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What is the status of Hotel Debt Finance in 2023?

5 July 2023

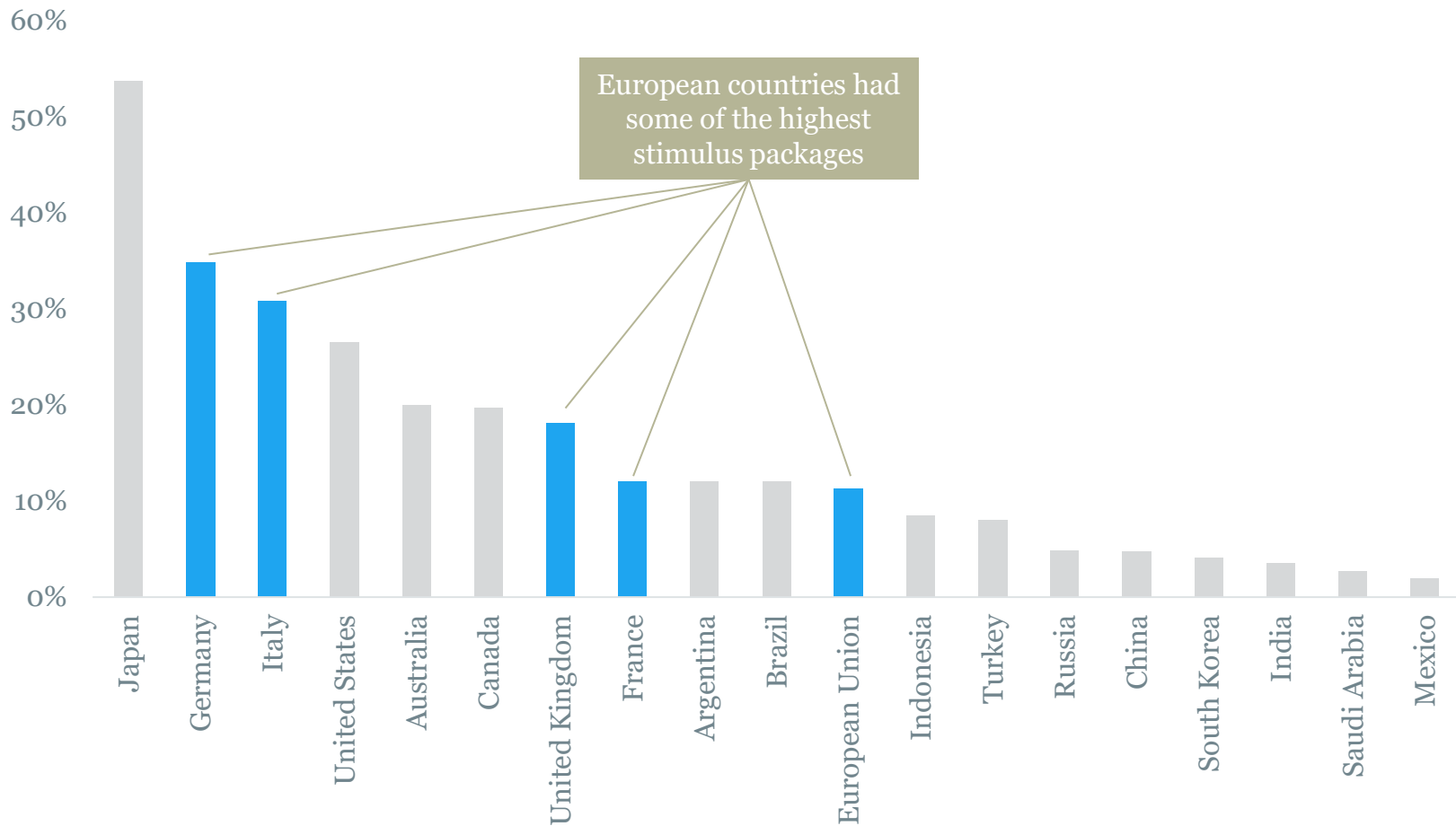


The Lending Climate

How did we
get here?



