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Introduction

The European hotel industry staged a good recovery in 2004, having experienced significant instability in recent times as a result of numerous unprecedented events worldwide. The resilience of the hotel market, as proven over the last three years, has resulted in hotel real estate now being considered a mainstream asset class. Moreover, the upside of hotels in a recovering market is very appealing, with the positive leverage resulting from improved profitability creating a very attractive environment for investors.

In 2004, the European hotel investment market shifted into top gear with a tremendous increase in activity, in terms of both single asset and portfolio transactions. HVS recorded a 31% increase in total investment activity in 2004 compared with the previous year, to approximately €8.9 billion. Hotel investment activity was fuelled by a significant number of private investors seeking opportunistic acquisitions and by private equity investors that were stimulated by the growth in popularity of innovative financial structures that give a combination of upside and security. This outstanding level of investment confirms the weight of money targeted at hotel real estate, in particular demand exists for assets with

good covenants, together with the exceptional level of private equity and institutional capital becoming available.

European Single Asset Transaction Activity

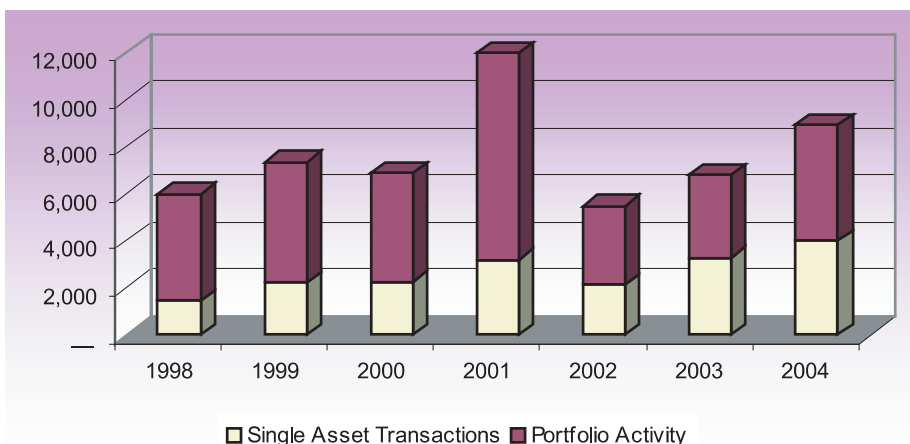
With no unprecedented events occurring in Europe during 2004 to send the industry into turmoil, the signs in late 2003 that many European markets were at the bottom of their cycles proved correct, with a number of European markets enjoying RevPAR growth in 2004. Although continental Europe experienced only marginal growth, an exceptionally strong amount of investment in single assets was made, with owners who had endured the turbulence of the past few years choosing to dispose of their assets. The criteria for deciding whether or not to dispose of assets include the future capital expenditure requirements following a period of deferred maintenance as owners seek to maximise cash flow; the strategic fit of the property within the portfolio as a whole; the opportunity of deploying capital in a more efficient arena or the ability to earn superior returns; the current local market conditions; the

availability of a buyer and the offer matching the vendor's expectations.

During 2004, HVS recorded a total of 137 single asset hotel transactions of more than €7.5 million, the minimum amount set for a transaction to qualify for inclusion in our survey. The total volume of single asset transactions was particularly impressive, resulting in a record level of investment; this investment, at approximately €4 billion, was 21% higher than it was the previous year. Single asset transactions accounted for approximately 45% of the total investment activity, less than the previous year; however, this was understandable considering the strong increase in portfolio activity following the subdued level of activity in 2003. Nevertheless, this volume of investment underpins the high level of buyer demand, with strong upside sentiment keeping prices high.

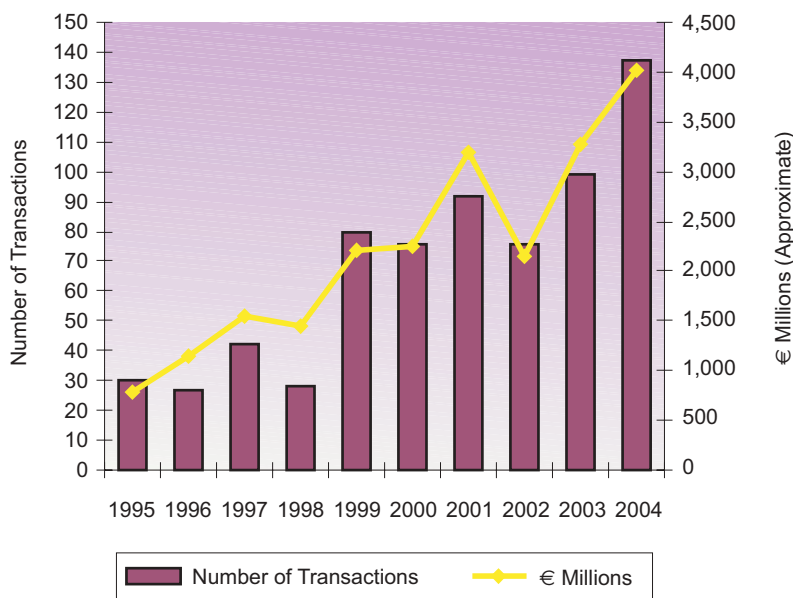
In 2004, Spain succeeded in being the most active market for hotel transactions, continuing the trend set the previous year. Spain recorded a total of 40 qualifying transactions representing over 8,100 rooms and totalling over €1 billion, some 25% of the total single asset transaction activity in terms of investment volume. The UK also enjoyed very strong liquidity, but had to settle for second place behind Spain with 33 qualifying transactions totalling approximately €980 million. Germany, meanwhile, enjoyed a buoyant hotel investment market, totalling around €370 million, and accounting for some 9% of the total transaction activity. Of the other main European countries, France, Italy, Ireland and the Netherlands all recorded a sizeable increase in single asset transaction activity by rooms sold in 2004. Meanwhile, following the expansion of the EU, with ten new members joining, investment activity in eastern European markets was prevalent as opportunistic investors looked to purchase real estate in strategic locations with repositioning potential. A total of 11 qualifying transactions took place in central and eastern Europe, representing 7% of total European investment volume. Elsewhere, Turkey and Cyprus were all investment hot spots during 2004, a

Figure 1 Total Hotel Investment Volumes 1998-04 (€ millions)



Source: HVS International Research

Figure 2 European Single Asset Hotel Transactions 1995–04



Source: HVS International Research

trend that is expected to continue in 2005 and beyond.

In 2004, the largest single asset to transact was in Monaco, where the 619-room Monte Carlo Grand Hotel sold for more than a reported €200 million. The landmark property was acquired by Cedar Capital Partners on behalf of FHR European Ventures, an equity fund backed by the Bank of Scotland, Fairmont Hotels and Kingdom Hotels International. The Monte Carlo Grand Hotel has been rebranded as a Fairmont Hotel and will undergo a €40 million renovation.

The following were among other notable single asset transactions in 2004.

