A Hotel Owner's Perspective:
Hotel Reopenings - The Impending Capital Gap

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This article is not about owners who are defaulting on loans now or who have exhausted all funds due to the COVID 19 closure. Even those owners who survive single digit or low two-digit occupancies and reduced rates and manage to cover their operating expenses have an upcoming challenge; the capital gap that concerns me is the one owners will face at year-end 2020, when managers present their 2021 operating budgets and capital requests to their owners.

One of my clients owns a twenty-year old hotel (>350 rooms, ≈88 sf/key meeting and group space, 2 F&B outlets, grab 'n go marketplace, Concierge Lounge, Fitness Center, Spa and Pool) that started a significant rooms and public area renovation in 2017. The capital plan presented by the owner's brand manager and ultimately undertaken by ownership for the years 2017 – 2021 (the last year of this group was presented solely as an estimate with the 2020 capital plan) is shown (with explanatory footnotes) in Table 1.

Table 1

Year	2017A	2018A	2019A	2020A	2021P^
Approved*	19,050,000[1]	1,800,00	1,810,000	1,800,000[2]	5,025,000

(Rounded)

^*presented by manager with 2020 approved capital budget*

**post-negotiation between owner and manager*

[1]*this was the requested amount; the approved amount was approximately $17 million and included a full rooms renovation; as it happened, the funds were spent into 2018*

[2]*pre-negotiation amount requested was over $3.5 million*

Of course, all major brands have suspended all unfinished capital programs for 2020 upon the onset of COVID 19 and permitted the owner to utilize the existing FF&E Reserve as working capital during the temporary suspension of operations (which continues as of publication of this article). To put that into perspective, the reserve in an ordinary year, would accrue some $1.1 million.

My client's hotel remained open, albeit with limited room availability and limited staff for several weeks, before the ownership took the decision to reduce staff further and close the hotel. At closure, cash on hand, including the reserve, was just more than $2 million, and the hotel had reduced its cash run rate to slightly more than $350,000 per month; the lender permitted the use of the reserve and agreed to a forbearance of principal (though, not interest) for 90 days.

We know that sanitation and cleanliness protocols are likely to increase costs of operations, though the industry anticipates savings in the reduction or elimination of in-stay, in-room housekeeping. How much that cost increase will be is a matter of speculation. Cost of acquisition of required PPE will be approximately $10,000 per month for an "average, full-service hotel" according to one of the major brands.

When hotels will reopen is a fair question; note that each hotel has its own cash run rate, even if closed. And, reopening will bring with it some expenses – costs associated with employee recall, costs associated with employee severance, ramp up costs for marketing and PR, new protocol training expenses, 'initial' inventories and working capital. And, though not yet known, it is likely that there will be required capital for physical changes because of COVID 19 related operating changes in hotels.

All of this is a predicate for my concerns for this hotel and for so many other hotels that might consider opening in the near future. If the closure lasts into 2021, then the capital concerns will be pushed further down the list of challenges.

Let's revert to my client's hotel. The projected capital expenditures budget for this hotel for the four years following 2021 (in the 2020 annual plan) are set forth in Table 2. This does not include those approved capital expenditures that were not completed in 2020 and deferred by agreement between owner and manager into 2021.

Table 2

Year	**2022P**	**2023P**	**2024P**	**2025P**
Projected^	770,000	567,000	3,110,000[1]	10,970,000[2]

(Rounded)

^*presented by manager with 2020 approved capital budget*

[1] *this amount includes planning for a rooms renovation to be started in 2025*

[2] *this amount includes the beginning of the rooms renovation*

The question raised by this lengthy recitation of facts makes itself clear: what will be the source of the funds to pay (i) the ongoing costs of operating the closed hotel or, if open, the hotel that is not yet breaking even, (ii) all debt service (if the principal forbearance is not continued), (iii) the "reopening expenses" (including severance) and (iv) significant upcoming capital expenditures, including expenditures deferred from 2020 and those mandated by COVID 19 operating changes?

I have not seen any written suggestions to answer this question. As the industry takes steps to have more reopened hotels, the availability of capital will weigh heavily on the owners of hotels across the country, if not the world.