New Frontiers in an Ancient Land: Iran's Emerging Hospitality Market

Hamid Mojtahedi
h.mojtahedi@tamimi.com

March 2016

From the ruins of the Persian Empire in Persepolis in the Southern Fars Province, to the Mountains of Sabalan and Damavand in the north and the torquise waters of the Gulf to the South, this ancient land has never ceased to intrigue. With a large and young population, relatively high GDP per capita, and a strategic location, Iran has strong potential to become a leading, well-educated economic and tourism market globally. The recent major lifting of the crippling sanctions imposed on Iran's key energy and financial sectors has already shifted the attention of global business leaders to the largest closed market to open for decades. In the year and months leading up to the implementation of the agreement that has effectively ushered in the new business opportunities, Iran has seen the inflow of interest from international business looking to either re-engage, or engage for the first time, with Iran in a cross section of sectors.

In the tourism and hospitality sector alone, the country will undoubtedly expect a marked growth in the inflow of tourists / travellers in a full range of segmentations – such as cultural, religious, medical, eco-tourism and adventure – business tourism alone demands a great deal of consideration in the aftermath of the removal of sanctions. Today, Iran and the capital Tehran in particular, is home to only a handful of locally branded hotels that have to some extent met the global hospitality standards. By contrast, Turkey as an immediate neighbouring country of similar size houses more than 20 internationally and 5 star branded hotels. The lack of internationally branded accommodation and quality business hotels is indeed an immediate market opportunity and a critical shortcoming in the coming years and beyond. The current predicament has not always been the case. Prior to the Iranian revolution in 1979, Tehran's hotel market had one of the highest penetrations of international hotel operators in the region, when it was home to IHG, Hyatt, Hilton Sheraton and Starwood, all of whom operated properties in prime locations within the city. Following the revolution, the industry witnessed decades of stagnation, which was compounded by the onset of the (1980-1988) Iraq-Iran war which made owners and investors reluctant to maintain and improve properties and to invest in new hospitality projects. Of course the post-revolutionary expropriation of foreign-owned assets in the hospitality sector was a major deterrent for any new inward investment.

The departure of international hotel operators had a profound impact on the management of the hotels in Tehran, which until recently, with the opening of a few locally branded hotels, tended to be old-fashioned and lacking in key techniques such as yield management. Furthermore, historically service levels in the hotels were generally poor, due in part to a shortage of suitably trained talent and a lack of quality hospitality and tourism training facilities in the country. The latter has been in part due to Iran's over-reliance on the public sector in recent years which has effectively owned and operated the tourism properties. In fact, most of the international brands that were once present in Tehran were expropriated by the revolutionary government and were in turn owned and managed by quasi-governmental entities such as the various "foundations" without any formal internationally accepted industry knowledge.

The current administration under President Rouhani is now keen to re-prioritize Iran's Travel and Tourism sector. Under Iran's 2025 vision, the government has planned for certain key structural improvements (through incentives) for the privatisation of the hotel and hospitality industry. Accordingly, with a sudden tourism boom that is expected, an indication of which is the almost exponential expansion of airline routes

to various destinations within Iran from regional hubs like the UAE led by Emirates Airlines (four full flights per day into Tehran alone), Fly Dubai and Air Arabia, as well as internationally, hotel Average Daily Rates (ADR) – as one of the most important indicators for hotel valuation and feasibility assessments – will surely witness an organic growth to reach close to regional standards. Iran is also upgrading its own fleet of aircraft by deals with Airbus and expected deals with Boeing. As a result, hotel development projects will begin to attract a significant share of investments initially from the domestic private sector, with foreign / regional investment to follow. The government has already undertaken concrete measures in that respect with the privatisation of the formerly publicly owned properties in Tehran, such as the former Hilton and Hyatt brands under the management of the "Parsian Group".

