Hotel Projects for the next generation: What are the key factors for foreign investors in order to ensure a successful running hotel business?

Commission in charge of the Workshop:

REAL ESTATE COMMISSION

Annual Congress London, 2015

GENERAL REPORTERS

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National Report of Switzerland

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January 2015

I. MARKET SITUATION / TYPE OF TRANSACTIONS / MIXED USED TYPE

I.1 Give a brief overview of the hotel sector market situation in your country (or region): Specifically, what are the current trends and/or what are the main targets for investors ? What are the general expectations for the near future ?

After the financial crisis in 2008/2009, Switzerland's hotel market regained confidence and has shown signs of recovery. Swiss hoteliers have been optimistic as regards the development of occupancy, average room rate and revenues for the hotel market in general as well as for their own hotel operation. Serious problems, however, remain due to Switzerland's currency and general high prices and low or non-existent profitability of smaller operations which are being driven out of business.

<u>Hereunder a brief overview of the Swiss hotel sector market:</u>

- The Swiss hotel sector represents 27 % of total income of the Swiss tourism industry;
- 71'000 persons are currently employed by Swiss hotels;
- In 2013, the number of nights increased in 11 of the 13 touristic regions of Switzerland;
- The exchange rate has a very important impact on Swiss hotel business, because a strong Swiss franc increases the holiday cost in Switzerland. Therefore, the markets' diversification is very important;
- Swiss hotel business has experienced structural changes in the past decades, with a clear tendency towards big hotels. In the cities, both supply and demand increased in the past years;
- Nowadays, the overnight stays are shorter than they were in the past. This is true specially as regards visitors from Asia;
- More than 50 % of the reservations are made for three or four stars hotels.

Of all European hotel real estate markets, Switzerland is probably the least transparent and the one with the highest barriers to entry. The barriers are the highest in cities such as Geneva and Zurich as there is little or no room for new constructions and the cost of transforming an existing office building into a hotel is too high to generate a profit. Furthermore, the legislation dictates that residential buildings cannot be converted into hotels or other types of use as there is a housing shortage in many big cities.

However, Switzerland's real estate market has shown resilience and displayed low volatility compared to neighbouring countries. Real estate transactions were attractive to investors because of historically low interest rates.

Main target for investors :

- On the five stars market, investors will be looking for existing hotels with an excellent reputation, belonging to a group or family, potentially for sale ;

- On the lower level market, investors will be looking for an existing building that could be transformed into a hotel, well situated in the city center.

The international investors, such as sovereign funds or institutional investors, tend to favor luxury hotel businesses on premium sites. These investors are looking for sustainable returns, value preservation and a certain prestige. Money is usually not an issue for this type of investors.

Despite the strong Swiss Franc, investors are still highly interested in the Geneva and Zurich markets and many companies and private investors are seeking opportunities to acquire existing properties.

As available properties are limited, prices for hotels tend to be on the high side. This does not discourage investors who seek trophy and good quality assets in a strong and stable environment.

General expectations for the near future :

Investors will be looking for lower level hotels and more upper mid-range hotels with less complications but standards nearly as high.

One big danger facing the Swiss hotel business now is the strong Swiss franc. As night stays are now more expensive for foreigners, the number of nights is surely going to decline.

Generally, the global hotel industries' optimism is on the rise again, albeit not in major increments. For the year 2015 hoteliers around the globe still hold an optimistic future market outlook for their industry.

I.2. What type of transactions are the most usual in your jurisdiction (development, purchase, sale, lease, management agreement, sale & lease-back, franchise, etc.) ?

There is very little information on this topic, because Switzerland's hotel supply counts roughly 10% of branded hotels, making it one of the European countries with the smallest percentage of internationally branded hotels. As a consequence, the hotel real estate market is quite illiquid and opaque.

Over the last few years, there have been very few reported hotel transactions, the details of which were mostly kept confidential. The "public" transactions all concerned sales: from 2010-2012, the recorded transactions (HVS figures 2010, 2011 and 2012) concerned mainly the five star segment, with notable transactions being the sale of the Richemond in Geneva by Rocco Forte to a Private investor, which also involved the management company changing to the Dorchester Collection, and the sale of the Bellevue in Gstaad. The largest transaction was the sale of the Montreux Palace, Swissôtel Plaza in Basel and Swissôtel Zurich (Blackstone portfolio) to the Credit Suisse Hospitality fund last year.

Some smaller and less public transactions involved the sale of the Hotel des Nations in Geneva to a local hotelier or the construction of a new hotel in Ecublens, also by a local hotel group.

However, the hotel chain Accor has been making a rather aggressive move into the Swiss market, particularly in Geneva with their Ibis brand, through a franchising model.

