



## *Credit Crisis Repercussion on the Hotel Industry*

New York Stock Exchange

Mounting fears that the credit crisis is beginning to spread out through the financial system have rocked shares and companies recently. Investment giant Lehman Brothers collapsed, rival Merrill Lynch was bought out by Bank of America, and the US government has bailed out insurer AIG with an US\$85bn rescue package and state-backed mortgage lenders Fannie Mae and Freddie Mac. Central banks around the world pumped billions of dollars of extra funding into money markets to ease the liquidity crisis. Today, the US and many other economies are either in recession or near one. While the governments are battling to restore confidence, the hotel industry is already experiencing collateral damage. Hotel investors are affected by the repercussion of the credit crunch, which is making banks less willing to lend money (see US Financial Turmoil and the Hotel Industry, April 2008 issue), and 2008-09 hotel performances are likely to be affected.

## 2008-09 – terrible years for hotel values

Hotel value is falling worldwide as a result of the global recession and the financial market meltdown. While hotel value has fallen, most owners are still making their mortgage payments and we do not foresee the massive foreclosure and bankruptcy problem we experienced during the early 1990s. Currently bargain hunters are probably disappointed that very few hotels will come to market at deeply discounted, distressed prices – be patient, this crisis is likely to last several years.

## Geographical diversification

Hotel investors should consider the fluctuation of the international currencies against their own. Historically the currency crisis significantly affected hotel performances, for instance in Asia: the 1997 real estate bubble burst in all major Southeast Asian cities, the Indonesian economic meltdown in 1998, and more recently the depreciation of the Thai Baht following political unrest. Currency risk is real; therefore, investors in foreign market must diversify their locations to alleviate exposure to currency.

Overseas hotel investments

are opportunities in another. Many hotel owners should diversify their portfolios to avoid too much concentration in specific markets.

## Consolidate existing investments and focus on long term

While the chain-affiliated luxury hotels such as Four Seasons, Raffles, Ritz-Carlton and Mandarin Oriental usually perform far better than their independent counterparts, as a whole, the luxury sector has difficulty producing financial returns that are commensurate with their more downscale counterparts. As history shows, the luxury market will be the first and most affected by the economical downturn: be prepared and consolidate your assets.

Hotel owners and operators need to think out of the box and develop creative approaches for building higher revenues and controlling expenses because every square foot and every employee must be a profit centre.

Hotel owners should consider bringing onboard independent asset managers, who will focus on profitability, maximising hotel real estate value, and who will ensure that all information, positive or negative, reaches the ownership as soon as possible. The asset

management company to ensure an appropriate plan of action is developed, and to closely monitor the implementation of corrective actions. Asset managers will monitor the hotel operation to maximise EBITDA, cash flow, and as a result sustain and increase real estate value.

For instance in a luxury hotel, lowering expenses without compromising service can be challenging: look for back-of-the-house opportunities such as waste management, recycling, energy conservation, improved workflow layout and functionality.

Employ technology or outsource where actual labour reduction can be achieved (e.g. reduce engineering inventory, outsource night cleaning). New accounting systems and yield management programs will often produce staffing reductions and cost controls.

Over the long term, hotel values will increase to levels at or above those achieved in the past three years.

The prospect of demand growth and limited additions to supply will support increases in net income levels. Moreover, operating efficiencies can be expected to increase, as operators work to control expenses during the current downturn and



*Alex Sogno is the Managing Director of Global Asset Solution, providing expert oversight and asset management in the hospitality industry throughout Middle East, Asia Pacific. For more information [info@globalassetsolution.com](mailto:info@globalassetsolution.com) or visit [www.globalassetsolution.com](http://www.globalassetsolution.com).*

provide many benefits such as stronger growth rates and diversification. Also since hotel markets are not synchronised in their variation of value, common sense suggests that when one region is down there

managers will visit the hotel on an ongoing basis to ensure that the management team is effectively managing, marketing, and maintaining the hotel.

Asset managers will analyse monthly financial results with the

continue these cost control measures as revenue levels improve. Competition for hospitality properties will gain momentum on both the debt and the equity side. The net effect of these influences will be a continual increase in values. **H**