INVESTMENT ALIGNMENT – OWNERS AND BRANDS MOVE CLOSER AS RECOVERY APPROACHES

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The second webinar in our series 'Hotels: Investment Alignment' brought together WFW Real Estate Partner Cyrille Gogny-Goubert, George Nicholas, Global Head of Hotels at Savills, Felicity Black-Roberts, VP Acquisitions and Development – Europe and North Africa at Hyatt and Yannis Ermilios, Managing Director – Portfolio Management at Colony Capital. The panel debated the potential for M&A in the hotel sector, as it lined up to be the fastest-recovering of the real estate segments.

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With the debate including key potential participants in any transactions, a number of points emerged which might surprise many in the sector during the depths of a global pandemic, during which hotels were closed in many locations around the world and fire sales were forecast.

1. The appetite for hotel assets was such that there were concerns that investors may be overpaying for the few products coming to market. So great was the wall of money, that many investors were bypassing traditional routes and going straight to owners with offers, with Cyrille Gogny-Goubert warning that the expectations of buyers and sellers had yet to align with "sellers expecting very high prices and buyers wanting a bargain".

2. In identifying what sort of down-turn the sector was likely to see, Yannis Ermilios described a "crisis all about liquidity", where the investment opportunity was in credit, providing opportunities for owners who might not want to sell. The cost of this credit could, it was mooted, trigger future problems. Banks, who might not be attracted to lending new money to struggling owners, might instead be prepared to waive covenants or roll up interest charges.

3. Government support for the sector, which has by no means been consistent around the world, has distorted the market and meant that the true state of many companies has been hidden from view. This was highlighted by differing levels of activity around the world, with muted and slow transaction activity in Asia, some stress in Europe, and the US seeing an increased level of bankruptcies. Cyrille Gogny-Goubert commented that most of the schemes would save hotels in the long run but not all of them, with the owners and operators who had cash having a much better chance of survival. With stress rather than distress being the current state of play, George Nicholas asked why investors would sell now if they did not have to? There was agreement that transactions would accelerate in the future and those who wanted to sell would be best not caught up in the melée, making an argument for disposals now.

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4. Despite the distraction of the pandemic, environmental, social and governance ("ESG") issues were still relevant and a growing number of investors were pushing this, with the brands helping to maintain momentum. Felicity Black-Roberts highlighted Hyatt's position as both an owner and operator, trying to explain to other investors the benefits of an upfront cost and long-term economic gains. For those less eager to participate, the twin motivators of ESG-driven funding and legislation such as the Paris Agreement were expected to keep the issue in investors', operators' and guests' minds.

5. The need to keep operational costs low remained pressing going into the second year of the pandemic, with Felicity Black-Roberts telling attendees that Hyatt had accelerated its adoption of technology such as contactless check-in. In considering permanent changes to operations after the pandemic, she cautioned that hotels needed to put human contact back and develop how staff and guests interacted.

6. The pandemic was helping to push a shift in how people travelled – although the panel concurred that old habits are likely to die hard – but the sale of luxury self-catering group Roompot last year was one of a number of transactions which illustrated shifts in demand away from the traditional hotel model. Yannis Ermilios confirmed the trend for developing high-end, eco-friendly resorts, with Felicity Black-Roberts looking to the move towards extended vacations, mixing work and a holiday, which had seen Hyatt focus on expanding its leisure and resort portfolio and consider participating in M&A itself.

With the pandemic passing its anniversary, the mood amongst investors is becoming impatient, as each deal attracts swarms of bidders. With owners having suffered a year of severely depressed trading, the relationships between all parts of the hotel stack are becoming more stressed and, as Felicity Black-Roberts said, although the company was seeing an increase in conversions as owners sought sanctuary in the brands, owners were also being more demanding on terms.

The key messages as we emerge from the pandemic, as drawn together by WFW's global Hotels & Hospitality team include:

- Flexibility is key when negotiating agreements between owners and brands. Felicity Black-Roberts had noted that "when people ask what terms are, I say let's just sit and talk for half an hour and understand what they want from the relationship. You've got to take some of the pain with people". Owners looking for a brand will increasingly shop around for those who can cooperate, rather than assuming, as was popular before the pandemic, that one agreement was much like another;

- Flexibility will also be a factor in operations. Hotels may need to switch from short-term to long-term stays and from business to luxury, and any brand agreement should include support for this. In some jurisdictions the domestic market is lower spending than the slow-to-return international market and more brand support will be needed, for example, in directing the use of the marketing contribution or supporting co working space;
- M&A is likely between the brands as some of the current support is withdrawn from the sector and owners must check terms to protect themselves if they face becoming part of a much-larger portfolio with adjoining competitive sites;
- Key money may be seen as attractive, but risks being 'lazy money' and risks the operator insisting on a proforma contract. From an asset valuation perspective, it is better longer term to have lower fees;

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- 'Unpacking' of all fees and charges is important, some of which appear to be circular, particularly on a loyalty side and bearing in mind the current focus on local markets;
- Consolidation is happening on the capital side as well and is one way of tipping the scale back in ownership's favour; and
- The brands need cash. There are signs that some may be more open to negotiating termination terms as a way of generating the funds they need.

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