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Insights

DISTRESSED HOTELS IN FRANCE

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SUMMARY

Partner Didier Bruere-Dawson has authored an article in the Fall 2022 edition of the *Real Estate Finance Journal* published by 'Thomson Reuters' discussing the impact of the COVID-19 pandemic on the French hospitality industry, and the industry's near-term future. Didier is a solicitor in England and Wales and Avocat au Barreau de Paris. He advises French and international companies, institutional and private investors, and family businesses on structuring and restructuring transactions.

In 2019, the French hospitality industry reached an unprecedented amount of transactions with a total volume of 4.4 billion euros compared to 1.8 billion euros in 2018, which included a large distress transaction completed by Colony.

The French market captured approximately 20 percent of the transactions (number and amount) completed in 2019 across Europe, the Middle East and Africa.

Many hotel owners in France are independent with limited financial backing and many investors in the hospitality industry anticipated that COVID-19 and its aftermath would lead to widespread distress activity.

But these distressed transactions did not occur in 2020 or in 2021 at the scale anticipated.

However, the level of accrued debt and the financial strain, supply chain issues, the lack of travellers from the United States, China, Middle East and Russia, and finally the challenges to attract and retain talent at traditional pay levels, are all adding significant pressure to the hospitality industry facing a business shift.

Owners have to either evolve with the existing market trends, which have been amplified by the pandemic, or accept the decrease of their revenue per available room ("RevPAR") and occupancy rates.

In this environment, investors seeking opportunities in French hospitality might either invest large scale via special purpose vehicles, raising funds, or in independent businesses that need cash injections for refurbishments and a business shift.

Even with the structure of the French hospitality industry, the expected wave of distressed transactions did not occur.

France has large leading international hotel groups such as Accor and Louvre. But unlike in many countries, 83 percent of the French hotels between one and four stars (60 percent in Paris) are independent with less financial backing and profitability. They belong either to individuals or to special purpose vehicles, set up for individual's tax exemption schemes. Ninety-three percent of the bookings go through the online tourism agencies ("OTAs") and this system is favorable for both the large groups and independent hotels.

Most five star hotels belong either to individuals (such as The Negresco in Nice) and family offices, or to foreign private equity investors or hotel groups (such as Groupe Barrière).

The 31 palaces (eight located in Paris) belong mainly to foreign investors such as the Brunei sovereign fund, the Saudi prince Al Walid, American billionaires Jennifer Pritzker (Hyatt) and Len Blavatnik, the Qatari ruler Sheikh Tamim bin Hamad Al Thani, and LVMH, etc.

When the pandemic arrived, many private equity investors were ready for distress acquisitions throughout France of independent luxury hotels ranging from three to five stars because of being a cash consuming industry.

But neither these insolvencies nor distress transactions occurred in 2020 and 2021 because of French bounce back loans with very low interest rates (the "PGE") that were widely and quickly granted to businesses in addition to various state subsidies, an advantageous furlough system and a stay imposed on creditors by law.

Most of the transactions that occurred in 2020 and 2021 related to indebtedness restructuring that did not slow down in bonus acquisitions. For example, in 2020, Accor faced a loss of two billion euros and at the same time opened 10 hotels in France. Most of the distress transactions that did occur related to issues that pre-existed the outbreak crisis (such as the acquisition of six luxury hotels from JJW group in 2021).

However, issues pre-existing the pandemic remain and a business model shift had been amplified and accelerated by the crisis.

In October 2020, Pierre-Frederic Roulot, chief executive officer of Louvre Hotels, said that "in Europe between 20 and 30 percent of the hotels will be shut down" and that "before COVID-19 crisis between two and three percent of the hotels were shut down each year." According to him, and as in many industries, “COVID-19 [was] an accelerator of business model shift and of subsequent market evolution."

THE IMPACT OF COVID-19

So what does this mean for the industry? It means that:

- Standardization and branding are no longer the solution for profitability;
- Technology must be at the core of the hotel experience in rooms but also before and after the trip; and
- Social responsibility is a moral and economic obligation of the business vis-àvis:

  (i) Employees (e.g. with pay raises and balance of life);

  (ii) Communities surrounding hotels; and

  (iii) Consumers.

Most of the hotels that are rebounding now are those that started to invest in order to shift in this direction prior to the crisis.

Many independent owners are late in this regard due to a lack of availability to invest. They are short of cash to invest in refurbishments because furniture, fittings and equipment (“FF&E”) reserves have been consumed as operating capital during the crisis. Additionally, their financial constraints are increasing because not only must they reimburse the bounce back loans they received, but also a 16 percent pay rise was implemented in January 2022.

POTENTIAL TARGETS IN FRANCE AND HOW TO APPROACH THEM

The three and four star hospitality sector faces the largest challenges. Paris and its region, which usually counts for more than a third of the hospitality revenue is still at less than half of pre-pandemic levels with a clear drop in RevPAR. It puts more strain on independent owners already facing above said burden.

This means that in Paris and its surroundings, like in other French inland cities, there are independent owners of mid-range and luxury hotels who are short on cash and seeking partners to fund the business shift and/or the refurbishment of their hotels.

But rather than to seek immediate opportunities for distress activities, sponsors must be willing to take a longer term view. Most owners expect recovery in their own valuable assets. Hence, having a preference for partnerships rather than outright sales.

Highly leveraged loans might be unattractive to many of these owners, who may find an alternative in a very active and efficient crowd funding system in France.

This means that apart from a very few opportunities in an insolvency environment, many discussions with owners will be for five year duration loans stipulating clear covenants with regards to the business model shift.

Hence it is wise to secure the funding in a conciliation protocol, which will ensure that investors have the benefit of new money privilege if any issues should occur later on.

RELATED PRACTICE AREAS

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MEET THE TEAM

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