To sum up, it is rather difficult to say what type of transactions are the most usual in the Swiss hotel market, because of the trade's opacity.

I.3. Are there mixed use types (Hotels & Residential or Resort/Relaxing facilities, condo-hotels/condominium, etc.) ? If so, please describe some typical schemes you know about or you find interesting to share. Please describe pros & cons, if so, of one structure compared with others.

There are some mixed use types, such as condo-hotels, that are quite popular in Switzerland. One of the main and recent examples is the "Stilli Park Davos". This luxurious concept in Davos offers a wide range of facilities, including a condo-hotel.

It is quite common to be able to rent a small flat with a kitchen and a room service, in the city centres or outside.

Ownership of apartments/condominiums, often entire floors, is not specifically regulated by Swiss law, but can be in certain aspects related to a typical co-ownership formula that includes special rights of exclusive use of parts of a building.

More economical than a single home, condominiums facilitate access to the status of ownership. Most buildings that are built now are condominiums. In the last ten years there has been a 5% increase in the number of homeowners in Switzerland.

I.4 Is the off-plan project always a common scheme to follow or is it an out of date concept ?

Basically off-plan projects are totally out of date in the cities. The reason for that is this there is no more available space.

In the country-side, off plan projects may occur sometimes, but it is definitely not a common scheme because of the lack of available space.

The risks of investing off-plan can be summarized as follows:

1. If property values start to fall before construction is completed, the lender may reduce the value of the loan or even deny financing, particularly if the buyer is buying the property as an investment rather than as a home. The buyer may be contractually obliged to buy the property at the original price and must thus make up for the short-fall from other sources or risk being sued if the buyer pulls out and the promoter sells the property at a lower price.

2. The constructor may go out of business before construction of the property is completed and the buyer may not be able to recover the monies advanced.

3. Another issue with off-plan property is that the finished property may not meet the buyer's original expectations, either because of subjective reasons or because of material defects.

To summarize, due to the above mentioned reasons, off plan projects are very rare in Switzerland.

I.5. Are new projects involving renewable energy popular in your country? Are those more attractive than standard projects even though they are more expensive? Do they involve lots of clauses which can be considered *"condicio sine qua non"* for the signing of the contracts?

New projects involving renewable energy are popular in Switzerland, for the two following reasons: mandatory legal obligations and awareness of environmental problems.

First of all, mandatory targets were implemented in Swiss federal public law, such as the reduction of carbon dioxide emissions by 20% by 2020 (compared with 1990 levels) (*Federal Law concerning the Reduction of Carbon Dioxide Emissions (Bundesgesetz über die Reduktion der CO2-Emissionen)*).

The reduction target will primarily be realised through voluntary measures, one of these being the Minergie quality standard for new residential buildings. Facilities built in accordance with the Minergie standard are characterised by high-grade, air-tight building envelopes (that is, the separation between the interior and the exterior environments of a building) and the continuous renewal of air in the building using an energy efficient ventilation system. Specific energy consumption is the main indicator of the required building quality.

Moreover, the Federal Council (*Bundesrat*) can charge a tax if the voluntary measures are insufficient to reach the reduction target. This provides an incentive to build in accordance with the Minergie standard. Additionally, some banks provide special incentives for the financing of houses fulfilling Minergie standards.

In addition to that, the past decades have seen a growing awareness amongst hoteliers and investors regarding the environmental and social impacts of hotel development and operations – to the extent where sustainability issues have permeated nearly every aspect of the hospitality industry.

Swiss tourism and its principal actors (including hotels) signed the « charte du développement durable du tourisme suisse », which encourages them in finding the right balance between economical as well as ecological aspects.

Clients are also very sensitive to the ecological aspects of hotels.

74 % of the Hotel managers say that they attach great importance to the ecological aspects of their hotel business.

However, hotel managers say that their impact on eco-mobility is weak. It is difficult for hotel managers to have an impact on the way their clients travel to the hotel.

The high costs of new ecological systems blocks hotel managers from investing for example in a new heating system. But, on the other hand, ecological investments made to save energy can be deducted from the tax declaration.

All the above mentioned reasons make projects involving renewable energy popular in Switzerland. Even though they are more expensive than standard projects, the new awareness of Swiss hoteliers and the legal mandatory measures that have to be taken result in a growing number of projects that take the environmental aspect into great consideration.

However, the projects involving renewable energy and environmental protection do not necessarily have *"condicio sine qua non"* clauses for the signing of the contract.

I.6. Lawyers and Project Managers: Do they work well together or is there friction between them ?

The usual frictions may occur notably with respect to completion deadlines, risk management and level of fees, but in general cooperation is adequate. This is among others due to the fact that the market is comparatively small and the actors of the industry tend to know each other.

