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GERMAN BANK SURVEY

THERE IS MONEY FOR HOTEL LENDING!

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Introduction

Hotel financing has seen a major shift since the credit crunch and subsequent economic recession in 2008. Whereas bank lending was widely available and not a particularly hot topic for discussion, it has since been the focal point of almost every hotel investment conference in Europe and further afield. Despite these constraints shackling hotel transaction activity, Germany is experiencing increased interest from the international hotel investor community. With all the debate over the level of lending and the terms, we want to quantify some of the most important lending parameters and selection criteria.

HVS London conducted a comprehensive confidential survey with the ten major German banks (including private banks, Landesbanken and Sparkassen) that are active in hotel lending. The survey assesses the investment activities and sentiment in German hotel lending. Presented in this article are the results and trends.

The Survey

The survey consisted of ten questions with regards to current lending parameters for new loans and refinancing, loan characteristics as well as a future outlook on lending criteria. 85% of the banks that are currently active in hotel lending in Germany were surveyed for this article.

Results

Leases are still the predominant form of operating model for German hotels. Even though the future of hotel leases has been questioned by the international investment community, German banks are clearly comfortable with the model. Leases are also developing, and the historical fixed lease is starting to be replaced by hybrid lease structures that are a mix of revenue-based variable rent and fixed base rent.

We have therefore adopted a two-tier approach in our survey differentiating between lease and management agreements when asking for lending parameters and criteria.

Parameters used for hotel loans for leases in Germany

In our first question we sought to establish a picture of lending criteria currently used in new hotel loans and refinancing for leases in Germany. We further distinguished between primary and secondary cities.

When asked the level of loan to value (LTV) ratio, all respondents indicated an LTV of above 50% in primary and secondary cities for new hotel loans. However, unsurprisingly, primary cities tend to achieve higher LTVs, predominantly in the 60-70% range, while secondary cities achieve 50-60%. During refinancing, 60% of the

FIGURE 1: LTV RATIOS NEW LOANS (LEASES)

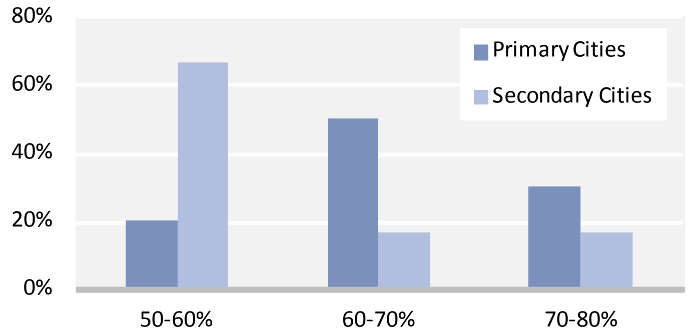
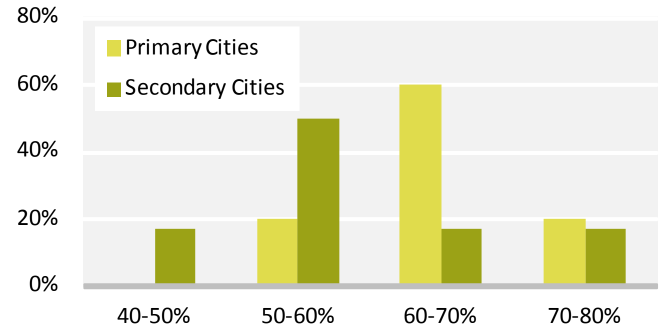


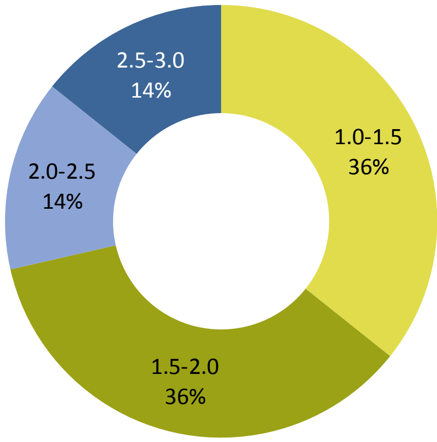
FIGURE 2: LTV RATIOS REFINANCING (LEASES)



respondents indicated that an LTV of 60-70% is applied in primary cities, which is a higher proportion than new loans, reflecting the existing relationship and performance history between the borrower and lender.

