

Funds & franchise - new partners?

Union Investment is open for this new operation variation



Master franchisees like Foremost - in the photo one of their rooms at the Holiday Inn Express in Hamburg - are professional partners for funds.

/ photo: map

Hamburg (October 1, 2010). Union Investment is not adverse towards concluding franchise agreements. This type of operation is another opportunity for the open investment fund of investing in hotels. However, strong brands are in high demand as partners. But Union Investment is also interested in professional franchisees in the form of individual hotels at highly attractive locations. Dr. Frank Billand, Managing Director of Union Investment, on funds and franchising - an issue he and his team would like to discuss at this year's Expo Real.

Why is a real estate fund interested in hotel franchising?

Dr. Frank Billand: Direct management agreements with all their chances and risks are not an option for open real estate funds due to legal restrictions concerning investments. Franchise agreements, however, are an attractive alternative in combination with lease agreements. Being a real estate investor, Union Investment has access to international hotel brands with franchising as well as to experienced professional lease agreement partners. For hotel operators without their own brands, franchising offers a good opportunity to take advantage of the sales power and brand standards of an international hotel chain. In Western European countries like Germany, France or the United Kingdom, franchising has become a major driver of expansion in the past few years.

Union Investment invests in hotels all over Europe. Do you have any comparison between franchise agreements in Germany and other European countries?

Dr. Frank Billand: At the moment, Union Investment has a hotel whose lessee is a franchisee at InterContinental Hotels Group (IHG). The hotel in question is the Holiday Inn Express in Luebecker Strasse, Hamburg. We are currently examining the possibility of further hotel investments with franchisees in Germany and in the German-speaking countries. All in all, the experience with franchise agreements in the hotel segment is still rather rare in Europe compared to Northern America. Market standards will therefore have to first establish themselves and get adjusted to local peculiarities. Wide market penetration with franchise agreements is still only left up to a few hotel brands like Holiday Inn Express in Germany. When it comes to countries like the UK or France, franchise systems are far more accepted in the hotel sector compared to Eastern Europe, for example.

What aspects need to be differently designed in European franchise agreements?

Dr. Frank Billand: Franchising is basically an agreement between a franchisor and a franchisee. In addition, certain franchisors demand so-called "owner agreements", which are common in Northern America, for Europe as well. The goal of this agreement is to protect franchisors against loss of the licensed hotel location, which is often related to a loss of a brand's reputation. In Germany, such agreements are just starting to assert themselves very slowly, as owners will accept such massive rights to intervene in real estate availability only under certain conditions.

So far, lease has been your domain as a fund. Is franchising a real alternative for you?

Dr. Frank Billand: With respect to our hotel investments, separating operational and investment risk remains in the focus. Lease agreements will therefore remain the core element of our investment policy in the hotel area. However, over the past few years, the major hotel chains have become less willing to take operational risks. At the same time, the number of some highly professional hotel operators without any brand name is increasing at very attractive locations offering alternative opportunities to invest.

Accepting franchising means trusting in the brand name on the hotel roof and thus the franchisor/licensor, but it also means trusting the franchisee/licensee. Which of the two partners is more important to you?

Dr. Frank Billand: Both partners are thoroughly checked in the course

of our purchase process and are equally important for the investment's success. In our daily business, we have a more direct relation to our lessee, the franchisee. The added value of the hotel brand derives from sales strength and acceptance at the relevant location. The franchisee needs to be in the position to realise the brand's standards adequately and sustainably generate the lease for the property by way of the profitability of its business.



Dr. Frank Billand.

What hotel types and what locations are suitable for franchising?

Dr. Frank Billand: Franchising is particularly suitable in the so-called economy and midscale segment due to the limited complexity of hotels as a product. In our point of view, franchising can be applied regardless of the location. We closely examine the market suitability of the relevant hotel brand. Investments in franchise agreements at Union Investment will particularly distinguish themselves through very good micro locations. Accordingly, our Motel One Hotel was opened close to the well-known Michel church in Hamburg.

Franchising trusts in the brand's attraction. You as an investor are interested in return on investment. How do you calculate the yield a brand can give you? What pillars would this calculation be based on?

Dr. Frank Billand: Calculation of yield is closely related to the type of agreement. The yield-increase potential is limited with respect to fixed lease agreements. Concerning these agreements, both the brand and operator are decisive for the maximum fixed lease. For hybrid agreements, the rule is: the higher a brand's expected profitability, the higher the yield potential for investors. It is always critical to what extent a hotel brand can contribute to above-average operational results.

Would Union work with master franchisees only or also with individual operators?

Dr. Frank Billand: In the hotel sector, Union Investment prefers collaboration with experienced master franchisees with good creditworthiness in order to reduce operator-related investment risks.

The most recent HVS report about franchising in Europe confirms that the European market has huge potential in this respect. Do you also see it that euphorically?

Dr. Frank Billand: Franchising is a growth market in Europe. However, only very few brands have managed to establish themselves on a large scale, and thus successfully, at least in Germany. The additional benefit compared to the added costs (particularly due to franchise fees), acceptance among investors, availability of franchisees that can be refinanced, and adaptability of franchise concepts in local markets will decide on the actual success of franchising

Thank you very much for the interview, Dr. Billand!

The interview was conducted by Maria Puetz-Willems.

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