I.7. Are there favorable tax or other promotion plans for resorts for elderly people in your country ?

There are no favourable tax or other promotion plans for resorts for elderly people in Switzerland.

In Swiss tax law, the homes for elderly people, if they are constituted as a legal entity, do not pay any taxes because they aim to offer a public service. Some of these houses are however very luxurious and tend to offer hotel-like services. The potential "clients" of these houses being financially well-off, they do not follow a public service purpose and are therefore not exonerated from paying taxes.

II. BUYING AND SELLING THE HOTEL BUSINESS: PLEASE DESCRIBE THE MAIN SCENARIOS WHEN IT COMES TO A HOTEL ASSET OR SHARE DEAL SITUATION

II.1.Please describe the pros & cons or simply the differences to keep in mind when the "Hotel business" changes ownership – the answers may contain legal as well as practical aspects.

A change of ownership through an asset deal is (at least in theory), less due diligence intensive but requires more formalities such as the intervention of a notary and registration with the local land register, which generates additional costs. Also, change of ownership through an asset deal entails an increased "risk" of publicity as the land register can be publicly consulted.

While the tax issues relating to a change of ownership through an asset deal are generally relatively straightforward (the real estate transfer tax if applicable being usually paid by the buyer in Switzerland), share deals in which one of the main asset of the company is real estate can raise significant issues linked to the discrepancy between the book value of assets and liabilities (under-evaluation of assets / over-evaluation of liabilities) and the economical and effective value of same (true and fair view / "hidden reserves"). Such hidden reserves create a deferred tax burden which potentially materializes in use of a future transfer of the real estate asset. This issue often leads to lengthy negotiations between potential buyers and sellers.

II. 2.In cross-border situations: Tell us about your experience or lessons learned when it comes to local differences and how to deal with these situations (e.g. are there some peculiar legal or cultural aspects, which investors should keep in mind when they want to invest in hotel business in your country?)

As regards Switzerland, it is important to note that there are still a number of hotel assets which often for generations have been run by families. The sale of such assets carries in itself a substantial emotional aspect and often the seller only reluctantly agrees to sell due to, for example, the increase in operational costs. This aspect must be respected and dealt with very carefully, and it is important to make potential foreign buyers aware of this.

II. 3.Have you had lots of M&A transactions involving Hotel Projects in your country in the last two years ?

There have been very few M&A transactions made public involving Hotel Projects in Switzerland, because, as we explained in question I. 1, of all European hotel real estate markets, Switzerland is probably the least transparent.

The most visible M&A transaction in 2014 has been the acquisition by the AEVIS Group of the Victoria-Jungfrau group of hotels. The hotel business group composed of the Hotel Victoria-Jungfrau of Interlaken, the Bellevue Palace of Bern, the Lucern Palace and the Eden Hotel at the lake of Zürich was subject to a takeover battle between Aevis Group and the Manz family.

Aevis Holding already announced they were planning other hotel business transactions to develop the hotel group.

III. HOTEL BUSINESS STRUCTURE – MANAGEMENT AGREEMENT / LEASE AGREEMENT / FRANCHISED OR ALL MANAGED BY THE OWNER

III. 1.How would you describe the usual business structures in your country. Who are the key parties / players involved and who is responsible for which part of the running business ?

In Switzerland, the hotel business structures are multiple, depending on the market.

In the lower and middle market, there are still a number of traditional family-held hotel businesses. Such hotels are almost exclusively owned and managed by the family.

On the other hand, there are approximately 100 five stars hotels in Switzerland. The majority of the five stars hotels are being managed through management or lease agreements.

In Geneva and Zurich, five star hotels are often owned by rich citizens from the Gulf, from Saudi Arabia or from Qatar. For example, the "Rolaco" group, which owns the Crowne Plaza hotel in Geneva and in Zürich, is owned by the Saudi family Al-Sulaiman and by the Swiss-Syrian family Jeanbart.

The "Accor" hotels in Switzerland are managed through a franchise system.

III. 2.In the event of a management agreement, i.e. the owner owns the building and the hotel business, what are the most important clauses or aspects to be structured or dealt with ?

A typical management agreement contract must contain:

• **Operating Fees**: An operator will typically receive remuneration from the owner, often termed a **base fee**, in exchange for performing the duties specified in the contract. Base fees typically range from 2% to 4% of total revenue;

• **Operator Guarantees** An operator guarantee ensures that the owner will receive a certain level of profit ;

• **Owner Approval**: Approval clauses set out the extent to which the consent of the owner is required for decisions affecting the operation of the hotel;

• **Non-Compete Clause**: by including a non-compete clause in a management agreement, the owner has the assurance that no other property with the same brand is allowed to open in a certain radius;

• **Dispute Resolution**: typical dispute resolution clauses will choose either to solve the problem in front of a court jurisdiction or in front of an arbitral court;

III. 3.In the event of a lease agreement, i.e. the owner owns the building but not the hotel business, what are the most important clauses or aspects to be structured or dealt with (duration, rent, early termination rights, change of control clauses, pre-emption rights, etc.)?

