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Resetting the hotel balance sheet to be fit for the recovery

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A number of factors have combined to result in very limited restructuring activity despite the massive disruption caused by COVID

	GFC	COVID entry phase
1 Lender landscape	• Concentrated • High street banks dominate	• **Diversified** • **Multiple institution types**
2 Leverage levels	• High LTVs	• **Lower LTVs** • **Valuations resilient due to yield compression**
3 Expected recovery shape	• Credit crunch, demand-led • Steep decline, slow recovery	• **Supply-side issue** • **Rapid demand recovery expected post vaccine**
4 Capital structures	• Mostly simple debt structures other than securitization vehicles	• **Increasingly complex** • **S&L, ground rents, REITS, CLBILS**
5 Funding options	• Capital flight due to crisis • Hotels not core asset class	• **Significant equity available** • **Government support and protections**

Market consensus has been to hold on and be supportive whilst the market recovers

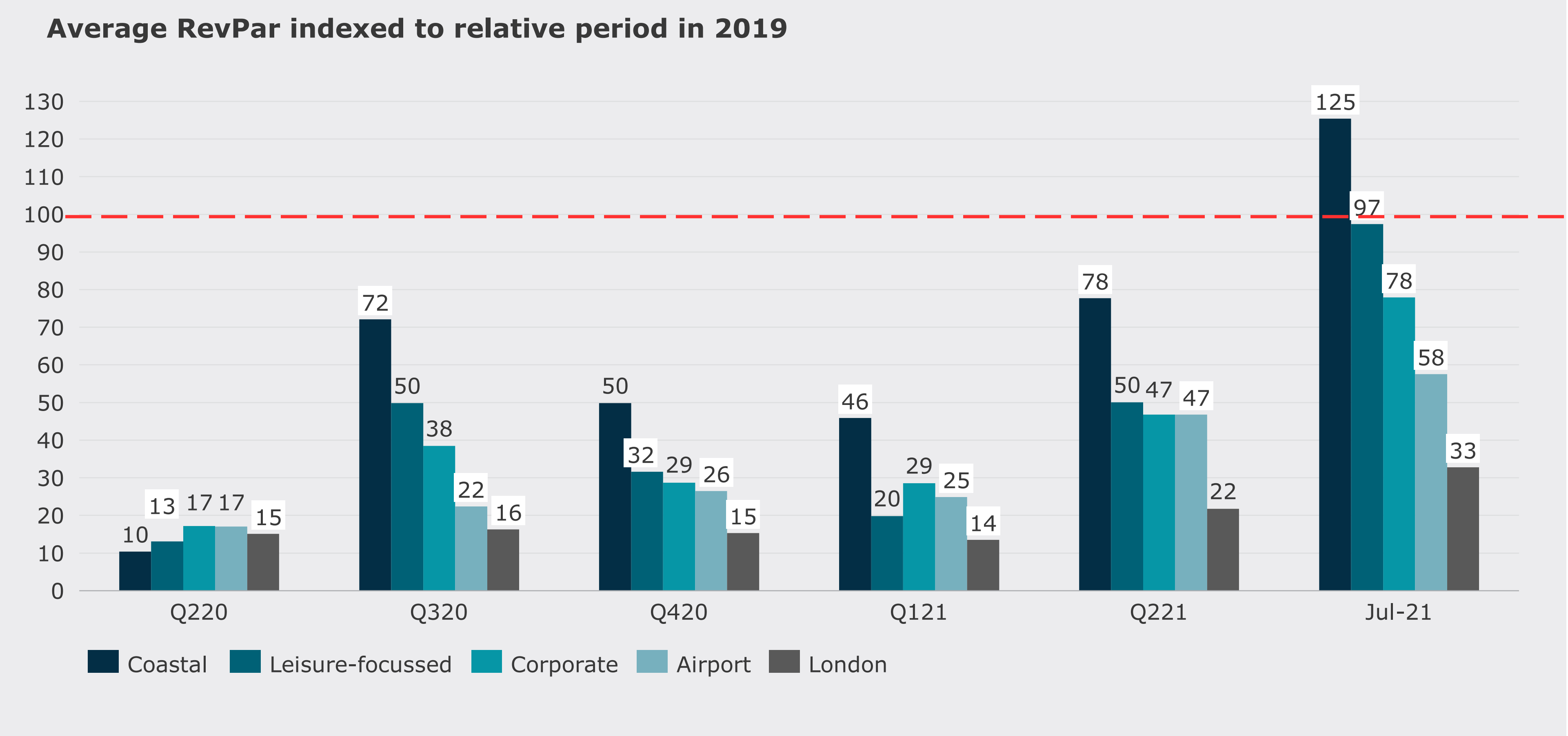
As we enter the recovery phase, a number of factors may result in the current standstill consensus falling away

