept. 2009)
1	Cologne (D)	-6.6 %	-15.6 %
2	Hamburg (D)	-7.5 %	-7.3 %
3	Frankfurt (D)	-9.9 %	-10.9 %
4	Munich (D)	-12.3 %	-19.2 %
5	Berlin (D)	-14.0 %	-9.2 %
10	Rome (I)	-16.3 %	-15.1 %
13	Paris (F)	-17.2 %	-13.9 %
18	London (UK)	-20.3 %	-12.4 %
40	Moscow (RU)	-41.7 %	-32.7 %

Source: STR global, 2009

In 2009, for the first time since it started, the crisis could be felt in the performance of the hotel sector in Germany. However, 2010 will show the real impact of the crisis on the German hotel market. As many contracts have been renegotiated, as well as some demand just collapsing, RevPAR may suffer even more than in 2009 – at least in the first half of 2010. However, as already stated, the impact will not be as hard as in

«spoiled» markets where the ARR usually is very high and the downturn is very noticeable. The other European destinations will therefore be faced with the same problems like Germany has had for years – small profits due to low rates.

The German hotel market has always been stable – at a low degree – and therefore will remain stable even during a recession. This is also due to the fact that Germany is a highly domestic market. Approx. 85 % of all overnights in Germany are generated by domestic travelers. Accordingly, this leads to a lower dependency on international business and therefore, the reaction to a downturn in international tourism is rather small. The problem for the German market will only come back when the economy is improving again. What will happen to the German markets when all other markets recover again? Will prices in Germany also go up, or will Germany – when the crisis is over – again be the last one in the row as far as prices are concerned?

Finding no. 1: Stable markets remain stable

2. Follow the signs

Tourism demand, in particular hotel demand, follows the economic cycles. A decline in Gross Domestic Product (GDP) results in a decline in hotel demand; an increase in GDP

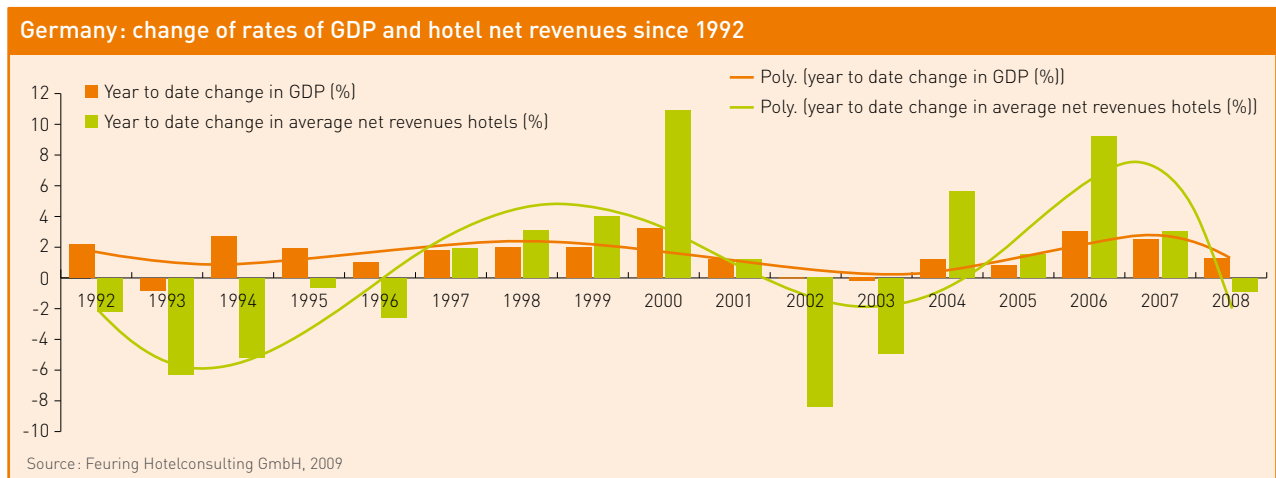
leads to an increase in hotel demand and therefore in the net revenues of the hotels. This is particularly true for chain hotels.

Hotel demand is highly dependent on the economy of the country it operates in, as well as the economy of its major source markets. The reaction of hotel demand – and hence the net revenues of the hotels – to the economic situation can therefore be seen with a short time lag, but it clearly follows the same pattern. Taking into account the slight increase in GDP of + 0.7 % in Germany in the third quarter of 2009 compared to the second quarter (source: Federal Statistical Office Germany) and cautious forecasts predicting a slow recovery of the economy by the end of 2009/beginning of 2010, we can also assume a recovery of the German hotel markets by the end of 2010 – taking into consideration the delay in the reaction.

