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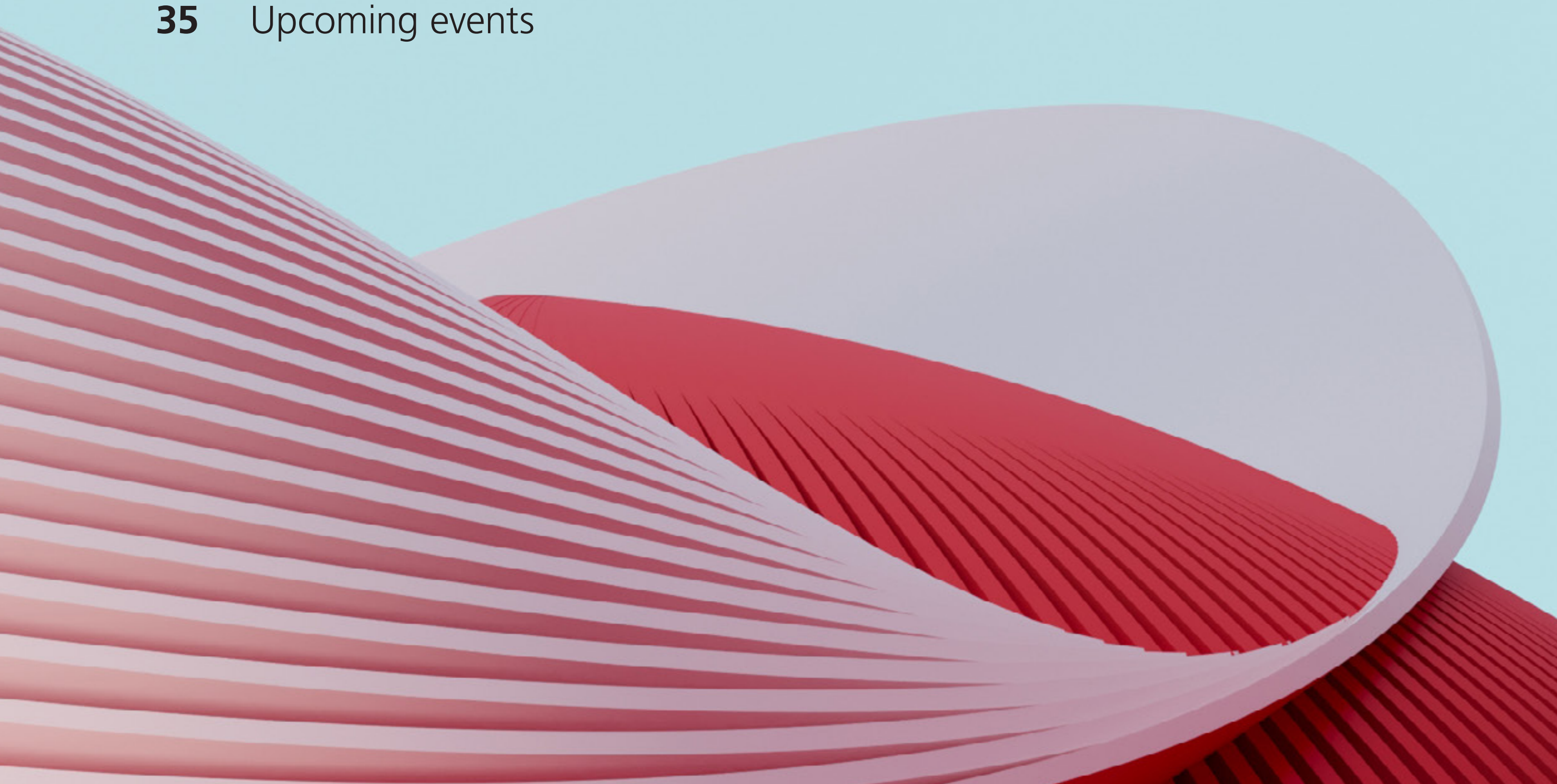
Hospitality Matters

Current topics in the hotel industry

Summer 2023

Contents



Welcome to Hospitality Matters

Welcome to the latest edition of Hospitality Matters – the first edition since the start of the COVID pandemic, when we got out of the previously regular habit of producing this publication. I think that in itself is just one small example of why more gets done when people are able to meet face-to-face. This allows ideas to spark, people to work collaboratively on joint projects and there is simply more energy and dynamism in what we do, when we do it together.