- The 98-room Le Richemond Hotel in Geneva, sold to Rocco Forte Hotels for €64 million (€660,000 per room);
- Two boutique hotels in Paris, the 70-room Hotel Balzac and the 37-room Hotel de Vigny, sold to JWW Hotels & Resorts for €53.5 million (€500,000 per room);
- The 73-room Sofitel Demeure Marignan in Paris, sold to a high-net-worth private investor for approximately €27.5 million (€377,000 per room);
- The La Manga Resort in Murcia, sold to the Spanish investment company Med Group for €146 million;
- The 168-room Radisson SAS Carlton Hotel in Bratislava, together with an office and retail complex, was acquired by a consortium of investors including Patron Capital Partners, Truthheim Invest and Nautical 1 for approximately €60 million;
- The leasehold interest in the 189-room Howard Hotel in London was acquired by Samosir, a private

company based in Hong Kong, for approximately €108 million (€571,000 per room). The deal is understood to represent a yield of less than 6%;

- The 140-unit Grosvenor House Serviced Apartments in London were sold by the Royal Bank of Scotland to the property group Bourne Capital in a deal estimated to be worth approximately €145 million (€1,042,000 per apartment). It is understood that a number of the apartments will be sold for residential use, but with the option of the inventory being placed into a rental pool, thereby providing an income stream to the owner when they are not in use.

One significant difference in transactional activity compared to the previous year was the near lack of trophy assets transacting; as a consequence, the average price per room declined. In 2004, investment activity centred to a greater extent on the mid-market sector and on a greater number of hotels transacting in secondary markets. Furthermore, the increased transaction activity in eastern Europe, together with hotel assets in Cyprus and Turkey, which typically command lower sale prices, had a negative impact on the total sales price per room. As a result of all these factors, our survey shows a 9% decline in the average price per room, to approximately €158,000. However, we would stress that this contradicts the trend shown by hotel asset values in 2004; values have increased by approximately 3%, as illustrated in the HVS publication *European Hotel Valuation Index 2005 (HVI)*. In addition, the average transaction price per room is

approximately 29% lower than the European average value per room recorded in the HVI of approximately €222,000 per room. The reason for this is that within the HVI survey the sample of hotels is limited to four-star and five-star branded hotels located in primary cities, whereas the HVS European Hotel Transactions review includes all publicly quoted hotel sales above €7.5 million and encompasses assets positioned in the budget, mid-market and luxury hotel sectors.

Portfolio Transaction Activity

Following two years of subdued investment activity in terms of portfolio transactions, 2004 witnessed a significant rebound. The increase was driven by various factors such as companies disposing of non-core, underperforming assets following a strategic review; an increasing trend to separate the property asset from the hotel business; and a wealth of capital invested in the sector by venture capitalists and private equity players seeking a portfolio with significant potential for growth.

HVS International recorded 22 portfolio transactions in 2004, compared with 13 the previous year. In 2004, portfolio activity amounted to approximately €4.9 billion, an impressive 39% increase on the previous year. Nevertheless, portfolio transaction activity still remained some 45% below the record level of activity in 2001 of €8.8 billion.

In 2004, portfolio transactions were plentiful, reversing the trend of the previous two years. One significant change witnessed was the increased trend for partnerships between high-net-worth individuals formed through syndicates. As high-net-worth individuals often have lower equity return thresholds, and benefit from tax-efficient deal structuring, pricing levels can be achieved that property funds and institutions cannot necessarily compete with. The following are examples of this trend.

- Quinlan Private's (the investment vehicle for the former Irish tax inspector Derek Quinlan) acquisition of the Savoy Group in a €1.1 billion deal from the Blackstone Group and Colony Capital. The price paid for the collection of four London hotels, comprising 772 rooms, averages €1.5 million per room, the highest price ever paid per room for a UK hotel asset. In January 2005, Quinlan Private proceeded to dispose of the 263-room Savoy Hotel for approximately €350 million (approximately €1,330,000

Table 1 Selected Portfolio Transactions 2004 (€)

Portfolio	Country	Number of Properties	Number of Rooms	Total Sales Price	Price per Room	Buyer
Savoy Group	UK	4	772	1,162,300,000	1,506,000	Quinlan Group
Queens Moat Houses	UK/Netherlands/Germany	78	11,110	813,100,000	73,000	Whitehall 2001
Premier Lodge	UK	141	10,062	758,800,000	75,000	Whitbread
Travelodge	UK	135	14,500	578,300,000	40,000	Prestbury Hotels Ltd
Paramount Hotel Group	UK	13	1,829	323,000,000	177,000	Dawnay Shore Hotels
Dividum	Finland	32	5,600	300,000,000	54,000	London and Regional Properties
Home Invest AB Hotels	Scandinavia	19	3,224	174,100,000	54,000	Capona
Courtyard by Marriott	UK	11	867	113,000,000	130,000	Syndicate of Private Investors
Grubarges Portfolio	Spain	5	1,068	105,000,000	98,000	Barcelo Hotels
Hotel Du Vin	UK	6	244	96,300,000	395,000	Marylebone Warwick Balfour Group
Queens Moat Houses	UK	4	488	57,200,000	117,000	Pederson Group
Three Accor Properties	UK	3	412	57,200,000	139,000	HerAx - Heron Corp & AXA Sun Life
Alias Hotels	UK	4	226	44,000,000	195,000	GuestInvest
Carestel	Belgium	7	728	34,300,000	47,000	Baupost/Westmont Hospitality Group
Travelodge Ireland	Ireland	8	520	22,200,000	43,000	Smorgs Ltd

Source: HVS International Research

per room) to FHR European Ventures;

- Dawnay Shore Hotels' (the hotel group established by Dawnay Day and Shore Capital) acquisition from Alchemy Partners of the 13-strong Paramount Hotel Group for €323 million (£215 million), or approximately €177,000 per room. The deal was financed through equity and mezzanine finance subscribed by clients of Shore Capital and by senior debt provided by Anglo Irish Bank. A considerable part of the equity finance came from The Hotel Corporation plc, which has been established as a public company trading on the Alternative Investment Market (AIM) to enable public company investors to invest directly into a private equity vehicle. Such a structure is referred to as public equity in private structured enterprise (PEPSE). The Paramount Hotel Group was acquired in order to provide a platform from which to establish a substantial chain of four-star UK regional hotels. In January 2005, Dawnay Shore Hotels completed the acquisition of three Hanover Hotels, totalling 587 rooms, for the sum of €82 million, or approximately €140,000 per room. A five-year investment plan is being considered, after which time the group is likely to be sold in its entirety through an IPO, by transfer to a REIT structure or sold to another private equity buyer.

Sale and leaseback deals featured prominently in portfolio transactions during 2004, and following are some examples.

- The property investment firm

HerAx, which was established in 2003 by the property firm Heron Corporation and the insurance company AXA Sun Life, made its first acquisition with a €57 million (£40 million) investment in three Accor Hotels. The acquisition, which comprised the 106-room Ibis Hull, the 124-room Novotel Milton Keynes and the 182-room Novotel London City South, involved Accor entering into a 25-year sale and leaseback agreement. The eventual aim of the HerAx fund, which intends to invest in different asset classes, is to attract investment from other institutional investors to grow the fund from €368 million to approximately €1.5 billion within three years;

- Travelodge completed a €580 million (£400 million) sale and leaseback deal on 136 properties with Prestbury Hotels Ltd that was estimated to be approximately €40,000 per room. Travelodge has engaged in leases ranging from 25 to 35 years and the deal is understood to be the first time a hotel group has completed the sale and leaseback of its entire property portfolio. Prestbury Hotels is backed by the investment companies Prestbury Investment Holdings and West Coast Capital.

