

# The NAMA Effect

CON QUIGLEY examines the impact of NAMA on the Irish hotel industry.



The Irish hotel industry continues to endure unprecedented times as trading still proves tough and new questions are raised about the outlook for the sector as it is estimated that up to 200 hotels may soon fall within control of the National Asset Management Agency (NAMA).

NAMA is an essential part of the Irish Government's response to the current global

banking crisis and an unexpected potential newcomer to Ireland's destabilised hotel market. NAMA's principal goal is to regularise the capital position of the five participating banks by removing the riskiest loans from those banks' portfolios. NAMA will take the place of the lender and intends to vigorously pursue all amounts owed. In turn, the banks should then be able to recommence funding for onward lending to SMEs, stimulating the Irish economy. Clearly, there are knock-on effects for the assets underpinning the debts in question, in particular hotels which represent €0.77bn of the initial tranche of loans transferred.

On 30 March this year, NAMA confirmed the first transfer of loans with a cumulative book value of €16.03bn from the five participants (Bank of Ireland, AIB, Anglo Irish Bank, EBS Building Society and Irish Nationwide Building Society), with the remainder of the approximately €81bn to be completed no later than the end of February 2011. An average discount, or 'haircut', of 47% was applied representing a payment by NAMA to the banks of approximately €8.51bn. This amount was calculated based upon a valuation of each loan including consideration of the quality of the underlying property, the security attaching to the asset and whether the loan is performing or non-performing.

Geographical Breakdown of Initial Tranche	€ Bn
Ireland	4.94
Northern Ireland	0.00
UK excluding N. Ireland	3.24
Other	0.34
<b>Total</b>	<b>8.51</b>

Source: NAMA

With hotel assets representing 9% of this payout, NAMA has become an overnight guardian of a significant part of the Irish-owned hotel industry in what are very troubled times.

This very much reflects the wider state of affairs in Irish hospitality – in the first quarter of 2010, we have already seen hospitality services (bars/restaurants/hotels/food processing) accounting for 56 out of 469 liquidations, receiverships and examiner appointments. This represents a 350% rise on the equivalent period in 2008.

Hotels continue to try and weather the downturn though the recessionary impact on both domestic and international markets and resulting fall in consumer spending has led to a market-wide battle on average daily rate (ADR) as hotels seek to hold up falling occupancies. The issue has been exacerbated by the proliferation of new hotels across the Irish market in recent years which has created an oversupply of hotel room stock, some estimate by up to 15,000 rooms (around 25% of Ireland's total room count). The net impact has been highly challenging trading conditions with operators facing falling revenues countered by a steady or rising cost base.

Adopting a policy of rate discounting has been much critiqued. The transparent nature of hotel pricing means short-term occupancy gains are quickly offset as competitors rapidly follow suit in cutting rates. This leads to a lower priced hotel market yielding lower revenues in the face of normally unchanged demand, proving that rate discounting alone does not induce additional hotel demand. The following table shows how Dublin hotels have been affected since 2008, highlighting particularly the trend of heavily cutting ADR:

Year	Occupancy (%)	% Chg	ADR (€)	% Chg	RevPAR (€)	% Chg
2008	66.5	-10.2	105.33	-3.5	63.98	-13.4
2009	63.5	-4.6	85.61	-18.6	54.33	-22.3
YTD 2010*	55.8	+4.5	77.43	-13.4	43.24	-9.5

\*Three months to 31 March 2010. Source: STR Global Ltd

Having now gained a vested interest in hotels, it is clear that NAMA will need to quickly gain expertise in the critical issues driving hotel performance and, in some cases, find asset management solutions for distressed assets.

## The Transfer & Review Process

When a loan is transferred to NAMA, the borrower has 30 days to submit a detailed three-year business plan to the Agency. NAMA then reviews the plan's viability and either rejects, approves or refers the business plan back to the borrower for amendment. In reviewing plans relating to loans secured against hotels, NAMA will have to be especially

cognisant of the challenges facing the industry referred to above. Where a business plan is approved, NAMA will monitor the subsequent performance of the borrower in order to ensure that targets are met. While this may seem onerous for hotel operators, it may well prompt them to recognise the challenges facing their hotel and provide a supervised road map to survival in some instances.

Where a business plan is rejected, NAMA has statutory powers to take whatever steps deemed necessary to protect the interests of the Irish taxpayer including, but not limited to, appointing receivers and use of vesting orders. While this may generate scope for opportunistic investors of distressed assets, it is important to note that some of the assets rumoured to be falling within NAMA's control, for instance Derek Quinlan's Maybourne Group (The Berkeley, Claridge's and The Connaught in London) are in themselves highly

in order to help stabilise both the Irish hotel market and the Irish Government's financial position.

If NAMA is successful in its aim to stimulate Ireland's economy, consumer sentiment in the domestic market will improve which should lead to an increase in occupancy from the domestic market. NAMA may also help alleviate the issue of oversupply of hotel rooms by forcing operators to review and make changes to their operations, for instance requiring all or part of a hotel to be converted to a different use or to incorporate seasonal closures, where NAMA believes that such changes will enhance the commercial viability of the hotel. Where NAMA appoints a receiver and manager to a hotel, the receiver and manager may recommend whether a change of use would be beneficial to the commercial viability of the asset.

While I and many others await keenly the fallout of

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successful trophy assets which may not be in default of their loan arrangements. However, due to other investments of the borrower in question, these properties might be caught up in a wider transfer to NAMA. Other renowned properties believed to be affected include Dublin's Shelbourne Hotel, The K Club and Wicklow's Ritz-Carlton. The hotel investment market is vigilantly watching as events unfold for NAMA and whether its involvement will culminate in the disposal of some highly attractive and marketable hotel assets.

I anticipate that, in the coming months, NAMA and the participant banks will need to either secure external hotel expertise or quickly become hotel specialists in order to gain a meaningful understanding of the borrower's business plans presented. It is essential that NAMA grasps the complexity of achieving hotel budgets in a challenged market and questions the likelihood of proposed targets being achieved. NAMA will require knowledge of hotel fundamentals, operational structures and their implications (for instance, whether a hotel is leased, held on a management contract or franchise, or run by an owner operator), efficiencies which drive hotel performance, as well as the expertise to enhance the value of the assets in question.

In theory, NAMA should become a self-sufficient operation with the interest payable on the issued Government securities being covered by the income generated from the loans and assets which NAMA has taken over. As an asset management agency, NAMA does not envisage a 'fire-sale' of hotel properties and has accordingly stated an intended workout period of seven to 10 years. Should this prove to be the case, NAMA will be under close scrutiny to ensure hotel assets are being managed effectively and optimum returns achieved,

NAMA's work, I also hope that it will bring a new energy to Ireland's troubled hotel industry and potentially remove the poorer struggling assets from the current market, either through a process of closure or sale for alternative use. However the outlook for Ireland's hotels continues to be pessimistic, though slightly less so than six months ago, and it will need to re-stabilise before it becomes an attractive investment option once again. In the meantime, the opportunistic investor will keep watch on NAMA's activities and the wider market in the hope of picking up distressed assets offering greatest turnaround potential. ♦



*Horwath HTL London team (back row, l-r) Con Quigley, Alexandra van Pelt, Erlend Heiberg (front row, l-r) Karen Derrington, Bernard Deloménie and Celine Vadam*

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