The same trend can be witnessed in debt coverage ratios for new loans – where 72% of the respondents indicated a requirement of up to 2.0 (Figure 3). Fixed interest rates surprisingly showed a varied response for both primary and secondary cities with the majority using more than 4.0%. Variable floating rates in basis points (bsp) saw a varied trend, with a wide range of between 100 and 400 basis points. For new hotel loans, 45% of respondents indicated 200-250 bsp for primary cities while secondary cities tend to require 300-350 bsp according to 50% of the respondents. This trend comes as no surprise, as the risk associated with secondary cities is generally perceived to be higher.

FIGURE 3: DEBT SERVICE COVERAGE



Debt service coverage ratios for refinancing showed a similar trend to new loans; 72% of respondents indicated a requirement of 1.0-2.0, of which 43% required 1.0 to 1.5, and 29% required 1.5 to2.0.

For refinancing, fixed interest rates also showed a varied response with the majority indicating an interest rate of more than 3.75%, a slightly lower level than that specified for new loans. Variable floating rates (bsp) applied are somewhat similar to the trend indicated in new hotel loans, with the majority apply 200 to 350 bsp in primary and secondary cities alike.

Parameters used for hotel loans for management agreements in Germany

Management agreements are still a somewhat second-tier model to leases in Germany where, as mentioned previously, most hotels operate under a lease.

The respondents mostly classified management agreements as receiving LTVs predominantly in the 50-60% range for new loans, for primary and secondary cities alike.

FIGURE 4: LTV RATIOS NEW LOANS (MANAGEMENT AGREEMENT)

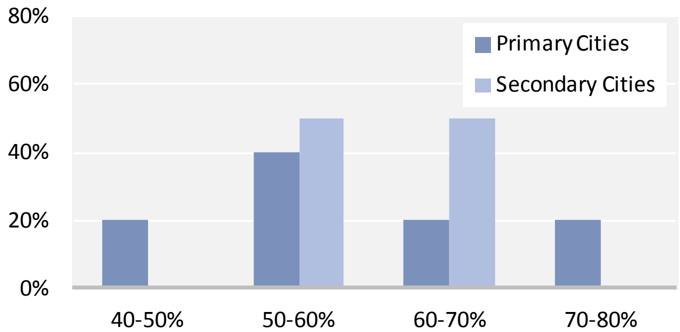
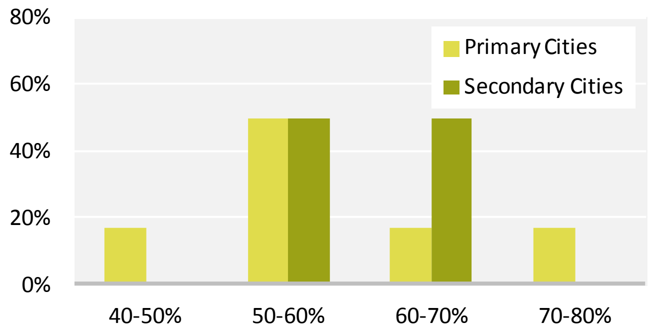


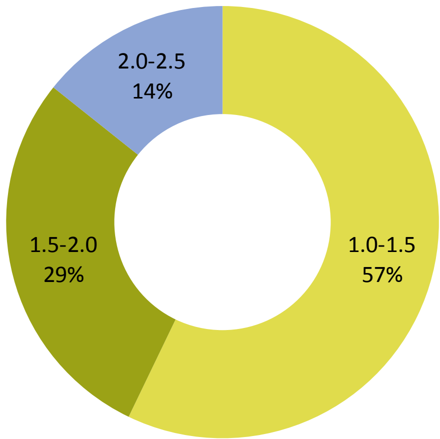
FIGURE 5: LTV RATIOS REFINANCING (MANAGEMENT AGREEMENT)



In terms of debt service coverage ratio, requirements are predominantly between 1.0 and 2.0 (Figure 7). When asked what variable rates for new loan scenarios are applied, the majority of respondents indicated 200 to 250 bsp.

The debt service coverage ratio for refinancing requires 1.0 to 1.5 according to 75% and 1.5 to 2.5 according to 25% and of the respondents. Similar to new loans, variable floating rates applied to refinancing scenarios are usually around 200 to 250. Fixed interest rates showed inconclusive results.

FIGURE 7: DEBT SERVICE COVERAGE



Conclusion of the comparison between leases and management agreements

When comparing results for leases and management agreements, LTVs for new loans tend to be higher for leases, which is somewhat expected owing to the perceived lower risk (fixed income stream). However, no clear differentiation can be seen for the refinancing scenario where similar levels are applied. Debt service coverage ratios used are similar in both leases and management agreements, with the only exception of leases in secondary cities where higher floating rates are applied. The majority of respondents indicated an amortisation period of 10 to 20 years in all scenarios.