This is relevant to the hospitality industry as this sector survives on people meeting face-to-face, whether for social or business purposes. Whilst it seems like the concept of being in an office five days a week is gone, concerns about long-term declines in travel now seem rather over-blown. Most hotel groups are reporting overall activity levels in line with pre-COVID levels.

Patterns of behaviour have changed though; and some markets or segments have gained at the expense of others. And the sector should not be complacent – we are yet to see the true impact of businesses looking to achieve their net zero carbon targets and the consequential effect that will have on travel, especially long-distance travel by air. Perhaps it is no co-incidence that many hotels have put more effort into seeking to integrate more into their local community and generate more revenue from those customers who do not need to travel long distances. This itself is one part of the ESG strategy of those increasing number of hotels who are putting ESG at the heart of their decision-making and strategic direction.

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Cost pressures continue to cause headaches for our clients, whether that is financing costs due to higher interest rates, inflation for supplies or wage inflation for their staff. At least energy costs have come back down from their winter peak, but there is no guarantee they will continue to do so, especially while supplies continue to remain constrained. But the hospitality sector has managed to get price increases to stick and the resulting revenue increases are off-setting the increases in expenses in many segments.

On the positive side, other real estate sectors are struggling and many real estate investors continue to see hotel investment as a natural inflation-hedge, compared to other sectors. So there appears to be no shortage of capital looking for investment into hotels, as long as it is at the right price.

In every edition we seek to have one article focusing on a single country or region. This time it is the turn of Scandinavia. Since the last edition of this publication, the Norwegian law firm Kluge has joined CMS; and we very much hope that Swedish firm Wistrand will be able to do the same later this year, once they have local Bar approval. We are grateful to our new colleagues in Norway and our prospective colleagues in Sweden for their thoughts on the Scandinavian hotel market.

Regional focus: Scandinavia

Introduction and characteristics

The hotels and leisure market in Scandinavia, geographically comprising Sweden, Norway, Denmark, is a dynamic and rapidly evolving sector that has experienced significant growth in recent years. The hotels and leisure market is mainly characterized by a few domestic operators who have a strong presence in the region. There are quite few international operators having a substantial presence on the market.

Unlike many other countries, one of the characteristics of the Scandinavian hotels and leisure market is that hotel management agreements are rarely used between hoteliers and management companies. Instead, lease agreements are the most commonly used form of contract. The ownership structure can be split between three entities: the property owner, the brand owner and the hotel management. In lease agreements it is, however, common that the operator owns both operations and the brand. The lease structure is usually designed with a guaranteed minimum rent and a percentage rent based on the operator's turnover. This structure is popular since it allows splitting the risk and upside potential between the parties. The property owner thereby still has an incentive to invest in the hotel, and the structure promotes collaboration between the property owner and the operator.

Developments during and post covid-19

The Scandinavian hotels and leisure market has seen significant developments during the recent years, driven mainly by changing consumer preferences, technological advancements and the impact of the COVID-19 pandemic. The changes have primarily concerned sustainability, digitalisation, domestic tourism, and personalized experiences.

The hotels and leisure market is recovering financially from the challenges posed by the COVID-19 pandemic. The second half of 2022 was the first period with no significant pandemic restrictions in Europe since 2019. For instance, the Nordic hotels and leisure market was by the end of 2022 on average of about five percentage points lower in terms of overnight stays as the pre-pandemic levels and compared to the equivalent quarter 2019. In regards of revenue per available room (RevPAR) the level of the hotels and leisure market was, as a whole, at the end of 2022 above the 2019 levels. More specifically compared with the fourth quarter 2019, the RevPAR increased by 20 per cent in Norway, and by 5 per cent in Sweden. In Denmark RevPAR was in line with 2019.[1]

As a consequence of the imposition of restrictions during the COVID-19 pandemic, domestic travel has become more popular and many hotels have shifted their focus to domestic tourism, offering staycation concepts and targeting local travellers. The market has also during the past years seen an increase in the number of boutique and lifestyle hotels. These hotels offer more unique and personalized experiences, catering to specific customer preferences.

Another development on the hotels and leisure market is the use of technology, with hotels using various digital tools to improve customer experience. Many hotels have implemented mobile check-in and check-out processes, enabling guests to skip the front desk and go straight to their rooms. Needless to say, the importance of digital third party booking channels, has also increased significantly.

The Nordic countries have long been known for their focus on sustainability, and this trend has been important for the hotel industry. Many hotels have implemented sustainable practices, such as using renewable energy sources and reducing waste in order to reduce their environmental impact.