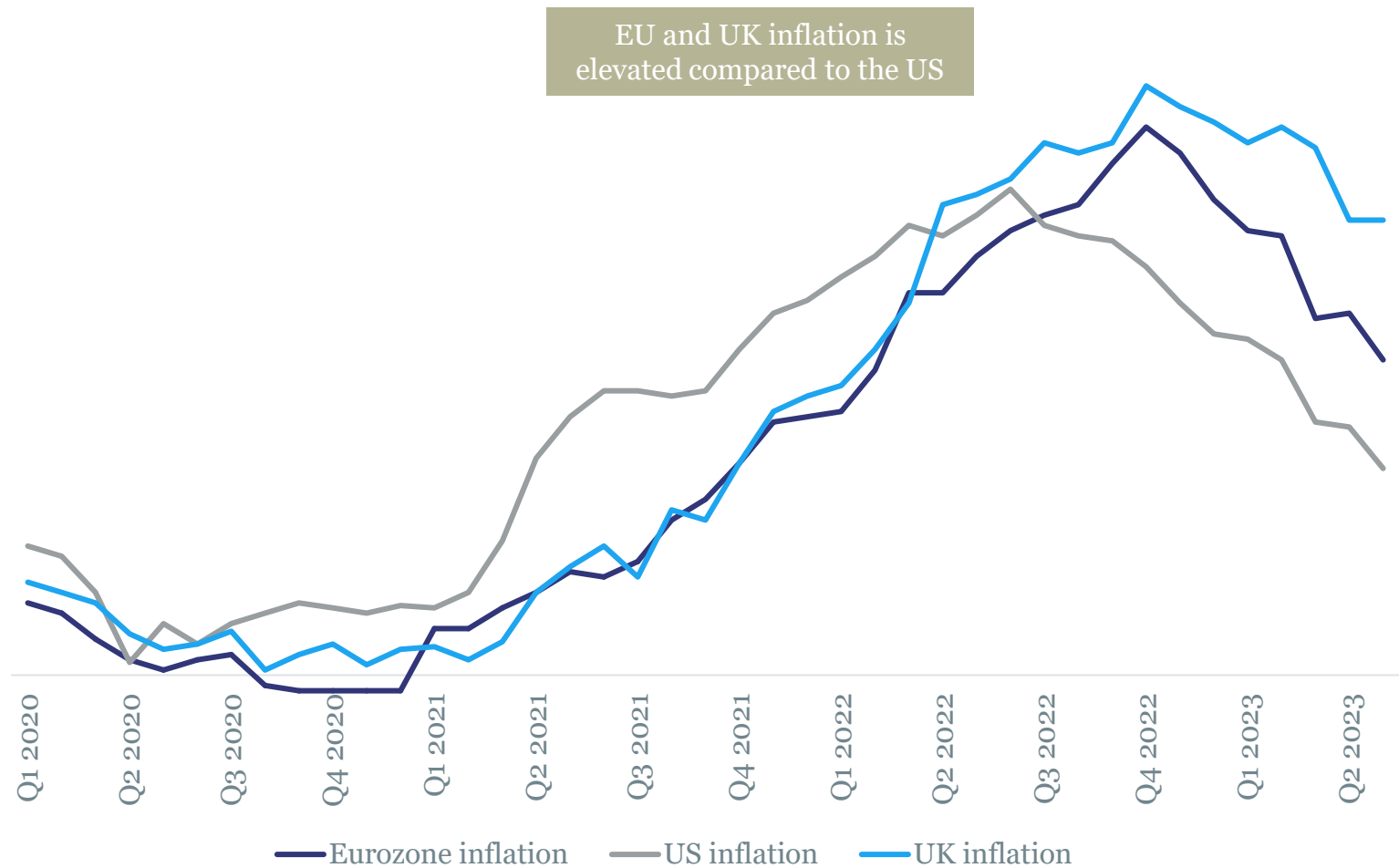
Stimulus Packages as a Percent of 2021 GDP