- **Hotel Rent Payment:** Rents can be fixed, variable or hybrids in hotel lease agreements. Fixed rents are typically increased annually by inflation. Variable rents are likely based on total hotel revenues.

- **Term of the Lease:** Frequent minimums are 20 years, though 30 to 40 years is common. Hotel operators are investing in the long term, as building awareness and stabilising cash flows takes time.

- **Capital Expenditure**: Hotel lease agreements must specify which party is responsible for major expenses (i.e. the building structure, boiler and pumping systems, roofs and elevators). These items are typically the responsibility of the owner.

- **Sub-Letting and Assignment:** This right is infrequently granted. Hotel owners want to lease their asset to screened, known and professional operators, for specific reasons. Allowing sub-letting might help the operators risk management, but it's definitely not in the hotel owner's interest.

- **Insurance and Risk protection:** Hotel lease agreements need to deal with insurance clauses and to determine who is liable for specific risks.

III. 4.In the event of a franchise system, what are the most important clauses or aspects to be structured or dealt with (contractual relationships and parties involved, etc.)?

- **Financial clauses**

The fee of the franchisor is usually composed of an initial fee to be paid at the outset and a royalty fee of a certain perigee of the monthly gross turnover achieved by the franchisor.

- **Exclusivity**

The Franchisee is usually granted exclusivity for a certain territory.

- **Access to premises**

The franchisor is usually granted certain rights of access to the franchisee premises in order to review the activity.

- **Confidentiality**

Very important as the franchisee gains access to privileged information of the franchisor. Clauses relating to the sale and supply of products.

III. 5.Please describe which one are the most common financial leverage or instruments to be arranged by the builders or investors ?

For large real estate acquisitions, senior bank loans of up to 80 % of the purchase price are common in Switzerland, such loans being secured by mortgages which take the form of physical mortgage certificates and other measures such as security on receivables.

III. 6.Is a private equity scheme more common than traditional bank loans in your jurisdiction?

In Switzerland, traditional bank loans for hotel acquisitions remain more common.

IV. EFFECTS OF THE FINANCIAL CRISIS

IV 1.Please describe the effects of the financial crisis in your jurisdiction, if any. Are there a lot of forced sales scenarios ? Give examples.

After a successful year in 2008, the Swiss hotel business suffered from the financial crisis with a 5 % loss of overnight stay in 2009.

Every region of Switzerland suffered from losses in overnights stays in 2009.

But, according to Gugliemo Brentel, president of "Hotelleriesuisse", the situation could have been worse. Other export markets, such as watchmaking, suffered from a 22 % loss in 2009.

The strong Swiss franc (1 CHF = 1 EUR) is also a problem for the Swiss hotel business. It is now more expensive for foreign travellers to stay in a Swiss hotel and Swiss people may be tempted to spend their holidays outside the country, now that it is cheaper for them.

Hotels that are located in the cities were less affected by the financial crisis than hotels in the countryside, because short stays in cities are increasing.

The "Sawiris project" in Andermatt has also been slowed down by the financial crisis. Orascom, M. Sawiris' group, suffered from the low occupancy rate in Andermatt.

The financial crisis was also difficult for luxury hotels. For example, the Intercontinental hotel in Davos went bankrupt in 2014. In the French speaking part of Switzerland, the effect of the crisis was slightly less strong on hotel businesses.

However, optimism is now the key word in the Swiss hotel business. For example, Château Gütsch in Lucern and the Chedi Hotel in Andermatt are now open and, depending on the season, fully booked.

IV. 2. Financing of hotel transactions – how does that work nowadays?

Financing has become increasingly available but mainly for prime assets being purchased by entities with strong credit credentials.

IV. 3. Litigation matters: are many of the failed transactions resolved by arbitration or is the traditional litigation used in your jurisdiction ?

Arbitration will widely be used for sophisticated cross-border hotel investments or projects, and generally speaking for share deals of a certain size. Real estate asset transfers will provide for the jurisdiction of the courts at the place of location of the asset.

IV. 4.In case a criminal proceeding is involved: is there also a way to protect third parties involved without awaiting the decision of the Criminal Court ?

IV. 5. In your opinion: Is the crisis also a financial opportunity for speculators who can invest in "unfinished projects" with few resources ?

This is a remote risk in Switzerland.