1	**Outlook**	• Tomorrow is no longer guaranteed to be better than today
2	**Government support**	• Support measures falling away will cause cash flow pressure for weaker operators
3	**Multi-speed recovery**	• Future performance will vary significantly by sector
4	**Bank attitudes**	• Support for borrowers has been consistent but banks may now look to reduce exposure to the sector
5	**Investor appetite**	• Continued demand for hotel assets gives confidence of value resilience

1. **Lender support decisions now situation specific**
2. **Plan to deleverage must be clear to maintain lender support**
3. **Confidence in value recovery may cause lenders to harden their position**

Leverage covenants will begin to be tested again – may trigger refinancing, restructuring or disposal processes

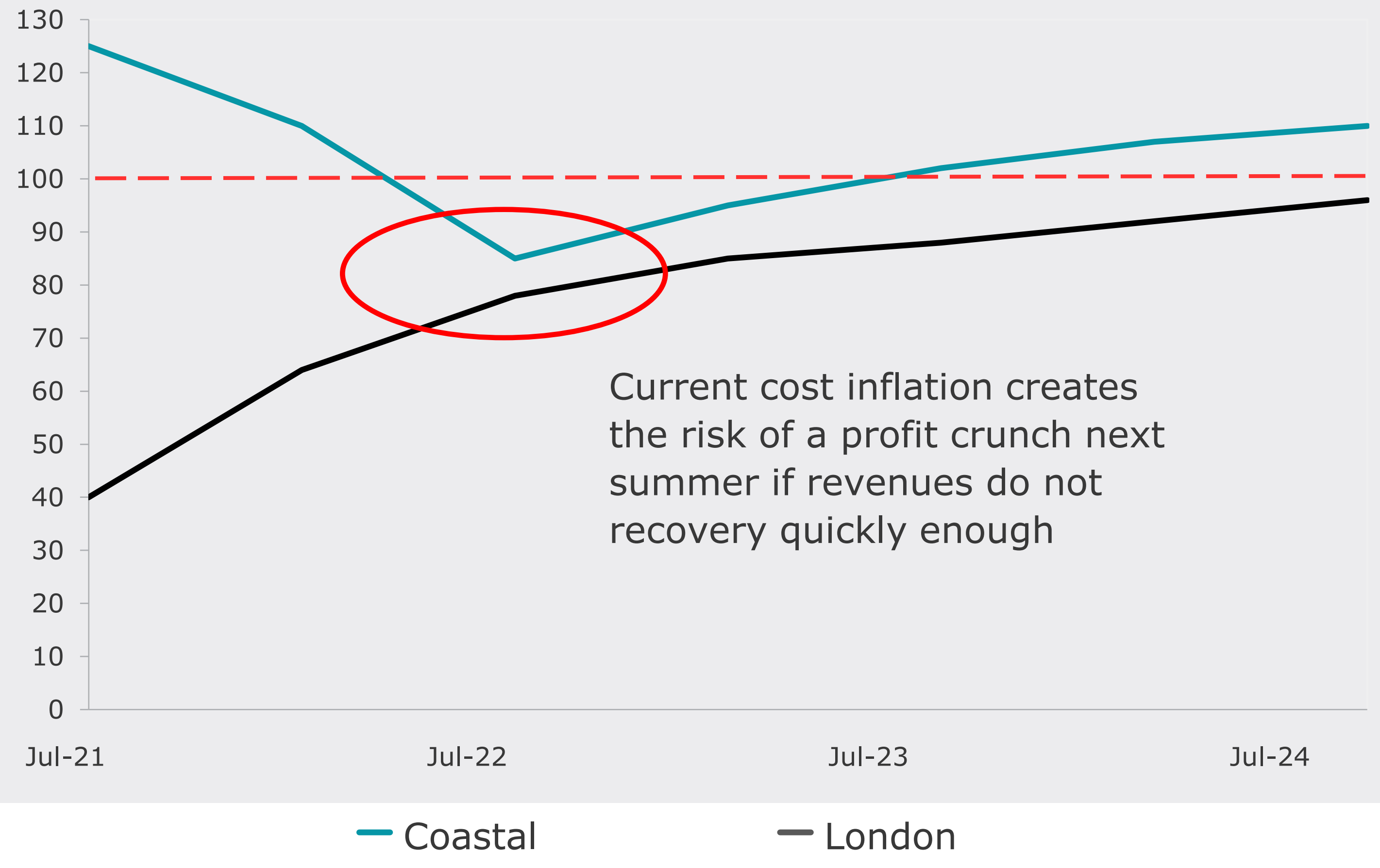
The multi-speed recovery in the hotel market is illustrated by UK performance through July 2021