Slide 3

Source: International Monetary Fund

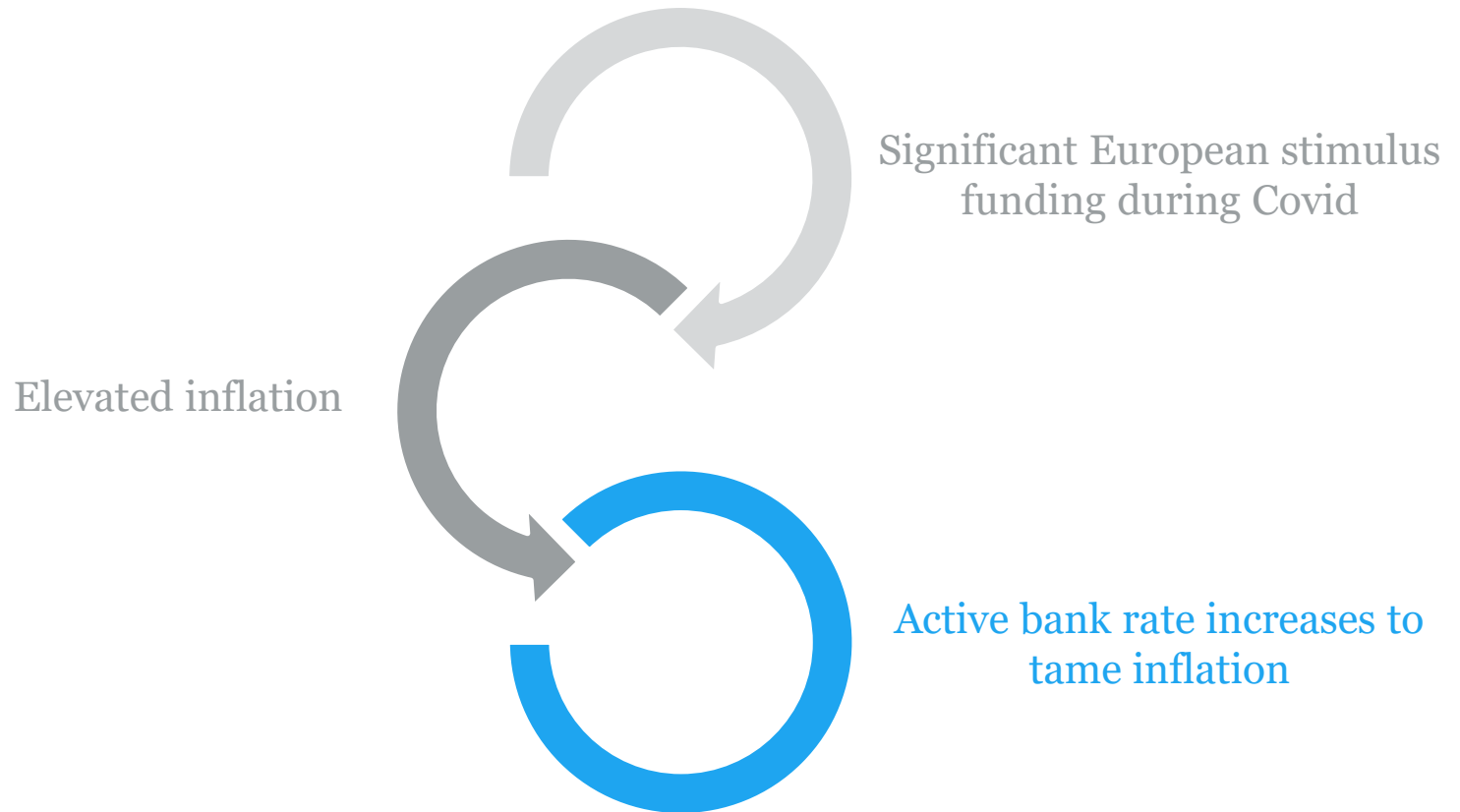
European Inflation Remains High