In terms of Foreign Direct Investment, the government has provided a series of incentives through the law on foreign investment in Iran named Foreign Investment Promotion and Protection Act (FIPPA). These incentives include a 50% full term tax reduction on income, loan structure and eligibility of government funding, property ownership rights including 100% ownership in free zones, unlimited reparation of profit capital and dividends from the country and security of ownership. This presents an immediate opportunity for international hotel operators through the rebranding of existing properties in the city, particularly the four and five star hotels. The rebranding of existing properties has a number of advantages including immediate market penetration, market leader positioning and direct cash flows from an existing hotel asset. With Iran now effectively being reintegrated into the global banking system (SWIFT) after the lifting of sanctions, the concerns over the ability of hotel operators to repatriate funds out of the country, or the initial cash injection into the proposed project is largely mitigated even thought there is still some apprehension on the part of regional and international banks to fully support the industry and re-engage with Iran. The laws governing direct foreign investment into Iran aim at alleviating some of the traditional concerns respecting the security of investment, repatriation of capital and profit, a lack of a transparent legal framework and a fair operational environment. In particular, whether the foreign investor enters the Iranian market on "Build-Operate-Transfer" (BOT) model, FDI or Joint Venture schemes with an Iranian counterpart, the government, via the instruments of the law on foreign investment (FIPPA), is intent on reducing the red tape of setting up companies, easing the facilitation of procurement of various operational licenses, and a sovereign guarantee in the event of expropriation or nationalization as well as the establishment of a one stop shop for foreign investors (Organization for Investment, Economic and Technical Assistance of Iran (OIETAI) in addition to laws on Public-Private Partnerships (PPP). The Government and indeed the City Municipalities may well be prepared to enter joint ventures under which they supply land and appropriate licences/consent in return for a slice of the action.

Iran is also a signatory to over 60 Bilateral Investment Treaties (BIT) all designed to encourage and protect the investment of foreigners.

It is against this backdrop that the French Accor Group acting as an operator officially signed two inaugural properties in Tehran with owning firm Aria Ziggurat Tourism Development Company of Iran. The two properties, Novotel and Ibis open their doors in October of 2016 at the site of the Tehran International Airport (IKA) being the first international hotel brands to have entered the Iranian hospitality market in 36 years post the Islamic revolution. Other international brands are looking at the huge growth potential in Iran. In particular, the UAE-based hospitality firm Rotana, has also signed management agreements for four hotels in Iran, two in Tehran (opening in 2018) and two in Mashad (opening in 2017). President Rouhani's ambitious plan to attract 20 million visitors to Iran by 2025, is being heeded by the international investors in the hospitality sector. However, the leisure travel to Iran is unlikely to lead the pack save and except for emerging tour operators who would typically package travel to the key destinations within the country. Rather it will be the regional and international corporate travel that will drive the growth in the medium term. Additionally, Iran has the potential to be the natural "halal destination", a feature that is uniquely attractive to Muslim travellers, and should be to potential foreign investors in this sector. This is indeed a significant factor given that Thomson Reuters has valued the global halal tourism market at $140 billion in 2013 and has predicted it to rise to at least $238 billion by 2019. Perhaps it is no surprise that the UAE based Rotana Group's upcoming Iranian properties, 4 and 5 stars alcohol free Rayhaan-branded properties will be in both Tehran and Mashad with the latter destination attracting large numbers of

Muslim pilgrims and religious tourists.

Despite the promises offered by the region's last frontier market, there are still challenges facing foreign investment in Iran's hospitality sector. While regional and international brands like Accor and Rotana, who have pioneered entry into the market, have surely benefited from a prior established and good relationship with their Iranian property owners/ counterparts, the same may not prove to be the case for others following suit. It is, therefore, imperative to have proper and sophisticated local knowledge and advice on the legal and commercial nuances of the Iranian landscape, including an ability to properly assess potential local business partners in Iran. Other challenges include the high and unpredictably volatile land prices in the country, in particular the capital, Tehran, which can prove to be prohibitive for new hospitality development projects. There are however, local entities in Iran that have large portfolios of land, both in the private sector and the public (including the Municipalities in Tehran and other major cities) who are in principle eager to enter into business partnership with the foreign investors and operators on a variety of models including a syndicated investment model that can offer the protections available under the FIPPA law. A further challenge, albeit one that will be ameliorated in time, is the scarcity of local talent with international standards of training in the hospitality sector. While Iran does have a young and highly educated population, with about 70 percent being under the age of 30, the absence of international brands in the market has not necessitated the requisite training and acquisition of skill sets, particularly in the service sector.

In light of the foregoing, perhaps the best early approach for the uninitiated foreign investor entering Iran's hospitality sector is to consider entering into management agreements for the re-branding and operation of the existing portfolio of properties in major cities including Tehran. This will allow for an immediate, soft market entry that can be the basis for future de novo direct investment in the development of new hotel / hospitality projects in Iran. In any event, the need for sophisticated local knowledge of Iran's legal and business landscape is paramount in order to mitigate the inherent risks associated with entering a frontier market. Fortune favours the brave, but the brave should not be foolish.