Finding no. 2: After a downturn there must be an upturn

3. Action - reaction

2010 will be the year of truth – not only for Germany but for the whole of Europe. In 2009 a development could be seen on the German hotel market which was overdue. Hotel operating contracts which were signed carelessly in times when hotel investments seemed to be «foolproof» now reveal ▶



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their real potential – downside. Operating agreements with parameters that are not at all market-adjusted and simply not achievable, especially not on the German market, are now collapsing. One prominent example is the former Kempinski Grand Hotel Heiligendamm, meanwhile only the « Grand Hotel Heiligendamm », which now even needs to be backed up by the state in order to keep operations going. Another example is the most famous hotel in Germany, the « Kempinski Hotel Adlon » in Berlin, which according to press reports can no longer pay the inappropriately high rent negotiated in the contract. Compared to that, the reported re-negotiations of the former Dorint group or NH Hoteles seem to be quite minimalistic.

What do hotel investors learn from this? On the one hand, that there were just too many fish in the bowl of hotel development – fish that cannot really swim. One of the major mistakes made in the boom phase of hotel development was to believe that lease contracts are the best solution for investors. Now, not only are they not receiving the expected rent, even worse, they have to back up their hotels with extra money to ensure necessary renovations or even to keep the daily business going.

So are management contracts the better vehicle? Not necessarily. As always, it depends on the project, the situation and the need of the investor. To evaluate all this, it is necessary to cooperate with specialists. Hotels are special real estate properties, so their development needs special assistance. In order not only to avoid bad surprises in terms of hotel operation contracts but also to ensure a hotel is developed according to the needs of its clientele, it is necessary to have a team with long-term experience in the field of hotel development. A result which could already be seen in 2009 will also be present in 2010 and the following years: negative experiences with hotel investments due to imprudent contracts lead to a defensive demeanor on the part of investors and particularly financing banks. Even for highly promising hotel products, the hurdles to get financing were, and will be, raised much higher.

Side note to the topic

Let's take a short look at the important success factor « project development » and mistakes made during this phase which can turn the best premises for a hotel into a major disadvantage during operation.

7 mistakes in the project development of luxury resorts

Rank	Mistake	Result
1	Configuration	If buildings are not linked to each other operations become difficult ; an inconvenient situation and long ways for guests (e.g. from guest rooms to the SPA) lead to dissatisfaction of guests.
2	Room layout	Rooms need to be spacious above average for long stays.
3	Completion	The hotel needs to be complete when opening. A hotel with everlasting conversions and extensions cannot justify international 5-star rates; in addition the development costs do not end with the opening but with the completion, hence do not overspend before completion!
4	Seasonality	facilities need to provide for year round attractiveness; offer must be structured accordingly.
5	Surrounding	Outside areas need to be attractive and easy to access; no « Camp David character », integrate neighbourhood and destination; adequate offers needed outside resort (shopping, culture, etc.).
6	International management	Strong international brand with experience and a global reservation and marketing system needed.
7	« Go global »	5-star resorts live on their international clientele and its global reputation.

2010 will reveal more hotel developments that stand on shaky grounds. An interesting case will be the projected Mövenpick Hotel in Dusseldorf, now taken over by Sol Meliá.

The upcoming year will also bring about a shake-out of the market. As many owners cannot guarantee for renovations due to the lack of financing, hotel operators will take the opportunity to get rid of old, unprofitable properties in order to look for new developments. We will therefore see an

«American» development in Germany and all over Europe: a change in the operation of many hotels. This «nomadism» will take place on both sides. Operators will try to get out of old contracts for old buildings in order to update their properties. On the other hand, where owners are not satisfied with the performance of their operators and have the possibility to terminate them – they will look at what alternatives there are around. In addition, many hotel companies will have to survive a closer look by their investors. Hotel companies held by private equity investors in particular will have to face a selection. Over the last decade, hotel companies tried to diversify their offer and often accepted a dilution of the brand range. In 2010 there will be an ideal situation to get rid of brands and products which do not really fit the core product. Candidates for such a clean-up are almost endless. 2010 will bring light into the darkness of brands. Also, not only within hotel chains will an adjustment take place, but within the portfolios of hotel investors, too. Particularly private equity firms holding hotel companies in their portfolios will perform an extensive calculation of the value of their equity – therefore, we will also see asset stripping and sales of whole companies, as already done with Steigenberger, or split-ups, as discussed for Accor.

What began in 2009 we will continue to see in 2010: good properties with good contracts under good management will be successful and «survive» the crisis – as always.