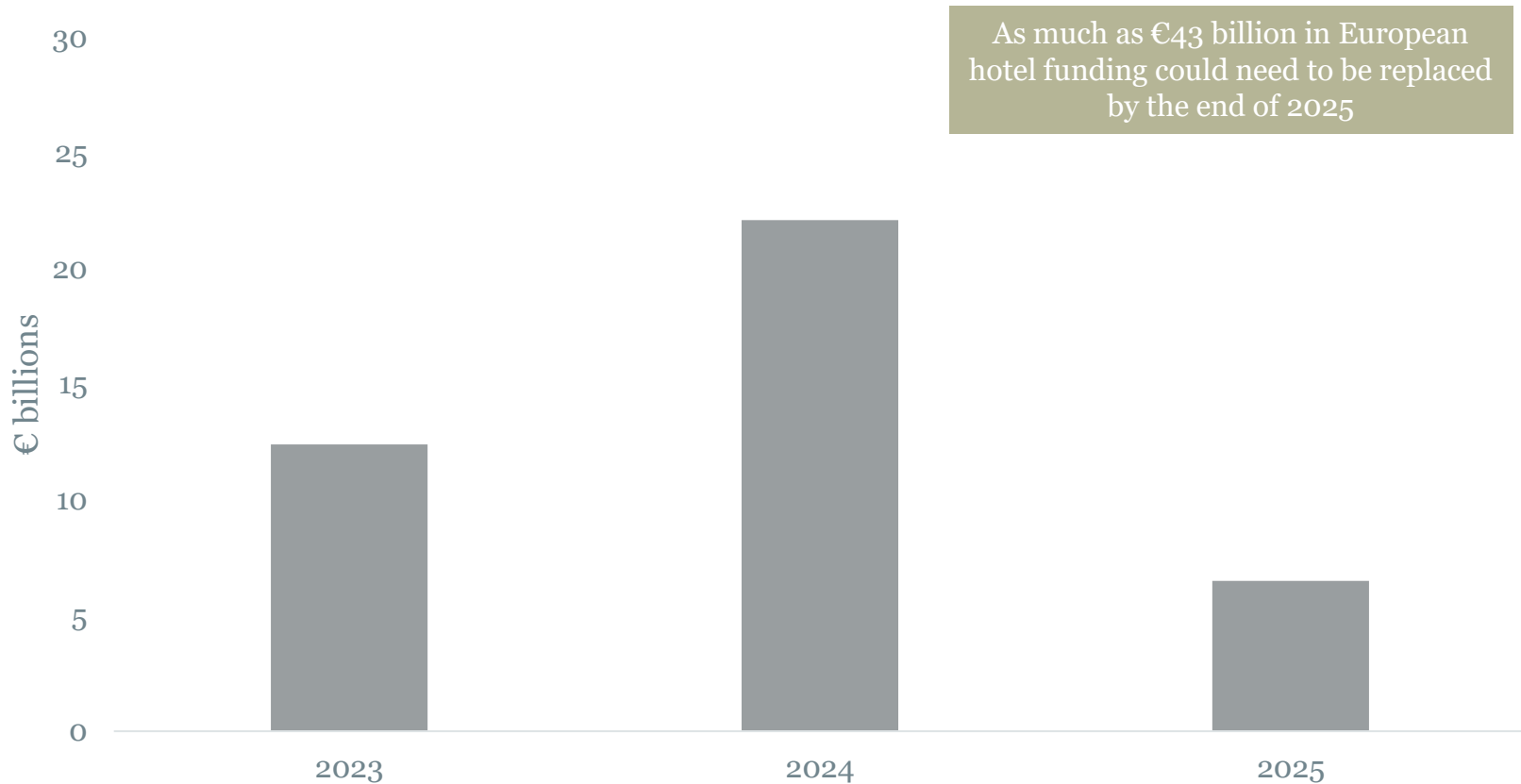
Slide 4

Source: Eurostat (harmonized index), US Bureau of Labor Statistics (CPI), UK Office of Statistics (CPI)

