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*"Never give up! Never, never, never!" - Sir Winston Churchill, British statesman*



Dear Readers,

admitted: Given the current situation, a quote from Churchill seems easy to say but implemented. At present, RevPAR achieves between 3 € and 9 € in the German primary locations! What are the prospects for the hotel industry if the lockdown is loosened?

Travel bans, island lockdowns, border closures, terminal closures, cancellation of trade fairs and events, hundreds of thousands of cancellations of overnight stays, ... . The industry has never been subjected to a stress test of this dimension.

**And hardly anyone could have guessed this dimension just a few weeks ago.** Nevertheless, we can see that the industry is using all available means: from short-time working and working capital loans to hotel closures. Hygiene concepts and delivery services are being introduced and discussions are underway about waiving cancellation and franchise fees. Even more important – since it is more effective – were the discussions with owners about deferments, remission or reductions of the lease or rent in recent weeks. A frequent result: lease payments for the months of April, May and June were suspended and agreements were reached to extend the operating agreement by corresponding months or to defer payment of the amount owed until 2023. This has given the industry – both on the owner and operator side – some time to recover. The crux of the matter, however, is that the current deferments of leases do not represent a long-term solution taking the industry's fixed cost dilemma into account in the respect of a long term view.

It is undisputed that the great challenge for society as a whole is to prevent a "second wave", because that would overwhelm government aid in the long term. But it is also undisputed that there will be no return to pre-crisis levels in the short term. This is already visible in the retail sector, where the hoped-for rush of customers failed to materialise after the easing of the regulations. The hotel industry – and, by the way, the also gastronomy – will experience a similar situation. In its updated Recovery Check, the German Federal Competence Centre for Tourism assumes that a gradual recovery (easing - revival - normalisation) of domestic tourism is realistically expected by mid 2021 and a full recovery only in 2023.

What does this mean in fact? Many hotels will not be fully rentable again even after the restrictions have been lifted and with gradual recovery, because pre-crisis revenues cannot be achieved so quickly. With our second "Corona Special Newsletter", we want to provide practical suggestions for various solutions on how the build-up phase can be successfully mastered together. Because we remain confident and convinced that, even if the build-up phase is likely to last several years, in retrospect it will become clear that good business models, entrepreneurial spirit and solidarity among the parties will lead to creative ways out of the crisis that would be acceptable to all parties

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**What we must prepare for:****Situation**

1. Travel in times of a pandemic will continue to be considered the ultimate risk. The volume of travel and overnight stays will continue to be reduced even after public life is revived. This is because the travel policies of many companies will only allow business travel to a limited extent or with clear specifications (e.g. no visits to trade fairs or congresses, no travel on public transport, no participation in breakfast buffets, etc.); the number of flight connections will also remain reduced (travel warnings, distance regulations also in the airplane, etc.); large events (including trade fairs!) will only be permitted under large restrictions which call into question of economic operation. Hamburg without musicals, Berlin without clubs, Munich without Oktoberfest and the omission of the many smaller travel motives such as leadership meetings, seminars, anniversaries, weddings, company celebrations - there will be an overnight accommodation volume in the 3-digit million range throughout Germany.
2. This means: significantly lower capacity utilisation, lower RevPARs, much lower F&B sales and hardly any other sales. Overall, sales losses of initially 50%, later 30% and 15% can potentially be expected according to German Federal Competence Centre for Tourism.
3. The lower total revenue leads – despite short-time working or partial closures – to a relatively higher fixed cost burden. The situation is aggravated by higher operating expenses, which are necessary due to compliance with distance and hygiene regulations. The operating result will therefore be severely decimated.
4. In other words, current rents will not be fully recoverable for months - probably even until 2021. Not to mention catching up on the deferred rents from April, May and June - which is effectively an additional rent.
5. It must be clear to all parties involved that - if no agreement is reached with the operator - operator insolvency also threatens those who were sustainably successful and solvent before the crisis. This must be avoided! In the current situation, the search for a new operator would not only be a great challenge, but would also involve lease reductions, investments in the hotel product, further incentives and the like.

**What can be done:****Solutions**

1. Basically: Each solution must be developed individually! Industry and financing models are too different for there to be a "one size fits all".
2. A reasonable option may be the longer-term use of lease incentives for the current operator.
3. Flat-rate / temporary fixed rent reductions are not a practicable solution, as in the coming months new market situations must continue to be expected, which will constantly change the monetary opportunity/risk profile between lessor and lessee. It is conceivable to grant further – also percentage and staggered – rent deferrals. Once the Conora crisis has subsided, the (interest-bearing) repayments could be spread over the term of the contract (short-term repayments within 2-3 years are unrealistic from today's perspective).
4. The use of variable rents, which are clearly limited in time from the outset – both

turnover- and result-dependent – in conjunction with a minimum rent can also be a solution. In this case, a scenario analysis agreed with banks and a detailed business plan of the operator are indispensable. A return to the original lease can be linked to performance data of the hotel or the respective hotel market.

5. Lease extensions or a higher indexation of the lease at the end of the contract can compensate cash flow losses and interim impairments in value at least partly in the long term.
6. Importantly: Any state subsidies in respect of rent payments which might still be decided in the coming months must be passed on to the landlord or at least taken into account in the new rent calculation.
7. The prerequisite for any negotiation is always the absolute transparency of turnover and costs by the operator and the assurance that, for example, internal (overhead) costs are covered. The proof is provided by short-term – e.g. weekly – reports. The greater the flexibility of the lessor should be, the more conclusively his chances must be presented.
8. Ultimately, a balance must always be struck between strategic goals, cash flow / liquidity requirements and property value aspects; even the scenario of a tough negotiating strategy must be thought through to the end. If necessary, opportunities for an exit may arise from the current commitment, e.g. in the form of an operator-free sale or a redevelopment.

#### **Attention should be paid to:**

- ⇒ All options must always be examined with regard to the legal framework, e.g. many properties are held by funds where variable lease models must be considered under investment law, also in order to avert the risk of commercialisation.
- ⇒ Furthermore, all contractual adjustments must also be analysed with regard to valuation standards in order not to burden the property values unnecessarily.
- ⇒ All measures (e.g. setting a new temporary minimum lease level) must be coordinated with the bank, because not only the lessor is dependent on a positive long-term prognosis for the continuation of the hotel.

Ultimately, transparency and constructive cooperation between lessees, lessors and banks are not only required in the short term during the shutdown, but above all in the long term. After all, the crisis and its effects will be with us for a long time to come and can only be healed through the time factor together.

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