

## Irish problems: typical, but not unique

### Not only Ireland needs a more strategic approach in hotel financing



**The Irish Hotel Federation observed a 53% increase in rooms since 2002. And it has been recommended to the IHF to remove 12,000-15,000 rooms from the market.**

*Dublin/London (June 6, 2010).* In Ireland, only 5% of hotels are generating a profit, hotel experts say. The impact of the over supply factor combined with the economic downturn is directly evident in hotel margins with declines in average occupancy and average RevPar. But this situation is not unique to Ireland, and not only the Irish sector badly needs to move from short term measures aimed solely at buying time to a more strategic approach aimed at restoring long term predictability and management stability to the sector. A case study of the Irish hotel market and similarities and differences to the UK.

Con Quigley, the author of this article is the Managing Partner of Horwath Bastow Charleton in Limerick and the chairman of the UK Horwath HTL firm. Horwath HTL is one of the world's largest consulting organizations specialized in the hospitality industry, with 50 offices in 39 countries. Horwath HTL is a member of Crowe Horwath International, one of the largest accounting and consulting networks in the World with offices in close to 400 cities in 88 countries. Today, Con Quigley examines the increased need for close asset management of hotel investments.

"Every day I see evidence that the problems with banking in the Irish hotel sector are not unique, and a similar situation is affecting the hotel sector globally. The situation is not markedly better in Spain and Portugal, parts of the UK, the US and Eastern Europe. It is possibly even worse for projects in developing markets and for niche destination products in newly developing isolated locations, no matter how high class and idyllic the opportunity may seem.

Similarly the excess of supply over demand is not unique to Ireland. Like many other markets, there is no doubt that the Irish hotel context requires a significant adjustment to take place. John Doe, the Irish Hotel Federation's (IHF) Chief Executive, recently observed that there has been a 53% increase in rooms available across the country since 2002, and it has been recommended to the IHF that some 12,000-15,000 rooms be removed from the market. The impact of the over supply factor combined with the economic downturn is directly evident in hotel margins with a 14% decline in average occupancy for 2009 and 32% drop in average RevPar for 2009 from peak levels in 2007 (Source: STR).

Many hotels are consequently in extreme breach of their loan covenants. With the lack of bank liquidity compounded by market doubts that values will improve in the short-term, banks are finding it very difficult to assist ailing hotels by increasing their working capital availability during their cash flow crisis.

#### **Only 5% of Irish hotels are profitable**

And it is indeed a crisis. A recent survey carried out by the IHF highlighted the stark reality that at present, only 5% of hotels are generating a profit in Ireland. With hotel occupancy rates currently at 15 year lows and average room rates in Dublin having decreased by approximately 21% since 2007 (source: STR) the impact on the net profit line has been drastic. This coupled with the drop in tourism levels in Ireland - figures recently released by the Central Statistics Office show a reduction of almost 600,000 visitors to Ireland in the first nine months of 2009, an 11.2 per cent year-on-year decline - has led to the closure of many hotel businesses in the country. It is not surprising that there have been a total of 154 insolvencies in the Irish hospitality sector in the period from January to December 2009, according to the "Insolvency Journal".



**Con Quigley from  
UK Horwarth HTL.**

### **Ireland and UK: "Open" banks revert**

And the situation in the United Kingdom is not unlike that in Ireland with hotels facing difficulties with falls in revenue due to decreased occupancy and increasingly competitive average room rates, while hotels try to maintain debt requirements as well as operate in a cost effective manner. An example would be Precinct Investments' announcement to sell the 188-bedroom Park Inn Hotel in London in an attempt to reduce the €120m debt which is outstanding to a number of lenders. The group's burden is evident in the financial results for 2008 which reported a €5.7m loss after interest payments had been made.

In the United Kingdom, as in Ireland, many banks which claimed to be 'open for business' have reverted to hoteliers with facility letters which for the most part are impracticable and far-reaching which meant funding was unattainable for many businesses. However, an important disparity between Ireland and the United Kingdom does exist in that the latter has only really seen signs of structural oversupply in certain locales. While the market has been adversely affected, in

particular the corporate sector, London has benefited greatly from the tourism market which has been supported by the weak Pound versus Euro tourist.