Drivers of Change



European Hotel Debt Funding Maturities



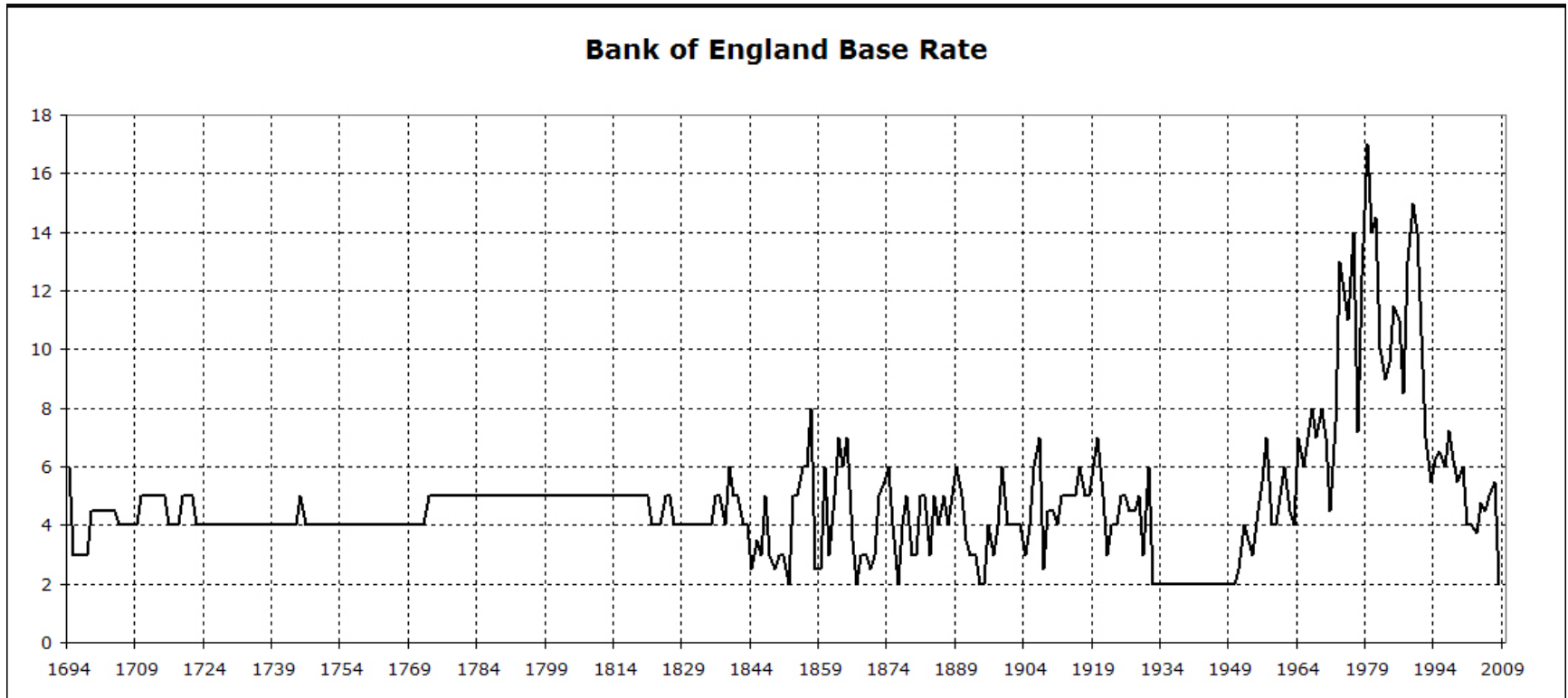
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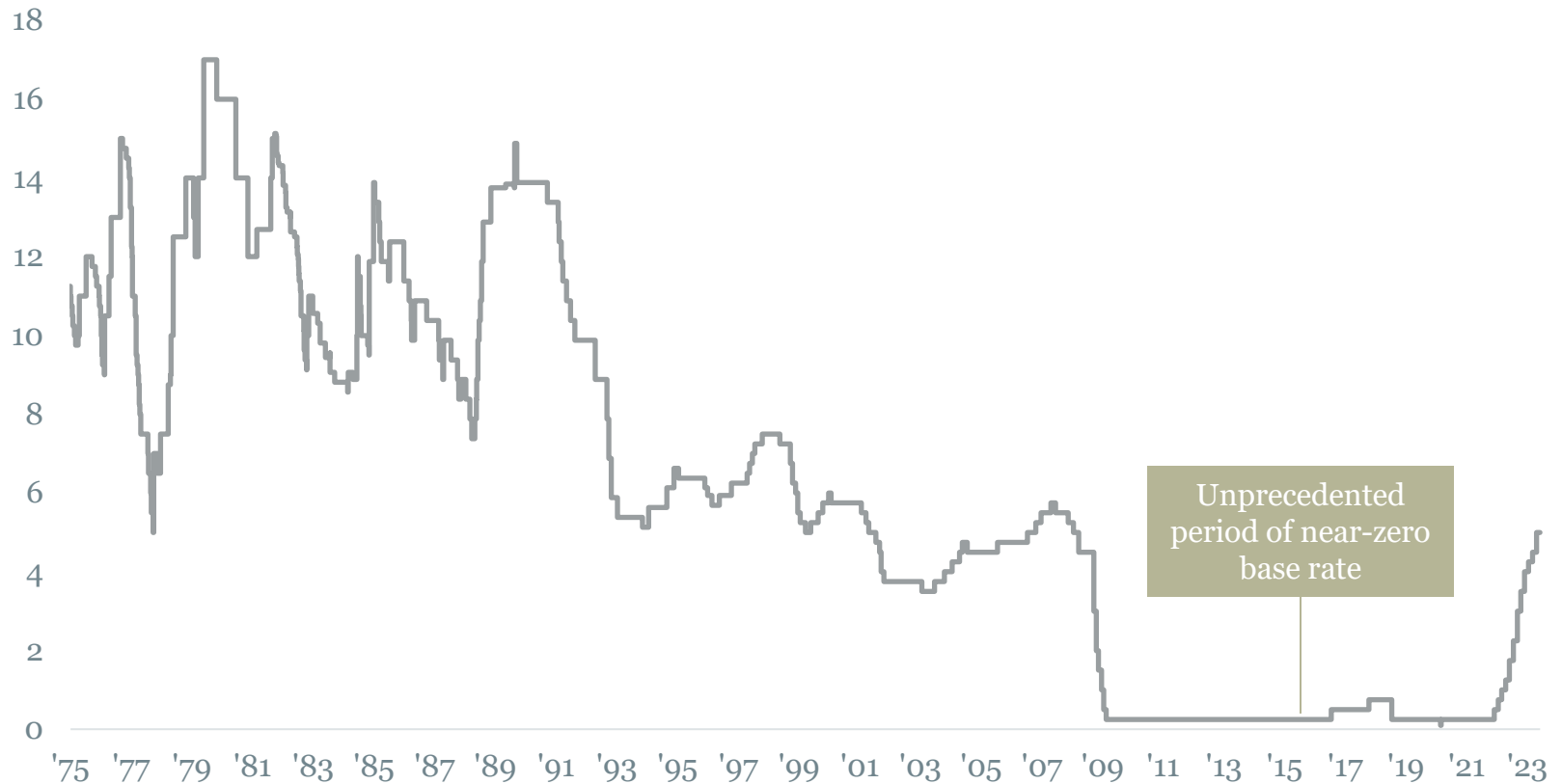
Where are we
now?