In addition to analysing lending parameters for leases and management agreements, we have concentrated on the factors that are important for banks to grant hotel loans as well as the general outlook of hotel lending in Germany.

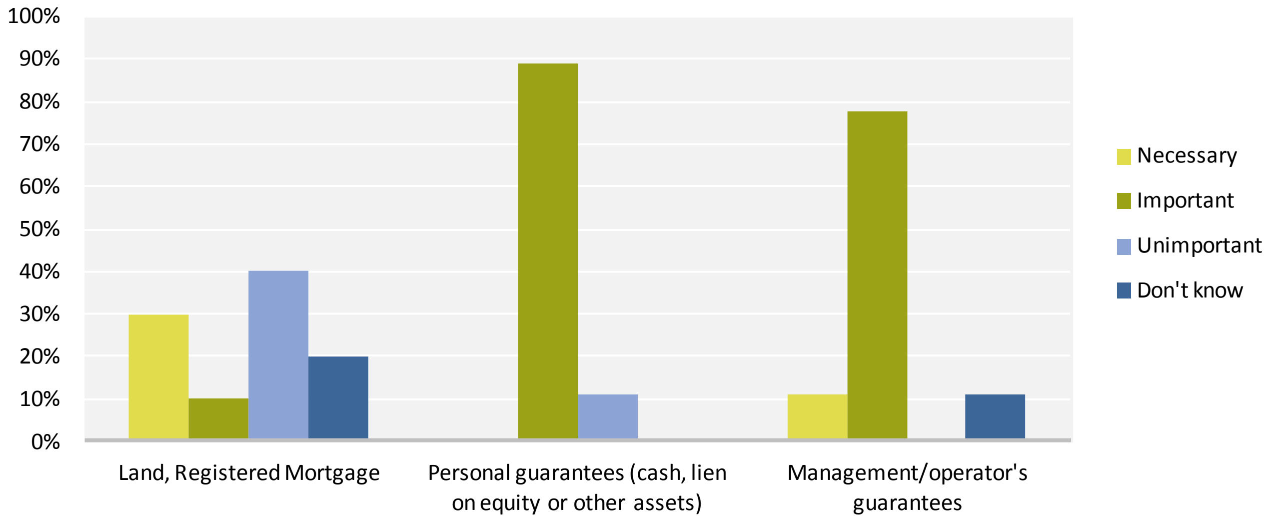
Outlook for loan proceeds

When asked what the typical purpose of loan proceeds is currently and in the foreseeable future, respondents generally suggested that most loans go towards acquisitions (more than 45% of loan proceeds) and refinancing (approximately 30%) in both branded and independent hotels. Renovation and new constructions seem to receive the lowest proceeds from loans. This is in line with the trend found in many other countries where existing and already income-generating projects receive favourable treatment over new developments or renovation/ expansion plans. However, HVS frequently undertakes feasibility studies and our survey is further confirmation that loans for developments are made available, albeit at more limited levels. The survey indicates that banks do lend on developments. Only 25% of respondents indicated that no loans are made available for new branded developments, while 60% of respondents do not lend on independent/unaffiliated developments.

What factors are important for securing a hotel loan?

HVS is often asked by clients what factors are actually determining the success of getting a hotel loan. Hence, our survey includes several pre-selected factors as per Figure 7. As a result, we discovered that personal and management guarantees were seen as important by the majority of banks. Land/registered mortgages showed a mixed response, with 30% deeming it as necessary while 40% considered it unimportant.

FIGURE 7: IMPORTANCE OF COLLATERAL FOR SECURING A HOTEL LOAN



Importance of borrower characteristics when making a hotel loan

When the respondents were asked about the importance of borrower characteristics when making a hotel loan, all of them saw the borrowers' solvency and the quality of the borrower's track record as necessary or important. Figure 8 indicates what is deemed as necessary or important; none of the respondents saw any of these characteristics as unimportant.

