

# Cleansing the Debt

Globally, asset management is seen as the only robust solution to the banking impasse in the hotel sector, says CON QUIGLEY.



Every day I see evidence that the problems with banking in the Irish hotel sector are not unique in the hotel sector globally through my role as chairman of the UK firm of Horwath HTL which is the world's largest consulting organisation specialised in the hospitality industry, with 47 offices in 37 countries. For example, the situation is no less dire in Spain and Portugal, parts of

the UK, the US and Eastern Europe. It is possibly worse for projects in new developing markets and for niche destination products in newly developing small island locations no matter how high class and idyllic.

15 year lows and average room rates in Dublin decreasing by approximately 21% since 2007 (*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 900,000 visitors to Ireland in the first 11 months of 2009, an 12% 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 hospitality sector in the period from January to December 2009 (*Insolvency Journal*).

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 an increasingly competitive average room rate and trying to maintain debt requirements as well as operating the hotels in a cost-effective manner. See the recent announcement (*Irish Independent*, 17 December 2009)

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Similarly the excess of supply over demand is not unique to Ireland. But there is no doubt that our market requires a significant adjustment as noted by John Power, the Irish Hotels Federation chief executive when he commented on the 53% increase in rooms available across the country, over 2002 levels. The impact can be seen in hotel margins and a 14% decline in average occupancy for 2009 and 32% drop in average RevPAR for 2009 from peak levels in 2007 (*STR*).

Many hotels are in extreme breach of their loan covenants. With the lack of bank liquidity compounded by markets' 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.

And it is indeed a crisis. A recent survey carried out by the IHF highlighted the stark reality that, at present, only a maximum of five per cent of hotels are generating a profit in Ireland. With hotel occupancy rates currently at

that Precinct Investments plans 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 UK, 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 UK 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.

We 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 the average room rate rising by 1.9% from £115.11 in 2008 to £117.27 this year as highlighted by a recent report issued by PKF which also noted that Edinburgh benefited too.

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 and Soccer World Cups 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.

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 is only really starting in Ireland in earnest in 2010. 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.

The short-termism is evidenced by the so-called restructuring and examinership efforts which are no better than standstill arrangements in which 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 – after and often before the frequently overlooked but ever present requirement for annual recurring capex budget to keep the property and the product up to date.

With over €11.2bn of debt outstanding in the hotel sector (*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. And although benefits have been obtained from the fall in interest rates, these benefits have been somewhat negated by the falling profit margins being generated by hotels. In many cases 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.

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examined when additional funding is being sought – the relationship with the client, the quality and location of the asset and the security of the income streams which improves the strength of the covenants.

It is critical for the Irish economy that 2010 becomes the year in which the debt structure of the business sector as a whole is cleansed and restructured in line with the new realities. It is only when this is complete 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 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 agitate 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 MSV (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.

We are involved in a number of cases where this is happening and we are 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 will prove 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 returns, values, rate, occupancy and cash flows. ♦



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