1 STR, Benchmarking Alliance

CMS comments – future challenges

Shortage of staff
The Nordic region is experiencing a labour shortage in the hospitality industry. This has been exacerbated by the COVID-19 pandemic and the majority of the hotels are struggling to recruit and retain skilled staff. Considering that the future lifting COVID-19 restrictions in Asia may lead to increased travel to the Nordic, the need for staff will most certainly remain and even increase.

Rising inflation / economic situation
As the rest of Europe, Scandinavia and the whole Nordic region faces increased inflation, largely fuelled by rising energy costs due to supply chain disruption post-pandemic and geopolitical instability emerging after Russia's invasion of Ukraine. Increased inflation comes with several challenges leading to higher operating costs, including higher interest rates and decreased consumer spending power. The increase of operation costs may not be adequately met by a price increase due to the declined purchasing power of customers. This may lead to decreased occupancy rates and revenue for hotels.

Sustainability
Sustainability is a growing concern worldwide which also affects the hospitality sector. One of the sustainability drivers is the rise of ESG (environmental, social and governance) as investment criteria. Furthermore, tourists are increasingly looking for eco-friendly options and hotels that prioritize sustainability may have a competitive advantage both in relation to attracting investment capital and towards customers.

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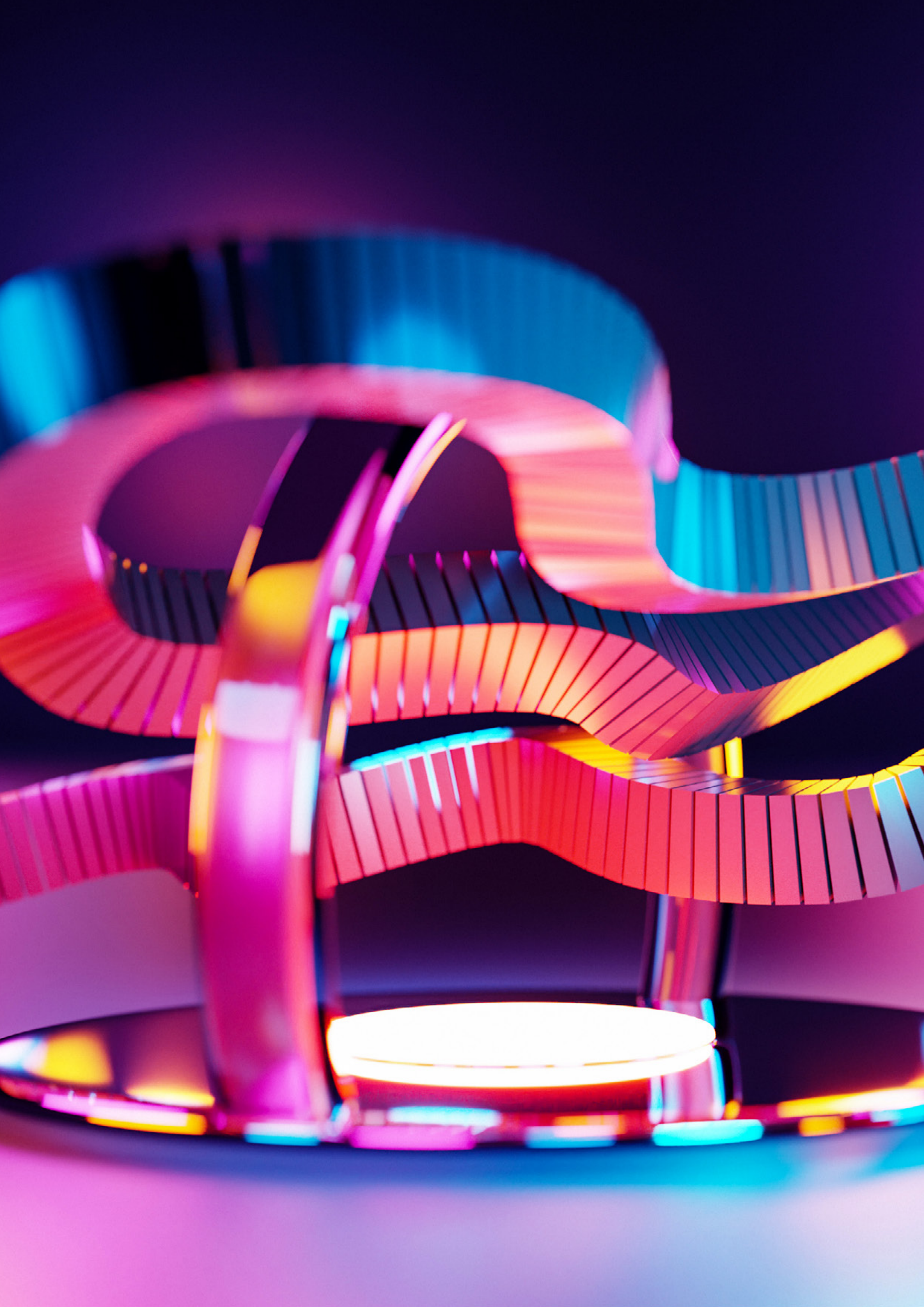