FIGURE 8: IMPORTANCE OF BORROWER CHARACTERISTICS

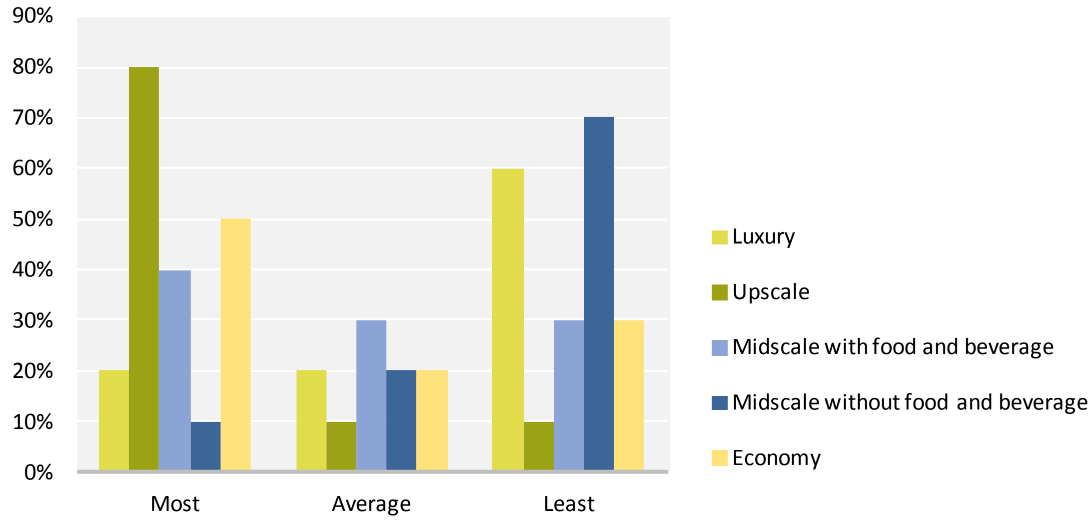
The quality of the borrower's track record	⬆
The quality of the relationship with the lender	↑
The borrower's solvency	⬆
The reputation of the borrower's management team	↑

Key:	
⬆	Necessary
↑	Important

Upscale hotels most favoured for hotel loans

Overall, upscale hotels seem to be the most favoured type of hotel to receive a loan, followed by economy and midscale with food and beverage outlets. Luxury and midscale without food and beverage outlets have received the least amount of borrowing from our respondents.

FIGURE 9: FAVOURED HOTEL LOANS



External factors determining the terms of the loan

When asked which external factors determine the terms of the loan, all respondents deemed location as important. Re-usability of the property was a further important factor, while inflation rate was generally seen as unimportant. In terms of GDP growth, projected growth was seen as relatively important while the historical growth was unimportant. Hotel-related factors that determine the loan terms include the historical and projected net operating income, average rate and occupancy, which were all seen as important by all respondents.

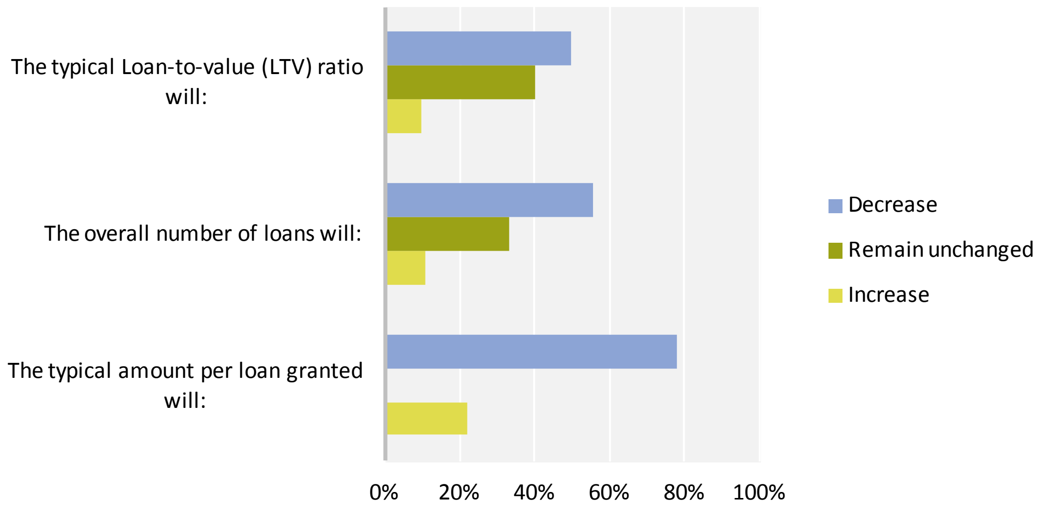
FIGURE 10: EXTERNAL FACTORS

Historical hotel occupancy level (OCC%)	
Historical hotel average room rate (ARR)	
Historical Net Operating Income (NOI)	
Projected hotel occupancy level (OCC%)	
Projected hotel average room rate (ARR)	
Projected Net Operating Income (NOI)	
Historical GDP growth rate of the country	
Projected GDP growth rate of the country	
Historical inflation rate of the country	
Projected inflation rate of the country	
Location	
Re-usability of the property	