In 2003, a number of public-to-private deals took place as the various management teams attempted to rescue their publicly listed companies from the perils of the Stock Exchange, following a severely depressed share price as the public markets lost confidence in a cyclical industry scarred by events such as the war in Iraq, SARS and the global economic slowdown. Following the privatisation

of Thistle Hotels, Macdonald Hotels and Jarvis Hotels in 2003, further public-to-private deals took place in 2004, the only exception being that it broadened the trend from being a purely UK phenomenon. We outline the following public-to-private transactions that took place in 2004.

- Pandox, a specialist hotel investment company, was privatised following the purchase by APES Holding AB of a 36% stake in November 2003 and an unconditional offer of €12 per share. In January 2004, it was announced that APES had attained a 96% holding in the company and that the compulsory purchase of the outstanding shares would be called. Consequently, Pandox was delisted from the Stockholm Stock Exchange in February 2004. The public-to-private transaction valued the company at approximately €400 million, equating to around €48,000 per room;
- A newly formed acquisition vehicle named Precinct Investments acquired the publicly listed Irish hotel company Gresham Hotel Group. The takeover resulted in the company's being taken private, with the final offer of €1.40 per share valuing the company at around €117.2 million, or around €118,000 per room.

Another factor evident in hotel portfolio investment activity during 2004 was the wide variety of investment capital available. Trade buyers, private equity, real estate investors and specialist hotel investment companies were all active. In 2004, other significant portfolio transactions included the following.

- The sale of the budget hotel chain Premier Lodge by the Spirit Group to Whitbread, involving 141 hotels, comprising over 10,000 rooms (including nine hotels currently under development) for €759 million (£505 million), or approximately €75,000 per room (£50,000). Whitbread agreed to invest a further €48 million to complete the nine Premier Lodge sites currently under development. Following the acquisition, the Premier Lodge sites have been integrated into Whitbread's existing Travel Inn business, with the entire portfolio being rebranded Premier Travel Inn. The race for the portfolio was hotly contested and much debate followed over the premium in the price paid for the entire portfolio compared to the cost of development of a new-build, which is estimated to be between €50,000 and €60,000 per room. Nevertheless, the deal secures Whitbread's position as the largest budget hotel operator in the UK;
- Whitbread exited the UK mid-market sector following the sale of its 11 Courtyard by Marriott hotels, comprising 867 rooms, to a group of private investors for €113 million (£79 million). The hotels will be leased to Kew Green Hotels, which will continue to operate the hotels under the Courtyard by Marriott brand, through a franchise agreement with Marriott International. The sale represents a key part of a €1.1 billion (£800 million) asset disposal announced at the company's interim results presentation, which is also likely to see Whitbread enter into sale and manageback agreements on its Marriott portfolio;
- Marylebone Warwick Balfour, the owners of the Malmaison hotel chain, acquired the Hotel du Vin portfolio, a collection of six boutique hotels, some 244 rooms, for €96 million, equivalent to €395,000 per room. The deal is understood to have been financed through a €245 million banking facility provided by the Bank of Scotland;
- The 32-strong Finnish Dividum hotel portfolio was sold to real estate investment firm London & Regional Properties. The portfolio comprised some 5,600 rooms and is thought to have transacted at around the book value of €300 million. The acquisition makes London & Regional Properties one of the biggest hotel property owners in Europe;
- Swedish hotel and leisure company Capona completed the purchase of 19 hotels from Norwegian real estate company Home Invest. As payment for the properties, which were reported as having a total book value

of €174.1 million, Home Invest purchased six million newly issued shares, which translates into a 24.3% holding in Capona. The deal gives the Swedish firm another 16 hotels in Sweden, two in Norway and one in Denmark;

- LBO France, a private equity firm, acquired 28 Libertel Hotels in Paris from ABC Hotels, a joint venture of Accor (30%), Blackstone (35%) and Colony (35%), for an undisclosed sum. In total the portfolio comprised 1,835 rooms, of which the five largest properties, which comprised 732 rooms, were to be rebranded as Mercure hotels, with Accor retaining the management contract. The remaining 23 hotels will retain the Libertel name, and whilst being marketed by Accor, they will be managed by Finhotel, a company created for this purpose by LBO France;
- Whitehall 2001, a consortium comprising the Goldman Sachs Group, Whitehall Street Real Estate Fund and Westmont Hospitality Group, acquired Queens Moat Houses for approximately €813 million, by offering 90 pence for every pound of junior term debt and one penny per ordinary and convertible share. The last few years had seen a deteriorating performance at Queens Moat Houses, exacerbated by high fixed charges as well as a weakened balance sheet. The deal is understood to be the best outcome for the troubled hotel company, with Whitehall 2001 in a much stronger position to invest new capital and to provide a solid platform from which to grow the business. The deal involves 24 hotels in Germany, branded as either Queens Hotels or under franchise to Holiday Inn, 19 Bilderberg hotels in the Netherlands

and 35 hotels in the UK either branded as Moat House or under franchise to Holiday Inn;

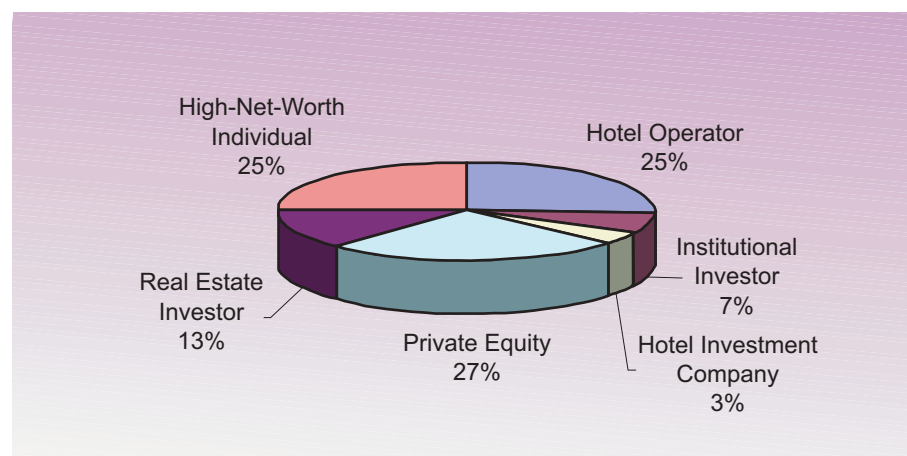
- The private company Smorgs Ltd acquired Travelodge's portfolio of eight hotels in Ireland, together with the rights to the Travelodge franchise in Ireland for approximately €22 million, or around €43,000 per room. Two of the hotels are in Dublin, with other properties in Waterford, Cork, Limerick, Galway, Belfast and Derry.

In 2005, we consider that an abundance of portfolio activity will occur, as the trend towards splitting hotel ownership from operation becomes more prevalent. For this reason, we consider that hotel operators will become less frequent buyers of hotel real estate, with private equity, institutional investors and high-net-worth individuals emerging as the dominant players. In 2005, it is a distinct possibility that portfolio activity will be even more robust than it was in 2004, particularly if hotel operators choose to divest themselves of ownership, a move that has been mooted by the likes of Whitbread, InterContinental Hotels Group and Millennium & Copthorne.

Profile of Investors

Significant changes in terms of the profile of investors occurred during 2004, in both single asset and portfolio activity. When consolidating both single asset and portfolio activity, three principal buyers emerged in 2004; private equity investors accounted for 27% of the activity, while hotel operators and high-net-worth individuals (or syndicates of high-net-worth individuals) each accounted for 25% of the total investment activity.