This volatility in pace of recovery has made revenue forecasting incredibly challenging

The shape of recovery will need to be taken into account when assessing deleveraging timetables and sustainable debt levels

LTM RevPAR illustrative recovery by hotel type – indexed to 2019



Coastal

Current outperformance only temporary due to travel restrictions

Risk of hangover next summer but permanent benefit may survive

- **Sustainable debt level needs to factor in V shaped recovery**

London

Slower recovery due to reliance on international travel

Rapid bounce-back as restrictions ease but corporate and MICE demand likely recover over multiple years

- **Lenders need to focus on asset value if cash flow is slow to recover**

After a strong summer for some, winter will be tougher; there are a number of areas to focus on to ensure balance sheet resilience to survive through to full recovery

Understand covenant and liquidity headroom in different scenarios

1

Be realistic about the outlook (including cost pressures) and plan accordingly

2

If headroom looks too tight, take action early to renegotiate terms or explore funding options

3

Actively engage with financial stakeholders to maintain support

4

As the recovery becomes established action may be required to match balance sheets to the recovery curve

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WHEN IT REALLY MATTERS.

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Resetting the Hotel Balance Sheet

James Salford

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Resetting the Hotel Balance Sheet

Where are we now?

- Lenders (supported by Governments and "encouraged" by regulators) have been very supportive of the hotel sector.
  - Government backed lending schemes / grants
  - Tax reductions / waivers /deferrals
  - Suspensions of creditors rights
  - Waiver of financial covenants and repayment holidays
- Hotel values have generally held up driven by the vast supply of international capital
- Market outlook is very hard to read and hasn't followed industry accepted norms for a recession. Staycations have driven performance in the domestic leisure market whilst luxury city centre, conference and airport hotels have struggled.
- Market now facing significant headwinds both for owners and lenders
  - Rising costs of goods and staff
  - Employee shortages
  - Long term structural changes in customer behaviour
  - Cost of capital on hotel loan books have increased

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The lending landscape

- Some banks still actively lending to hotels, but in significantly smaller numbers than before the Pandemic
- Debt funds and alternative lenders active in the sector
- Significant increase in the availability of mezzanine and pref. equity capital
- Loan pricing has increased, base rate has fallen
- Refinancing – Many lenders using refinancing of existing deals to reduce gearing and/or increase pricing
- Challenges facing other real estate sectors (Retail/office) mean that hotels remain attractive as an asset class
- Development finance difficult to obtain and expensive.
- Ground rent financing still available
- Lenders have typically asked for collateral to support interest payments

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The lending landscape – Some predictions

- Shift from banks to alternative lenders has been happening for a while but has accelerated due to Covid. This is likely to be a permanent change
- Alternative lender pricing will become more competitive.
- Growth of alternative lenders may allow for higher gearing if cash flows allow
- Banks will return to the market but initially for established customers on conservative deals
- Rising construction costs and market uncertainty will make development finance difficult for the foreseeable future

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Where are the main challenges?

- Macro economic issues
  - Rising interest rates
  - Currency movement for Sterling denominated deals
    - Impact on tourism
    - Impact on inbound investment
  - Impact of inflation and tax rises on consumer discretionary spend
- Challenges to hotel performance
- Lack of clarity on how established behaviours will return post pandemic
- Cashflow pressures
- Financial covenant compliance

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Insolvency

- Lenders were reluctant to enforce during the Pandemic but is that about to change?
- Formal insolvency process vs soft enforcement
- What factors will drive enforcement?
  - Leverage
  - Market values
  - Perception of market demand for that product
  - Type of Lender
  - Refinance risk

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Thank you & Bird & Bird

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