Finding no. 3: «Pride goeth before a fall» – careless actions will be badly punished

4. Be good – be better

Apart from a market adjustment, the year 2010 will also show the first examples of successful counter-cyclical investments in Germany. Hotel developments which are now under construction and will be open by the end of 2010/beginning of 2011 – in parallel to the expected economic upturn – will be cash cows for their owners. While many existing hotels had to postpone renovations because of lacking (financial) resources, new hotels offer an up-to-date standard and will easily outshine their competitors. These brand new hotels will then not only offer the best product on the market but they will

absorb the – by then achievable – high prices on the market. Hotel openings in late 2010/beginning 2011 therefore have the best chances of success. Examples to be kept in mind will be the Hyatt Regency Düsseldorf or the Jumeirah Hotel in Frankfurt.

Finding no. 4: Upcoming stars will shine

5. The budget segment: savior or less-than-ideal solution?

The crisis is often linked to a crisis on the luxury hotel market and therefore seems to lead to a boom in the budget segment. This conclusion is misleading, particularly for the German market. As already stated above, the German hotel market suffers from a very low price range. Before this economic downturn, the price of an international 5-star hotel in Berlin corresponded to the price of a 3-star hotel in London. The logical conclusion therefore must be that international travelers coming to Germany tend to book hotels in the 4 and 5-star segment, as these hotels always correspond to their travel guidelines. This behavior may have changed during recent months; however, only about a quarter of business travelers expect to be «downgraded» from 4 and 5-star hotels due to budget restrictions, according to a study conducted by the Amadeus IT Group. Hence the majority of business travelers, particularly international travelers, coming to Germany will still stay at high-class hotels. In fact, companies will rather try to renegotiate corporate rates at hotels instead of completely changing their habits of accommodation. So 2010 will also bring this trend: renegotiation of corporate rates. This will lead to an exchange: more guaranteed bookings by companies at a preferable, namely lower, rate in hotels in the upscale market.

In addition, it could be seen on an international level for the year 2008 as well as for the first half of 2009, that not only the high-class and luxury segment is having to face a decline, but the budget segment is, too. This leads to the conclusion that (a) yes, demand for 4 and 5-star hotels has declined, and former guests now book into lower categories, but (b) demand in the budget segment has also declined as some guests just do not book anymore, or instead of booking cheaper business ►

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trips now book shorter ones – so that no hotel segment really benefits. In addition, the same study of the Amadeus IT Group from February 2009 proved that (c) particularly for business travelers, international service and quality standards and a renowned hotel brand are the most important criteria when choosing a hotel. As the budget segment is still under development, particularly international travelers will prefer to book higher categories with well-positioned brands instead of mostly local budget brands.

Finding no. 5: The most obvious solution is not always the best one

6. Back to the roots

In 2010, a trend will continue which we have already observed over the last years, even if the development happened somewhat « under the radar »: holidays in Germany are more popular than ever. In times of financial insecurity and international terrorist attacks, people tend to « remember their roots » and spend their vacation in their home country. However, this can also be linked to recent developments in the German leisure tourism infrastructure. New hotels, and in particular resorts with an excellent standard and – most important – a wide range of services which enable year-round operation, attract people of all ages and lifestyles. Family resorts such as the « Land Fleesensee » or on the isle of Sylt have become one of the major tourism destinations for family vacations.

The German tour operator TUI discovered this huge potential and invested well in time. Also, successful traditional hotels and resorts such as the « Hotel Bareiss » or the « Traube Tonbach » in the Black Forest have been operating successfully for decades – on an international level at international prices. This shows a trend which will become more and more obvious during the coming years: excellent hotels with an elaborated concept and high standards achieve prices which are equivalent to the quality they offer. Although German cities such as Berlin cannot achieve rates that are on an international level, German resorts can. The highest hotel rates in Germany are generated by resort hotels. In 2008, the leading hotel in

terms of prices in Germany was the Brenner's Park Hotel, a traditional health resort in the spa town Baden-Baden. This fact has not yet reached investors, though. Developing resort hotels – particularly in Germany – is very difficult due to the resentments of financing banks. The reasons for this were often the poor chances resort hotels in Germany were assumed to have, which is also true for the whole of Europe, by the way.

Nowadays, however, resorts are not only linked to their location but particularly to their concept and their range of offers. If a resort can offer year-round attractions due to an excellent spa, cultural events, haute cuisine, sports activities, meeting facilities etc., a resort hotel can be more successful than a city hotel will ever be. The successful new development « Schloss Elmau » close to Garmisch-Partenkirchen in Bavaria is a fantastic example, not only of a successful operation of a resort hotel with year-round attractions for guests of all age groups, but also of a successful project development. Elmau easily achieves an Average Room Occupancy (AOC) of over 70 % – a level of performance that city hotels in Germany can often only dream of. Hotels like Elmau will be the winners not only in 2010 but during the coming years, as they have identified the needs of today's travelers and, even more important, actually satisfy them. This guest satisfaction has its origin in three important factors:

- **Successful project development:** Resort hotels need a clear structure to function well. The space allocation is very important as e.g. no guest likes to walk across the whole site in his bathrobe to go to the sauna. It is often hardly possible to correct mistakes in the project development and they often come out disproportionately expensive once the hotel is under operation.
- **Concept:** Again, a hotel – and particularly a resort hotel – cannot function without an overall concept attracting guests on a year-round basis. If a hotel offers no more than the possibility to go skiing, it is sure to have to shut down during the summer months.