### **Lucky London**

Horwarth HTL saw first hand that hotels in London were able to cash in on the weak Pound for incoming shoppers in December, but many of the rest of the UK's hotels were not so lucky. In London, occupancy increased year on year by 5.3%, from 72.8% in 2008 to 76.7% in 2009 with average room rate rising by 1.9% from £115.11 in 2008 (about 132 Euro today) to £117.27 this year (about 134 Euro today) as highlighted by a recent report issued by PKF. Outwith London, trading has been more difficult and this has been only compounded in 2010 by events such as the winter snowfalls and recent volcanic ash travel disruptions.

There is reasonable confidence that London hotel profits and asset values will undoubtedly benefit from the Olympic Games which are taking place in 2012, followed by the Rugby World Cup and possibly the Soccer World Cup taking place in 2015 and 2018 respectively. Generally, where hotel borrowers are demonstrating the ability to sustain the payment of interest the banks do not see a benefit of foreclosure.

### **Ireland needs a more strategic and long term approach**

Furthermore, there is general agreement that the process of restructuring and asset management in the sector has already commenced in the global marketplace. However it has only really started in Ireland in earnest this year. The Irish sector badly needs to move from short term measures aimed solely at buying time to a more strategic approach aimed at restoring long term predictability and management stability to the sector.

This short-termism is evidenced by the so-called restructuring and examinership efforts which create standstill arrangements whereby trade creditors are unreasonably wiped out and borrowers are left with no debt reduction and no working capital. This effective stalemate is understandable in the context of zero equity available for turnarounds and a distressingly large number of properties that are incapable of generating even a single €1 in operating cash surplus – often before consideration has been taken of the ever-present requirement for an annual recurring capital expenditure budget to keep the hotel product up to date.

With over €11.2 billion of debt outstanding in the hotel sector (source: Central Bank report at June 2009) it is no surprise that the vast majority of hotels are grappling to service and maintain their financial obligations as well as being able to sustain a sufficient working capital capable of getting them through this crisis. Although benefits have been obtained from the fall in interest rates, these have been somewhat negated by hotels' falling profit margins. Often, where banks are willing to offer working capital solutions to hotels, it is predicated on the outcome of independent business reviews carried out by financial advisors – the cost of which is usually undertaken by the hotel.

### **No help from the "support funds"**

A number of 'support funds' were advertised by certain lending institutions as being available to the hotel sector specifically over the last 12 months. It is hard to argue with industry insider protests that these funds were used, at least in part, to prop up high profile examinerships and receiverships rather than to assist struggling hoteliers in the last year. In many cases hoteliers faced a closed door which ultimately led to the closure of their businesses. In any event, banks have clearly indicated the criteria for consideration if additional funding is being sought, including the relationship, quality and location of the asset and the security of the income stream which improves the strength of the covenant.

It is critical for the Irish economy that 2010 becomes the year in which the business sector's debt structure as a whole is cleansed and restructured in line with the new realities. It is only when this has been completed or largely so, that any path towards growth and prosperity can be charted. This has to happen from the bottom up - loan-by-loan - as well as from the top down. There is no doubt that Ireland's state appointed National Asset Management Agency (NAMA) will assist and lead this process – and make no mistake, it is essential

and overdue that it does so. But banks must drive it too - on a case by case basis. For this to happen, borrowers should fight for a process that is based on:

- Asset management approaches - based on proper cash flow analysis and realistic identification of cash requirements (including capex), long term goal-setting and monitoring over a three to five year period based on industry benchmarking and maximizing shareholder value.
- Debt write-downs to appropriate levels.
- Corporate finance structures and strategies which place management excellence at the centre - rather than as an afterthought.

Horwath HTL involved in a number of cases where this is happening and is confident that there will be more. This is the only route to the win-win that banks, borrowers and the sector are seeking.

There is no doubt that 2010 is proving a difficult year for hoteliers in general but one would hope that with the introduction of NAMA by the Irish government and the UK's Asset Protection Scheme we could potentially revert to a semi-liquid banking system which is a much needed requirement in the hotel sector at present. Through the approach outlined above, the limited amount of new debt and turnaround equity that is available can be used prudently to restructure the whole sector and once that is achieved, then the potential for growth will return to values, rate, occupancy and cash flows."

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