Figure 3 Single Asset and Portfolio Investment Activity by Buyer Category 2004



Source: HVS International Research

Private equity remains an important source of capital (for portfolio transactions), despite declining by 53% on the previous year; however, it is important to appreciate that the share of the capital placed by private equity investors would have been considerably greater if the deal involving the InterContinental Hotel Group's owned assets in the UK, which are currently in exclusivity, were to have completed.

The other significant change has been the rise of the high-net-worth investor, increasing by 82% compared with investment levels in 2003. We envisage that both private equity and high-net-worth individuals will continue to be dominant players in the hotel investment arena, particularly as the industry's structure is changing, with the hotel operator becoming further detached from hotel ownership.

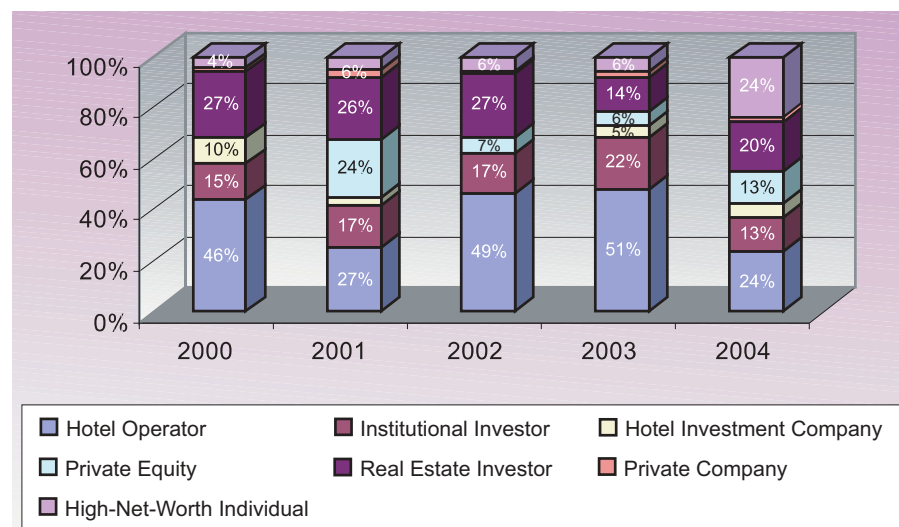
In respect of single asset transactions, hotel operators were much less prevalent, compared to previous years, with investment totalling €940 million. They accounted for 24% of the activity compared to 50% the previous year. A major shift in the investor profile came with the emergence of a greater number of high-net-worth individuals investing in real estate. Acquisitions made by high-net-worth individuals included the Hilton and Ibis hotels in Prague by the Quinn Group, the Mirabeau Hotel in Monaco by the Barclay Brothers and the Marriott Marble Arch Hotel in London, by Solomon Noe. Overall, high-net-worth individuals represented some 24% of total single asset activity, approximately €930 million, compared to only 6% in 2003 (€171 million).

Private equity investors also became more prominent in 2004, representing as they did 13% of the total single asset activity, with approximately €514 million. This bucks the trend of private equity investors typically preferring to invest in portfolio deals, due to the fact that they need to place large sums of equity and are typically seeking a high return on investment. However, with the acquisition of the Radisson SAS in Bratislava, private equity investors have started to show an interest in acquiring desirable assets in high-yielding emerging markets. Other private equity acquisitions included the Monte Carlo Grand Hotel in Monaco by FHR European Ventures and the La Manga Resort in Spain by the Med Group.

Institutional investor activity within hotel investment was scarcer than it had been in previous years, with the majority of acquisitions made by German investment funds. DIFA was particularly active investing in three hotels, the Radisson SAS in Manchester, the Marriott in Hamburg and the Le Meridien in Stuttgart.

In respect of portfolio transactions, capital sourced by private equity continued to dominate portfolio activity,

Figure 4 Single Asset Investment Activity by Buyer Category 2000–04



Source: HVS International Research

albeit at a much reduced level compared to the previous year. Private equity investments totalled approximately €1.75 billion, which accounted for 35% of the total portfolio activity. The decline in private equity investors is due largely to fewer acquisitions being made by US-based funds, which were particularly active in 2003. The increased numbers of hotels available on the market in the USA and an unfavourable exchange rate are the two main reasons why US investors have pooled resources away from Europe.

Hotel operators continued to present a significant proportion of portfolio deals. However, in 2004 hotel operators were also active buyers, as they continued to build a dominant global or regional presence. In 2004, hotel operator investment in portfolio deals totalled approximately €1.3 billion, or some 26% of the total portfolio activity.

Meanwhile, in a pattern similar to that seen with single asset activity, high-net-worth individuals emerged in portfolio-related activity, with an increasing trend for high-net-worth individuals investing in a portfolio of assets as part of a syndicate. The acquisition of the Savoy Group by Quinlan Private is an example of such an investor type. In 2004, acquisitions made by high-net-worth individuals totalled €1.25 billion, or approximately 26% of the total portfolio activity.

The Continuing Rise of Management Contracts

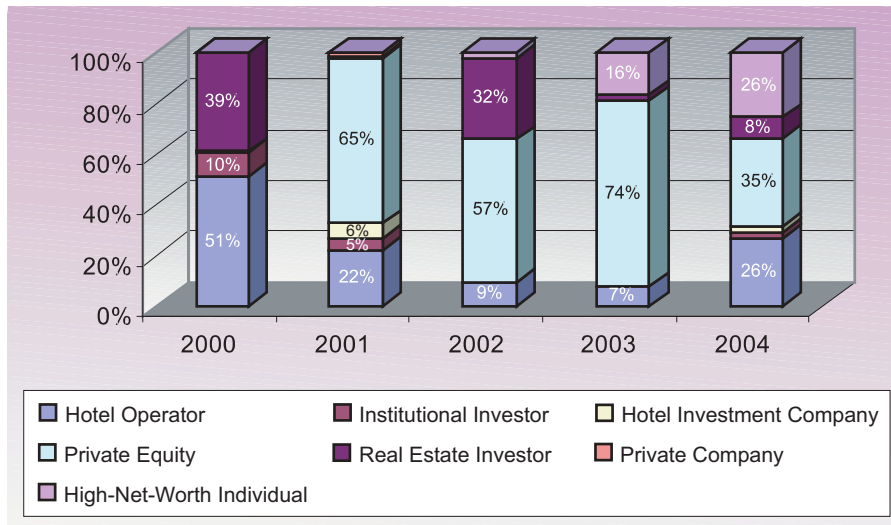
Reducing asset intensity appears to be a key theme of hotel operators in today's market. With most of the major hotel operators publicly listed,

hotel asset values are important drivers in the sector's share price. There are two main reasons for this. First, the return on capital is extremely low and one primary means of creating shareholder value is through asset disposals, which are considered to be earnings enhancing (if the book value is achieved). Second, asset prices remain robust with strong demand from a wide source of investment capital.

The emergence of property, institutional and private equity investors, as proven by the weight of capital entering the sector, confirms the acceptance of hotels as a mainstream asset class. In recent years, sale and leaseback deals have contributed to a change in the shape of the industry. Hotel operators by divesting themselves of ownership of hotel assets in return for leases and management contracts have gained a considerable sum of capital that can be put towards refurbishment and used to fund acquisition and development activity. Furthermore, their other advantage was that they were considered to be 'off-balance sheet financing', thereby improving financial ratios. However, this advantage has been thwarted as, credit rating agencies capitalise lease liabilities at around seven to eight times the annual rental obligations, which has become a real issue for listed companies.