The future of lending parameters

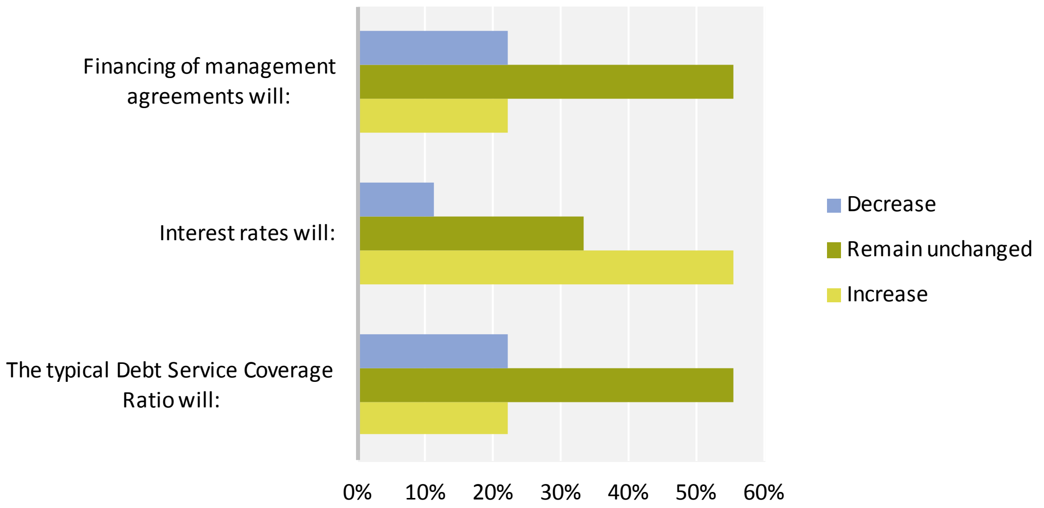
As a final question, we asked the respondents to indicate how they feel lending parameters will evolve in Germany over the next two years. Respondents were generally pessimistic in the outlook for the number of loans as well as the volume of loans, where the majority indicated a decrease. This sentiment reflects the continuous restraints of bank lending for hotel developments, not only in Germany but throughout Europe. In terms of LTV, some 40% indicated that it will remain largely the same. However, some 10-20% said that LTVs, the number of loans and the amount per loan will increase over the coming years, indicating some selective optimism.

FIGURE 11: FUTURE OUTLOOK FOR LENDING PARAMETERS



The general responses for the financing of management agreements and debt service coverage ratios indicated that they will remain unchanged, while interest rates are likely to be on the rise again. The outcome related to interest rates does not come as a surprise as they are currently at historical lows; however, the outcome of this is highly dependent on the development of the economies in Europe and Germany in particular.

FIGURE 12: FUTURE OUTLOOK FOR LENDING PARAMETERS



Whereas bank lending will not get back to historical levels in the short term, and arguably the medium term, hotel investors and developers are getting more creative in regards to filling this gap. We are looking forward to finding out what 2013 has in store.

CONCLUSION

We are delighted to confirm our survey of German banks indicates a healthy appetite for hotel investments. Financiers are not giving the money away and remain sensible/prudent, but for the right transaction a proper amount of debt is available at the right price.

About HVS

HVS is the world's leading consulting and services organisation focused on the hotel, restaurant, shared ownership, gaming and leisure industries. Established in 1980, the company performs more than 2,000 assignments per year for virtually every major industry participant. HVS principals are regarded as the leading professionals in their respective regions of the globe. Through a worldwide network of 30 offices staffed by 300 seasoned industry professionals, HVS provides an unparalleled range of complementary services for the hospitality industry. For further information regarding our expertise and specifics about our services, please visit www.hvs.com.

With offices in London since 1990, **HVS London** serves clients with interests in the UK, Europe, the Middle East and Africa (EMEA). We have appraised almost 4,000 hotels or projects in 50 countries in all major markets within the EMEA region for leading hotel companies, hotel owners and developers, investment groups and banks. Known as one of the foremost providers of hotel valuations and feasibility studies, and for our ability, experience and relationships throughout Europe, HVS London is on the valuation panels of numerous top international banks which finance hotels and portfolios. For further information about the services of the London office, please contact Arlett Oehmichen, Associate Director, on +44 20 7878 7700 or aoehmichen@hvs.com.

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