Bank of England Base Rate 1694-2009



Bank of England Base Rate 1975-2023



Where are we now?

- **Interest Cover Ratio will be challenged / breached**
- **Fall in values will also result in challenges to LTV**
- **Many existing deals are now outside of lending mandates**
- **"Extend and pretend" not a long term option**
- **Credit/investment committees concerns:**
 - Have interest rates peaked yet?
 - Existing loan portfolio performance & cost of capital
 - Impact of macro-economic issues on hotel performance
- **Bid/ask gap has led to a lack of transactions and uncertainty over value**
- **Many hotel owners took on additional debt during COVID**
- **Significant number of alternative lenders now keen to lend to the sector**
- **Hotels now seen as a mainstream investment class**

Current swap rates

SONIA swaps



	Current	29 Jun 2023	30 May 2023	30 Jun 2022
1 Year	5.924%	5.871%	5.230%	2.431%
2 Year	5.865%	5.775%	5.082%	2.618%
3 Year	5.576%	5.485%	4.857%	2.581%
5 Year	5.022%	4.952%	4.512%	2.490%
7 Year	4.632%	4.579%	4.285%	2.395%
10 Year	4.306%	4.275%	4.127%	2.342%
15 Year	4.092%	4.077%	4.053%	2.310%
30 Year	3.773%	3.778%	3.889%	2.184%

Updated 03 Jul 2023 | 09:00 GMT

3-month EURIBOR swaps



	Current	29 Jun 2023	30 May 2023	30 Jun 2022
1 Year	3.866%	3.868%	3.669%	0.805%
2 Year	3.683%	3.674%	3.374%	1.305%
3 Year	3.446%	3.433%	3.149%	1.500%
5 Year	3.120%	3.117%	2.935%	1.730%
7 Year	2.971%	2.983%	2.877%	1.870%
10 Year	2.903%	2.927%	2.893%	2.103%
15 Year	2.885%	2.916%	2.950%	2.343%
30 Year	2.521%	2.562%	2.621%	1.987%

Updated 03 Jul 2023 | 09:00 GMT

An example of the interest rate challenge

Hotel Value - £50m

EBITDA - £3m

Senior Debt - £25m (50% LTV)

Margin – 3.25%

Interest Position (June 2022)

Interest @ 5.75% = £1,437,500

Surplus Cash = £1,562,500

ICR = 209%

Interest Position (June 2023)

Interest @ 8.75% = £2,187,500

Surplus Cash = £812,500

ICR = 137%



Issues for refinancing / raising new finance

- **Borrowers looking to refinance may be faced with a reduced debt quantum requiring additional equity, mezzanine debt or asset disposals**
- **Deals that are over-leveraged, hotels in non-prime locations or assets with challenges (ground rents, under-investment, asylum hotels, new build) will be difficult to finance**
- **Balancing the Lender's need for amortisation with the owners need for a return on capital will be challenging**
- **Setting achievable ICR covenants**
- **Until market activity increases establishing value will be challenging**