A further significant event, which has impacted upon hotel operators' perception of leases, at least within the UK, is the change to the Stamp Duty Land Tax (SDLT) introduced in December 2003. The changes resulted in the SDLT charge being made on each real estate transaction, as opposed to a tax on documents. Furthermore, the tax calculation is now based upon the discounted capitalised value of the rental payment as opposed to the

Figure 5 Portfolio Investment Activity by Buyer Category 2000–04



Source: HVS International Research

average annual passing rent. As a consequence, normal operating leases may be subject to up to nine times the duty they were previously, which therefore has significant cost implications for the operator taking the hotel lease.

Consequently, hotel operators are increasingly favouring management contracts, as opposed to leases when structuring deals, as leases are increasingly viewed by operators as an expensive form of financing, whereby they derive little of the benefits of ownership, but take the added risk of exposure to upwards-only rent reviews, resulting in increased fixed costs. Nevertheless, competitive buyers in Europe, such as institutional investors, still have a preference for acquiring hotels with leases or long guarantees, as building trust in the operator, and monitoring and enforcing the contract all take time and valuable resources. A further downside of a sale and manageback deal is the challenge of selling on an asset that is encumbered.

For this reason, we envisage that lease structures will continue to play an important role in providing more secure and attractive investments. An example of this is the purchase by DIFA of the Marriott Hotel in Hamburg, with a lease structure in place, together with a management contract, with a guaranteed level of net income, backed up by the covenant of Strategic Hotel Capital. A deal structured in this way is sufficient to qualify as a purchase under the regulations of German open-ended funds.

While some investors will continue to prefer leases, it is clear that management contracts will increase

in popularity, particularly with the growing trend of separating the ownership from the operations and as more capital becomes available that is likely to buy via management agreements, such as experienced skilled owners and high net worth individuals.

Cross-Border Activity

European hotel investment is increasingly becoming a global affair. Cross-border deals continue to be facilitated by the euro, as it has allowed greater transparency and increased the pool of potential lenders and investors seeking to invest in European markets. The continued desire to diversify risk and reap the benefit of growth opportunities in different hotel markets has enticed further inter-regional and intra-regional investment.

In 2004, non-domestic transactions totalled €4 billion, of which 39% represented single asset transactions and 61% portfolio transactions. In 2004, approximately 59% of the single asset transactions involved investors purchasing assets in their country of origin, a similar trend to the previous year. A shift in portfolio transactions was however more evident, with 50% of investors purchasing assets outside of their country of origin; this is a noticeable increase on 2003, when over 70% of portfolio transactions involved domestic buyers.

While 2004 has witnessed a lower number of US investors, interest from Middle East and Asian buyers appeared to be on the increase.

UK Property Investment Funds – The Story So Far

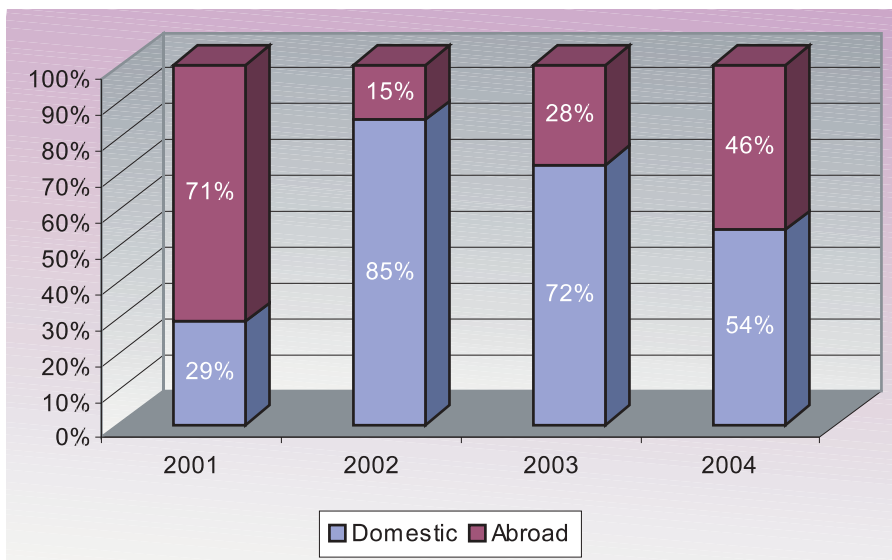
In March 2004 the UK government expressed its commitment to a UK equivalent of a Real Estate Investment Trust (REIT), to be known as property investment funds (PIFs). An REIT is a listed or listable portfolio real estate investment vehicle that has to distribute a substantial proportion of its income in return for exemption from corporation and capital gains tax. The UK government published an initial consultation document in March 2004, following which a period of consultation ensued. One of the main reasons to establish UK PIFs is that the existing structures do not provide sufficient incentive for companies to retain property ownership in the UK, due to tax leakage. As a result many firms have set up offshore structures. A second main driver to establishing a PIF is their growing prevalence in other countries. Most recently, France introduced Société d'Investissements Immobiliers Cotées (SIIC) and in 2004 there have been a significant number of conversions of existing property companies and funds to SIICs.

The UK consultation paper states, however, that the proposed PIF should only be available for investment in property types where the rental returns reflect the underlying property assets. As such, PIFs would be restricted to commercial, office and residential property, while real estate that forms part of a leisure or hospitality trading company, such as hotels, would be excluded. By focusing on a market rent as opposed to a turnover or profit rent, key asset classes, such as shopping centres, have also been excluded. The response to the consultation paper by hotel industry professionals and the wider property sector has been quite substantial, resulting in a delay in the introduction of PIFs, with a discussion paper due to be published prior to the 2005 budget.

Hotel lobbyists have undertaken a detailed response to the government's initial proposal, focusing first on educating the government on the importance of hotels as an asset class and second on proposing ways in which it would be possible to structure a PIF to include hotels. Lobbyists argue that the exclusion of hotels would deny investor choice, as the creation of PIFs would enable the setting up of vehicles by which high-net-worth individuals could invest directly into hotel property assets and in doing so permit even greater diversification of investment in property.

Successful Hotel REITs exist in the USA. A similar format adopted in the

Figure 6 Cross-Border Activity – Single Asset and Portfolio Transactions 2001–04



Source: HVS International Research

UK would be the most desired outcome for the UK hotel investment market. For a hotel PIF to trade in the UK, it would require the separation of the business from the property. The hotel property asset would be owned by the PIF directly, while the hotel business operated from the asset would be owned by a taxable operating subsidiary of the PIF. As rents would be the only form of PIF-qualified income, the PIF would then grant a lease of the hotel asset to the operating subsidiary, which reflects the underlying property asset. Under the rules of the PIF, the activities in which it can engage would be restricted, meaning it is unlikely that the PIF can own a brand or operate hotels; consequently, these activities would be contracted out to third parties.

Any profit from the operation of the hotel, after deduction of the management fee paid to the operating company and after deduction of the rent paid to the PIF and any other qualifying expenditure, would be received by the taxable operating subsidiary which owns the hotel business; assuming a profit is made, tax would be payable in the normal way.