- **Experience:** In order to give life to these two factors, the operation of a resort needs experience in this field. Guests coming to a resort for their annual holiday require other treatments and services than guests staying in a city hotel during a business trip. Therefore, even if these first two conditions are fulfilled, a resort hotel will not necessarily work properly. As the example of the « Seehotel Überfahrt » at the Bavarian Tegernsee shows, you need more than a good hotel to be successful; you need to know how to operate the hotel in order to make its concept work. When Althoff Hotel Collection took over operations, the same hotel, formerly operated under another brand, finally became a success.

Hence 2010 will bring a change, not only to the habit of guests staying in Germany for their holidays more often, but particularly in the treatment of resort hotels as an investment.

Finding no. 6: Bella Germania!

7. Location, location, location?

Conrad Hilton has long been overtaken. It is no longer « location, location, location » that decides the success of a hotel, but – as already stated – it is more than ever « concept, concept, concept ». The development of the hotel market since the beginning of the crisis shows clearly where mistakes have been made in hotel development and operation. These mistakes will become even more obvious in 2010. Locations will only work with the right concept.

This will become especially true when looking at the development of budget hotels. The best location can be wrong if the concept does not fit the place. Maximilian Square in Munich or the Binnenalster in Hamburg are perfect locations for a hotel development – but will not work for a budget hotel. Even if the prices for land and particularly for existing – vacant – buildings are dropping and developments at places like these suddenly become affordable, cities in particular will register that they have to carefully evaluate where to support which hotel development in order to keep up the city's image.



Hyatt Regency Düsseldorf

Also, the « concept » as criterion for success is again highly linked to the experience, of both hotel operators and guests. Where new entrants in a hotel market often need to acquire price awareness, even in top locations, experienced hotel operators win by offering a renowned concept and experience in operation. This means guests trust their experience and prefer international brands, particularly in locations they do not know yet. This makes the entrance for new brands, or even unbranded hotels, difficult and often leads to a lower price for these products. Hence, what could already be observed, ►

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namely that chain hotels are doing better during the crisis than unbranded hotels, will continue in 2010 and even in the following years. Whereas today, Germany only has a market penetration by branded hotels of about 20 %, other countries register more than 50 % (UK) or even 80 % (USA). This development will also materialize for Germany, particularly taking into account the preference of (business) guests to stay in internationally renowned hotels and therefore branded hotels.

In addition, it can be said that hotel demand has changed over the years. The *necessity* of hotel demand – i.e. the need to stay somewhere overnight – is no longer the decisive element governing the choice of a hotel. Since there is a choice nowadays, a hotel with an appropriate concept, for example fitness facilities for business guests who want to relax after a hard day's work, will always be preferred to a hotel with no such facilities – even if the location of the latter hotel is better. The same is true for a ski resort offering an attractive spa area. This will always be preferred even if another hotel is closer to the ski lift. Hence, the most important criterion for the success of a hotel is the concept – before the location.

Finding no. 7: No concept, no success

So, what is our overall conclusion for the German hotel market in the year 2010? One thing is sure, we will not be out of the crisis. There will be no « business as usual » on the hotel market – that is the good news! In project development in particular, a high level of experience and knowledge is required to develop marketable hotels. Not everyone can provide this special knowledge, and therefore we will see a market adjustment – which will not only have negative impacts for the industry. Existing hotels, no matter if linked to a chain or independently operated, will have to do a recapitulation of their businesses. Now is the time to think over business models and react to the changing demands of guests. To remain at the top of the market, it is indispensable to provide the standard and the service quality guests are willing to pay for. A profitable hotel can only be reached via the satisfaction of its guests, in other words by offering the right product for the right clientele at the right place – namely by having the right concept.

The year 2010 will be the year of truth for the whole industry. With the reaction of the government and the decrease of the VAT for accommodation services in Germany from 19 % to 7 % the hotel industry gets some – much needed – help from outside. The effect of this economic action remains to be seen. However, hotel operators are already welcoming the measure and see a realistic chance to finally achieve and keep up average net rates in Germany and to directly benefit through this tax adjustment, and therefore get the chance to invest in their businesses and personnel.

In 2010, a separation of the wheat from the chaff will take place, everywhere: in project development, operations and demand. So the bad news for 2010 is this: We will have to say goodbye to some market players. However, there is always some good news, too: There is potential on the market. The question in 2010 will be how to use it... and *who* will use it! ■

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