JF CAPITAL ADVISORS

JF CAPITAL THOUGHTS: WHEN WILL SHUT DOWN HOTELS RE-OPEN?

April 30, 2020

It is unclear when hotels that are shut down or running with limited operations will reopen. Issues and considerations will vary by market. Re-opening decisions will depend on numerous factors described below. The decisions will be influenced by the timing of vaccine availability, broad based testing, re-opening of schools, re-introduction of professional sports, theater, conferences, and conventions. Our current expectation is that different social distancing guidelines will be put in place by municipalities and states including limitations for some period of time on the maximum number of people for each event. In gateway markets this will also be impacted by the re-emergence of international travel.

Reopening: Many shut down hotels may not re-open promptly if at all. Re-opening or re-launching a hotel requires a significant financial investment in order to fund salaries, benefits, recruiting, training, marketing, and inventories. Re-launching also requires significant amounts of working capital to address outstanding payables, re-establishment of vendor and service provider relationships. Re-opening may also require inspections of fire and life safety systems from the brands and local municipalities. In order to re-open effectiveley, marketing channels need to be switched back on including GDS, OTA, and others which takes a few weeks.

Group Hotels: Large group hotels with significant amounts of meeting space will be the last to re-open as they are heavily dependent on large group meetings and events to drive room nights and related F&B spending. Large group hotels are also concentrated in major urban and resort markets. These hotels are also heavily dependent on air travel, especially international travel which will take a substantial amount of time to recover.

Breakeven: A hotel typically needs about 50%-60% occupancy in order to generate positive cash flow fixed costs including after debt service. 15%-20% occupancy in a non-union environment may generate enough operating revenue to offset variable operating expenses (excluding fixed costs such as property taxes, insurance, and debt service). The breakeven occupancy level will generally be much higher for hotels with union collective bargaining agreements.

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Refinancing: Hotels with mortgage loans maturing in the next few years will be hard pressed to make large working capital investments or to fund any property improvements without a defined and viable refinancing strategy. Borrowers will be looking to lenders for some relief, which will vary by situation. Shut down hotels with imminent debt maturities will need meaningful debt restructuring. The timing of these restructurings will significantly impact when the hotels will re-open.

Cash Management: Substantially all hotel loans which have cash management systems will be subject to hard and soft lockbox structures with related cash sweeps and cash traps, ultimately requiring more working capital than otherwise necessary. Many of these stringent cash management structures kick in after breaching a DSCR covenant. By the end of Q2 2020, almost all hotels or hotel companies which have DSCR covenants in their loan agreements will have breached their financial covenants.

Re-opening Timeline: For those hotels that are reopening, initial demand will be slow and sporadic, and as such the facilities may re-open in stages (only 1 wing, not all F&B outlets open, no or limited meeting or function space, reduced food and beverage menus and operations).

It takes a significant amount of time to rebuild a book of business for a shut down hotel. Hotel operations are organic, so that sales efforts and bookings made today heavily impact future business volumes. This requires significant sales and marketing efforts all while competitors are fighting aggressively for all available business. Many customers (corporate, group, and leisure) will be shopping for low rates and concessions and are likely to be successful.

Branded hotels usually rely significantly on the major brands for certain national corporate accounts and on group leads through the brand national sales teams. In this environment much of the brand support has evaporated and will take time to restore. Most of the major brands have suspended their marketing efforts and furloughed their brand marketing and sales experts. In re-opening, many hotels will need to utilize their own direct marketing channels and create their own demand.

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Corporate RFP: The corporate RFP season which begins in July and runs through the end of the year will be very challenging, and highly unusual. In many cases neither the hotels nor the corporate accounts will have clarity on 2021 actual needs or on actual availability of rooms and meeting spaces in each market. Hotels may be in a position where they are bidding on business without understanding the competitive landscape.

Union Labor: Hotels with union labor in markets like New York will have a very challenging time rationalizing their labor model as the union collective bargaining agreements provide for very high salaries, extremely expensive benefits, and work rules that are cost prohibitive and allow for limited flexibility. As a result, many big-box union hotels may take longer to open if they re-open at all. Many are likely to seriously consider converting all or part of their facilities to other higher margin and less volatile uses such as multi-family, student housing, or other.

If you would like to discuss the impact of shut down hotels and how they relate to your current or contemplated hotel debt or equity investments, I can be reached at jonathan@jfcap.com or 917-238-6917.

Stay safe,

Jonathan Falik