The PIF discussion is much broader than the brief synopsis of issues outlined here; however, the general consensus is that it would be highly advantageous for the UK hotel investment market to increase the scope of PIFs to include hotels. The advantages of PIFs include improved liquidity; increased diversification into the regional markets and to mid-market and budget hotel brands in particular; increased transparency in the real estate market; access to a wider range of capital,

including cheaper debt finance; and improved quality of hotel real estate. While we remain positive in our belief that all-encompassing PIF structures will be designed to incorporate hotels, it is not beyond the realms of possibility for hotels to be excluded from the initial development of UK PIFs. If this does indeed occur, many of the pitfalls and costly errors incurred by the initial players would be ironed out in time for the eventual entry of hotels.

The current trend for hotel ownership to be separate from the operating business will become much more prevalent if UK hotels are to benefit from PIFs. What is certain is that if PIFs are extended to include hotels, then the hotel investment market, which has been undergoing a period of profound change, is set for further transformation.

Conclusions and Outlook

In 2004, with an upturn in trading evident in a number of European markets, the sector witnessed a significant amount of investment capital from a wide spectrum of sources. With turbulence in the public equity markets over the past few years many investors have flocked to hotel real estate to provide greater diversification within their portfolios. With the sector having shown strong resilience throughout the extended period of economic downturn, the cyclical nature of the hotel business makes hotels even more appealing to investors in a recovering market, where

significant upside is achievable with improved profitability.

Investor confidence in the hotel sector has been robust, with 2004 witnessing a 31% increase in the level of hotel investment, driven by a 21% increase in single asset transactions, to €4 billion, and a 39% rise in the level of portfolio activity to €4.9 billion. In addition to hotel operators and private equity capital continuing to invest strongly within the sector, high-net-worth-individuals have emerged as a prominent source of investment capital. In 2005, continued changes in the structure of hotel ownership are likely to see a continued reduction in the number of hotel operators owning hotels, while private equity investors and high-net-worth individuals are likely to extend their standing further. The future of PIFs in the UK and their inclusion of hotels currently remains uncertain, but if the government approves the widening of the scope of PIFs to include hotels, then they are certainly likely to have a considerable impact on the UK hotel investment market, influencing once more the profile of investors.

In 2005, we envisage the strong level of investment activity to continue, driven by the continued weight of money targeted at hotel real estate. Single asset investment is likely to witness a greater number of quality assets coming to the market as trading performance improves. With 2005 having already witnessed the sale of The Savoy Hotel in London, the Shelbourne Hotel in Dublin and the Grand Hotel Europe in St Petersburg, this level of activity is likely to be just a foretaste of the market's full potential. Other single assets on the market include, the InterContinental Paris, the Hotel Danieli in Venice and the Marriott Park Lane in London.

Meanwhile, the trend for hotel operation to be separate from ownership is also likely to drive a significant proportion of portfolio investment activity, particularly in the UK. The InterContinental Hotels Group is known to have a significant proportion of its UK property on the market; the sale of a portfolio of 11 Hilton hotels currently on the market is understood to be nearing completion, with further disposals planned; and Whitbread is mooted to be engaged in a potential sale and manageback deal. Meanwhile, the future of Le Meridien is likely to be settled in 2005. Investor confidence in the sector can be seen to be particularly robust, which bodes well for the image of the sector and its continued acceptance as a mainstream asset class.

EUROPEAN SINGLE ASSET HOTEL TRANSACTIONS 2004 (€)

Property	City	Country	Rooms	Sales Price	Sales Price per Room	Buyer	Seller
InterContinental Loipersdorf	Loipersdorf	Austria	300	20,000,000	67,000	Consortium of investors	Raiffeisen AG (RIAG); Siemens Oesterreich AG
Arcotel Wimberger	Vienna	Austria	225	Price Not Disclosed	—	Arcotel Hotels & Resorts	French Tour Operator
Libertas Hotel	Dubrovnik	Croatia	300	Price Not Disclosed	—	Rixos Hotels	Bulgarian Holding MultiGroup
Grand Hotel Park - 87.51% Stake	Dubrovnik	Croatia	162	7,400,000	52,000	Ubertas	The Croatian Privatisation Fund
Hotel Mlini (88.66% stake)	nr. Dubrovnik	Croatia	443	9,600,000	24,000	HBI - Hotel Company	The Croatian Privatisation Fund
Hotel Split (68.08% Stake)	Split	Croatia	145	11,700,000	119,000	Hypo Alpe-Adria-Bank	The Croatian Privatisation Fund
Marathon Beach Hotel	Limassol	Cyprus	130	7,300,000	56,000	Lydgewood Properties Ltd	New Marathon Tours
Hilton Prague	Prague	Czech Republic	1,014	145,000,000	143,000	Quinn Group	Highridge & DB Real Estate Global
Ibis Karlin	Prague	Czech Republic	Included in Hilton Prague transaction above			Quinn Group	Highridge & DB Real Estate Global
Ramada Presidentti Hotel	Helsinki	Finland	495	Price Not Disclosed	—	Suomen Osuuskaupp ojen Keskuskunta (SOK)	Helsingin Osuuskaupp a-Elanto (HOK)
Le Metropole	Beaulieu, Cote d'Azur	France	43	17,000,000	395,000	Meridien Securities	Unknown
Sofitel Demeure Marignan	Paris	France	73	27,500,000	377,000	Richard Family	Accor/Blackstone/Colony Capital
Bel Ami Hotel	Paris	France	115	Confidential	—	Le Cabinet Bessé	Westmont Hospitality
Hotel Balzac	Paris	France	107	53,500,000	500,000	JJW Hotels & Resorts	Pacific Investment Plc
Hotel De Vigny	Paris	France	Included in Balzac Hotel transaction above			JJW Hotels & Resorts	Pacific Investment Plc
Courtyard Neuilly	Paris	France	242	Price Not Disclosed	—	Middle East Private Investor/JER	Bouygues
Sofitel Demeure Le Castille	Paris	France	107	31,100,000	291,000	Star Hotels	Accor/Blackstone/Colony Capital
Accor Suitehotel	Berlin	Germany	592	50,000,000	84,000	DB Real Estate	Kaphag
Ibis Hotel	Berlin	Germany	Included in Accor Suitehotel transaction above			DB Real Estate	Kaphag
Etap Hotel	Berlin	Germany	Included in Accor Suitehotel transaction above			DB Real Estate	Kaphag
Meliá Hotel Berlin	Berlin	Germany	364	81,000,000	223,000	Middle East Private Investor	MAB
Mercure Hotel	Berlin	Germany	120	13,000,000	108,000	Unknown	Unknown
Maritim Hotel Project	Dresden	Germany	328	60,000,000	183,000	AXA Immobilien	Hochtief Construction AG
Courtyard by Marriott	Düsseldorf	Germany	139	16,500,000	119,000	Dock 13 MBH	Hochtief Construction AG
Tryp Hotel	Frankfurt	Germany	177	21,000,000	119,000	LB Immoinvest	GBI Berlin
Mövenpick Hotel Project	Hamburg	Germany	226	Confidential	—	DB Real Estate	Patrizia
Marriott Hotel	Hamburg	Germany	277	Confidential	—	DIFA	Strategic Hotel Capital
Regent Hotel	Munich	Germany	183	Price Not Disclosed	—	Reinbold Co.KG (Private Company)	Weinfurter (Private Investors)
Holiday Inn Erlenhofpark	Munich Unterhaching	Germany	270	27,500,000	102,000	Undisclosed	Erlenhostarkpr GMBH
Meridien Stuttgart	Stuttgart	Germany	281	Price Not Disclosed	—	DIFA	Aachener & Münchner
Nordsee Tropen Holiday Park	Tossens	Germany	320	8,600,000	27,000	Center Parcs Europe	EuroHypo AG
Marriott Hotel	Budapest	Hungary	362	48,900,000	135,000	Erste Bank	Host Marriott
Alba Regia Hotel	Szekesfehervar	Hungary	104	Price Not Disclosed	—	Forhecz Ingtatlan	Undisclosed
Fitzpatrick Bunratty Hotel	Bunratty	Ireland	115	13,000,000	113,000	Pugadar	Fitzpatrick Hotel Group