Issues for refinancing / raising new finance

- **Is Mezzanine Finance an option to bridge the gap?**
- Mezzanine debt is widely available
- Difficult to structure into existing deals
 - Senior Lenders reluctant to allow mezzanine debt
 - Even at lower levels Senior debt service will consume a greater proportion of EBITDA
 - Increased interest rates will also push up the cost of mezzanine debt
 - Significantly increases transaction costs
 - Options on refinancing
- Pre-packaged whole debt solutions more likely to be achievable
- Pref-equity deals may become common
- **Borrowers face a difficult decision on interest rate hedging**

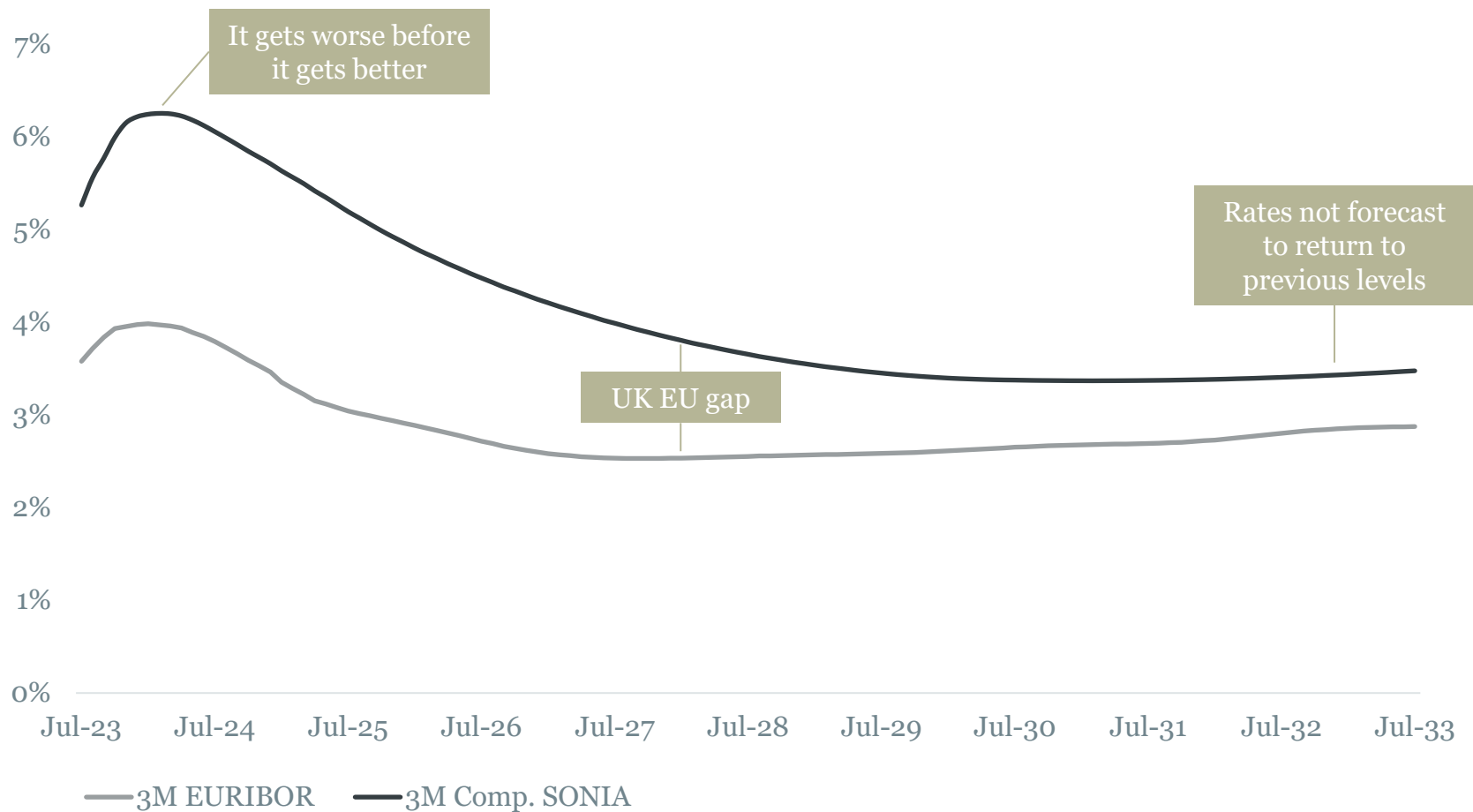
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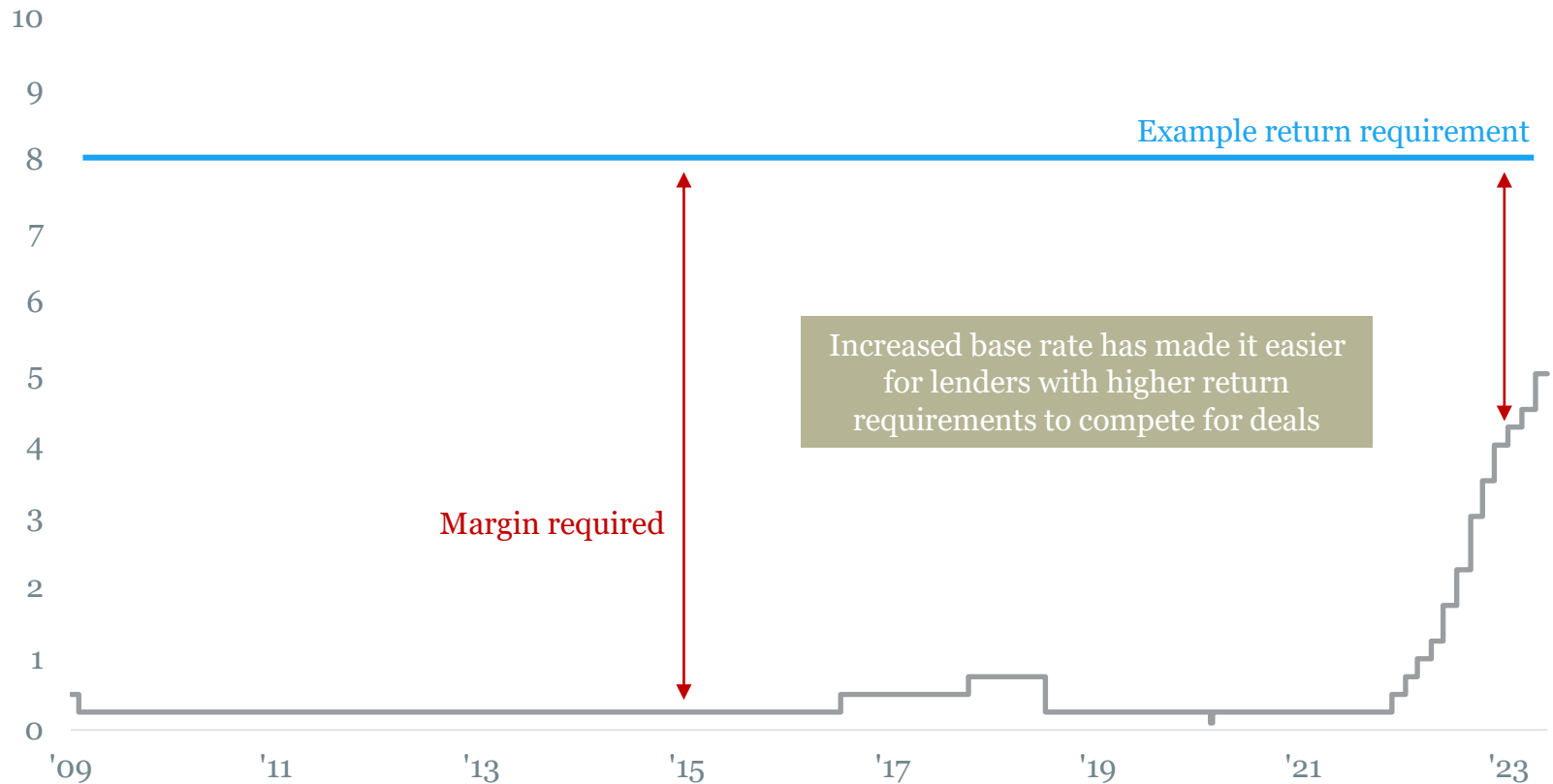
Where are we
going?



European Forward Curves



Higher IRR Lenders Move Down The Risk Curve



What trends can we expect over the next 12-24 months?

- **Lenders likely to insist upon debt reduction/sale of assets on existing deals**
- **Some distress although probably more "soft enforcement" than formal insolvency**
- **Alternative lenders continue to take market share from traditional banks**
- **Investors and lenders will favour Europe over UK**
- **Growth in pref-equity transactions**
- **Position on development finance is complex**
- **Concerns around FF&E and Capex spend being maintained**
- **Higher interest rates are here to stay!**

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