EUROPEAN SINGLE ASSET HOTEL TRANSACTIONS 2004 (€) – continued

Property	City	Country	Rooms	Sales Price	Sales Price per Room	Buyer	Seller
Jurys Inn Christchurch	Dublin	Ireland	185	9,000,000	49,000	Jurys Doyle Hotel Group	Unknown
Dublin Hotel - Finglas Road	Dublin	Ireland	96	15,000,000	156,000	McEniff Hotel Group	Dublin City Council
Jurys Inn Galway	Galway	Ireland	130	11,000,000	85,000	Jurys Doyle Hotel Group	Unknown
Kenmare Bay Hotel	Kerry	Ireland	137	7,000,000	51,000	Robert Lyne	Lee Hotel Chain
Jurys Limerick Hotel	Limerick	Ireland	95	9,800,000	103,000	Danesfield Ltd	Jurys Doyle Hotel Group
The Castletroy Park Hotel	Limerick	Ireland	107	25,000,000	234,000	Private property company	Private Individual
Greif Hotel	Corvara	Italy	60	10,000,000	167,000	Tivigest Vacanze	Undisclosed
Sofitel Hotel	Isola, Venice	Italy	300	95,000,000	317,000	Middle East Private Investor	CIT SpA
Dehon Hotel	Rome	Italy	165	7,000,000	42,000	Pierre & Vacances	Beni Stabili
Cicerone	Rome	Italy	292	70,000,000	240,000	Daniilo Coppola	Undisclosed
Le Palme Hotel	Sardinia	Italy	125	16,700,000	134,000	Rena Bianca	Country Village
Ibis	Sesto Fiorentino	Italy	220	13,100,000	60,000	Polis	Sifalalberghi
NH Laguna Palace	Venice	Italy	384	10,500,000	27,000	NH Hoteles	Danielli
Ecotel Vilnius	Vilnius	Lithuania	322	Price Not Disclosed	—	Invalda Real Estate	MG Baltic
Monte Carlo Grand Hotel	Monte Carlo	Monaco	619	Confidential	—	FHR European Ventures	Undisclosed
Mirabeau Hotel	Monte Carlo	Monaco	103	38,700,000	376,000	Barclay Brothers	Ellerman Investments
Mövenpick Hotel Project	Amsterdam	Netherlands	410	Confidential	—	West Invest	Dr Ebertz & Partners
Steigenberger Kurhaus Hotel	The Hague	Netherlands	245	46,000,000	188,000	Private Investor	Undisclosed
Ibis Hotel	The Hague	Netherlands	197	14,500,000	74,000	Private Investor	Accor SA
Portimao Marina Hotel	Algarve	Portugal	196	14,000,000	71,000	Espirito Santo Hotel Group	Undisclosed
Radisson SAS Carlton Hotel	Bratislava	Slovakia	168	60,000,000	—	Nautical 1, Patron Capital and Truthheim Invest	Suez-Tractebel SA
Zdravilisce Radenci Spa Resort	Radenci	Slovenia	357	17,700,000	50,000	Sava Group	Pivovarna Lasko
Silken Hotel Turnkey Project	Alicante	Spain	400	50,000,000	125,000	Silken Hoteles	Riofisa/Renfe
Silken Hotel Turnkey Project	Coruna	Spain	Included in Turn Key transaction above			Silken Hoteles	Riofisa/Renfe
Gran Hotel Almería	Almeria	Spain	110	22,000,000	200,000	Citymar Hotels and Apartments	Servicios Hoteleros Gran Hotel Almeria
Embajador	Almeria	Spain	67	Price Not Disclosed	—	Predios del Sureste	Antonio Reyes Aguilar
Meliá Almunecar	Almunecar	Spain	227	24,000,000	106,000	Playa Senator	Comarex
Steigenberger La Canaria	Arguineguin, Grand Canary	Spain	249	32,000,000	129,000	Dunas Hoteles	Steigenberger
La Siesta	Arona	Spain	282	15,000,000	53,000	Soteltur, Occidental Hoteles y la Caixa Holding	Hotel La Siesta Tenerife II - Family Barberá Agrás
Hotel España	Barcelona	Spain	84	13,200,000	157,000	Grupo General de Relojeria	Emilio Ballina Bao
Turnkey Project	Barcelona	Spain	126	25,000,000	198,000	Rafaelhoteles	Castmor
Parcela Hotelera	Barcelona	Spain	230	23,000,000	100,000	AB Hoteles	Hovisa
Sol Aloha Playa	Benalmádena, Málaga	Spain	172	11,500,000	67,000	Private investor	Sol Meliá
Cáceres Golf	Cáceres	Spain	103	8,000,000	78,000	Manuel Cordero Alvarez SL	Progemisa

EUROPEAN SINGLE ASSET HOTEL TRANSACTIONS 2004 (€) – continued

Property	City	Country	Rooms	Sales Price	Sales Price per Room	Buyer	Seller
Lido Palace	Camp de Mar (Majorca)	Spain	117	15,000,000	128,000	BMC.Family Clubs	Blau Hoteles
Pueblo Acantilado	Campello	Spain	120	10,000,000	83,000	Grupo Fuertes	Grupo Boluda
Anfi del Mar Holiday Resort – 50% stake	Canary Islands	Spain	677	150,000,000	222,000	Hermanos Santana Cazorla	TUI & ANFI Group
La Motilla	Dos Hermanas	Spain	101	12,000,000	119,000	TRH Hoteles	Private Investors
Las Dunas Beach Hotel	Estepona	Spain	101	20,000,000	198,000	Middle Eastern Private investor	Private investor
Fuerteventura Playa	Fuerteventura	Spain	300	20,000,000	67,000	Sun & Beach Hotels SL	Group of German investors
Mare Nostrum	Ibiza	Spain	528	20,000,000	38,000	Grupo Playa Sol	Accionistas
Marco Polo	Ibiza	Spain	107	8,000,000	75,000	Grupo Playa Sol	Invisa Hoteles
Tivoli	Ibiza	Spain	106	8,000,000	75,000	Grupo Playa Sol	Fiesta Hotels
Palmera Plaza G.Hotel	Jerez de la Frontera	Spain	52	12,000,000	231,000	Prestige Hotels	Private Investors
H10 Paradise Island	Lanzarote	Spain	290	20,000,000	69,000	Hoteles Lopez	Group H10 Hotels
Jardines del Sol	Lanzarote, Canary Islands	Spain	54	Price Not Disclosed	—	Sunterra Corporation	Undisclosed
Mindanao Hotel	Madrid	Spain	281	105,000,000	374,000	Nozar Grupo Inmobiliario	David Shamoon
Hotel Diana Park	Torrequebrada, Málaga	Spain	350	43,600,000	125,000	Middle Eastern Private investor	Asesoramiento y Direccion de Hoteles
Occidental Coral Beach	Marbella	Spain	170	20,000,000	118,000	Inmob. Pontegadea	Familia Chammas
Oasis Park	Minorca	Spain	187	8,100,000	43,000	Roc Hotels Balear	Thomas Cook
Indamar	Mojácar	Spain	72	12,000,000	167,000	Valma Inversiones	Sol, Loz y Mar en Andalucia
La Manga Resort	Murcia	Spain	420	146,000,000	—	Med Group/Grove Capital	P&O
Hotel Las Aguilas	Puerto de la Cruz, Tenerife	Spain	219	18,000,000	82,000	Rambla Hoteles	Construcciones Gomasper
Barcelo Punta Umbria	Punta Umbria	Spain	298	15,000,000	50,000	Punta Umbria Turist.	Grubarges
Bahía Park	S´Arenal	Spain	154	Price Not Disclosed	—	MLL Hoteles	Hoteles Piñero
Mexico	S´Arenal	Spain	112	Price Not Disclosed	—	Summa Hoteles	Mexiplaya
Occidental Sevilla	Seville	Spain	241	25,000,000	104,000	Private Investor	Occidental Hoteles
Eurotel G.Punta Rotja	Son Servera	Spain	202	12,000,000	59,000	Hipotels	Private Investors
NH Sotogrande	Sotogrande	Spain	106	9,000,000	85,000	Sotogrande	HG Hoteles&Gestion
Miramar de Calafell Hotel	Tarragona	Spain	212	7,000,000	33,000	Ramblas Hoteles SA	Unknown
Cervantes	Torremolinos	Spain	397	30,000,000	76,000	Hotasa	Accionistas
Westin La Lanera	Valencia	Spain	145	30,000,000	207,000	Bancaja/Greco	Barcelona Project'
First Hotel G	Gothenburg	Sweden	305	27,000,000	89,000	Host Hotelleiendom	NCC Property Development
Aronsborg Conference Hotel	Balsta	Sweden	196	39,600,000	202,000	Choice Hotels Scandinavia	Capona
Drei-Koenige Hotel	Basel	Switzerland	88	43,500,000	494,000	Private Investor	Richemond Hotels Holding SA
Noga Hilton Complex	Geneva	Switzerland	410	Confidential	—	Private Investor	BNP Paribas & UBS
Le Richemond Hotel	Geneva	Switzerland	98	64,700,000	660,000	Sir Rocco Forte and Family (Luxury Hotels)	Richemond Hotel Holdings SA
Falez Hotel	Antalya	Turkey	340	23,500,000	69,000	Vakifbank, Turkish State bank	Orsa Holding

EUROPEAN SINGLE ASSET HOTEL TRANSACTIONS 2004 (€) – continued

Property	City	Country	Rooms	Sales Price	Sales Price per Room	Buyer	Seller
Grand Hotel Mercure	Izmir	Turkey	185	8,600,000	46,000	Ozkardes Group	OYAK - Turkish Army Pension Fund
Robinson Select Maris Hotel	Marmaris	Turkey	293	23,100,000	79,000	Turkon Holdings	Entesynonal
Ramada Aberdeen City Hotel	Aberdeen	UK	98	9,000,000	92,000	Festival Inns	Jarvis Hotels
De Vere Bellhouse	Beaconsfield	UK	136	21,200,000	156,000	Cain Hotel Group	De Vere Group
De Vere Dormy	Bournemouth	UK	115	21,300,000	185,000	Unnamed Local Developer	De Vere Group
Holiday Inn - Gatwick	Crawley	UK	238	19,500,000	82,000	Private Investor	InterContinental Hotels
Days Hotel Derby	Derby	UK	100	8,600,000	86,000	GSC Property Holdings	Undisclosed
Edinburgh Capital Moat House	Edinburgh	UK	111	7,800,000	70,000	Portland Hotels	Queens Moat Houses
Old Course Hotel, St Andrews	Fife	UK	134	50,800,000	379,000	Kohler Co	Kosaido Corporation
The County Hotel	Ipswich	UK	76	7,000,000	92,000	Elizabeth Hotels	County Hotels
Dorset Square Hotel	London	UK	38	12,600,000	332,000	Canada Life	Henderson Global Investors
Drury Lane Moat House	London	UK	163	16,400,000	101,000	TLLC Group Holdings - Travelodge	Queens Moat Houses
Caesar Hotel	London	UK	160	30,100,000	188,000	Derby Hotels & Metropolis Investment Group	Undisclosed
Days Inn	London	UK	160	21,100,000	132,000	Sellar Property Group	Quercus Fund
Thistle Hotel Islington	London	UK	375	55,000,000	147,000	Kirkmore Securities	Thistle Hotels
London Ryan Hotel	London	UK	211	27,900,000	132,000	Kirkmore Securities	Thistle Hotels
Sloane Square Moat House	London	UK	105	18,600,000	177,000	Sloane Square Hotel Ltd	Queens Moat Houses
Quality Hotel Kensington	London	UK	72	10,500,000	146,000	Western Heritable	International Currency Exchange
Ramada Jarvis Kensington	London	UK	82	18,800,000	229,000	Undisclosed	Jarvis Hotels
Crown Hotel Paddington	London	UK	95	22,400,000	236,000	London Town Hotels	Undisclosed
Holiday Inn London Victoria	London	UK	212	53,000,000	250,000	Hesperia Hoteles	Whitehall/Westmont
Blake's Hotel	London	UK	51	Price Not Disclosed	—	Phillimore Estates	Anouska Hempel
The Howard	London	UK	189	107,500,000	569,000	Samosir	Marylebone Warwick Balfour
The Grosvenor House Serviced Apartments	London	UK	140	145,900,000	1,042,000	Bourne Capital	The Royal Bank of Scotland
Marriott Marble Arch	London	UK	240	54,700,000	228,000	Private Investor - Solomon Noe	Middle Eastern Private Investor
Jurys Inn	London, Heathrow	UK	364	23,300,000	64,000	Blair Group	BAA Lynton
Midland Hotel	Manchester	UK	303	53,900,000	178,000	Quintessential Hotels	InterContinental Hotels Group/Modesole/Northern Assurance
Radisson SAS Hotel Manchester Airport	Manchester	UK	360	75,500,000	210,000	DIFA	Private Offshore Investment Company
The Peebles Hotel Hydro	Peebles	UK	128	Price Not Disclosed	—	McMillan Hotels	Peebles Hotel Hydropathic Ltd
Sharrow Bay Country House Hotel	Penrith	UK	24	7,900,000	329,000	Von Essen Hotels	Private Individual
Holiday Inn Preston	Preston	UK	129	Price Not Disclosed	85,000	Centre Island Development Company	InterContinental Hotels Group
Express by Holiday Inn	Stansted Airport	UK	255	10,900,000	43,000	Airport Hotel Partnership	BAA Lynton
Radisson SAS	Stansted Airport	UK	500	34,300,000	69,000	Airport Hotel Partnership	BAA Lynton
Ramada Encore	Swansea	UK	99	Price Not Disclosed	—	Pearl Hotels	BDL Hotel Group
Wigan Standish Moat House	Wigan	UK	124	10,300,000	83,000	Britannia Hotels	Bank of Scotland



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