Michel Cottray in conversation with Thomas Page

Michel Cottray is the General Manager of Hotel Martinez, Cannes, a member of The Unbound Collection by Hyatt. Thomas Page is the Global Head of the Hotel & Leisure Group at CMS. This interview took place at the CMS Global Partner Summit in Cannes in November 2022.

Thomas Page
Michel, I wanted to talk to you about the challenges and issues that the hotel industry is currently facing, and the first one would be labour shortages across Europe. What is the situation for the Martinez Hotel, and Hyatt in general?

Michel Cottray
As, as you know the skilled and committed employees for our sector is a big dilemma worldwide, regardless of the location. In France, during the summer, we had a shortage of 250,000 employees in the hospitality industry alone. I think to cope with that we need to present the hospitality industry as much more dynamic and appealing to the younger generation. I think Hyatt is much more committed to looking into ways of providing young people with new work experience. For several years we have been only guest-centric, but we have now added an employee-centric element. We look more for the right attitude, rather than skill set. We also believe that to the young generation, we need to be more flexible in the way we structure our employment contracts. We also need to offer them opportunities to grow quickly. In my view, this is probably the most important thing, as the young generation of employees want to learn a lot quickly, gain experience, and move forward with their professional careers. We are also working with local schools and vocational institutions to provide training and employment opportunities to young people in the community.

T.P.
Another challenge I wanted to touch upon is the energy prices this year. I wonder how you tackle this issue, as I imagine that for a hotel like Martinez with huge energy requirements, it is a very challenging task to mitigate the impact of energy prices, and still satisfy your guests needs?

M.C.
Energy prices have doubled this year so we simply needed to go back to the basics in terms of saving energy. These are really not very sophisticated methods, like closing the doors or going back to revolving doors, switching off our facade lights during the night, and shutting off the curtains against the heat and the cold. In my view, the good thing is that we used to have these issues in the past, but it was more difficult to persuade the employees to get actively involved in the process. Today I think they also feel responsible and involved. The cost of energy is also relevant to our carbon reduction commitments so we look for efficiencies from that perspective. We do have a Net Zero Target, and we have been working on a comprehensive plan to achieve it. This includes reducing our energy consumption, increasing our use of renewable energy, and implementing more sustainable practices throughout the hotel, from sourcing supplies to managing waste. One needs to be aware though, that in luxury hospitality, it is sometimes very difficult to find the right balance between various savings and client expectations, but of course, as a GM I have now a set of efficiency goals to achieve which I am cascading down to my teams.

T.P.
One of the challenges in a managed hotel like Martinez is the interaction between the owner and the operator and their different potential intentions and targets. What is the situation in the case of the hotel you are in charge of?

M.C.
There can sometimes be some differences of opinion, but we have a strong working relationship with our owners, and I would say we are very fortunate to have such responsible and aware owners. They always engage in managing various challenges and issues. For example, we often review our equipment and appliances (from the electricity consumption angle) like our dishwashers (which in a hotel may cost between EUR 60-80,000 per annum), kitchen ovens, elevators, and also the pool. We have a good Building Management System (BMS), helping us to collect the data and control energy consumption on a more granular level. The BMS is evolving technology, which can pinpoint the highest energy consumers in the hotel. However, as mentioned earlier, in a luxury hotel, the

energy-saving policy can often conflict with brand standards, and the question is always if the guests are willing to accept these policies since they chose our hotel for certain standards.

T.P.

In terms of enhancing the BMS and other improvements leading to improved ESG compliance, which require capex funding from the owners, do you think it is the responsibility of the operator to make the suggestions when it comes to the annual budget to say, for example, if we spend EUR 250,000 on a new BMS we can generate savings, or should such suggestions rather come from the owner?

M.C.

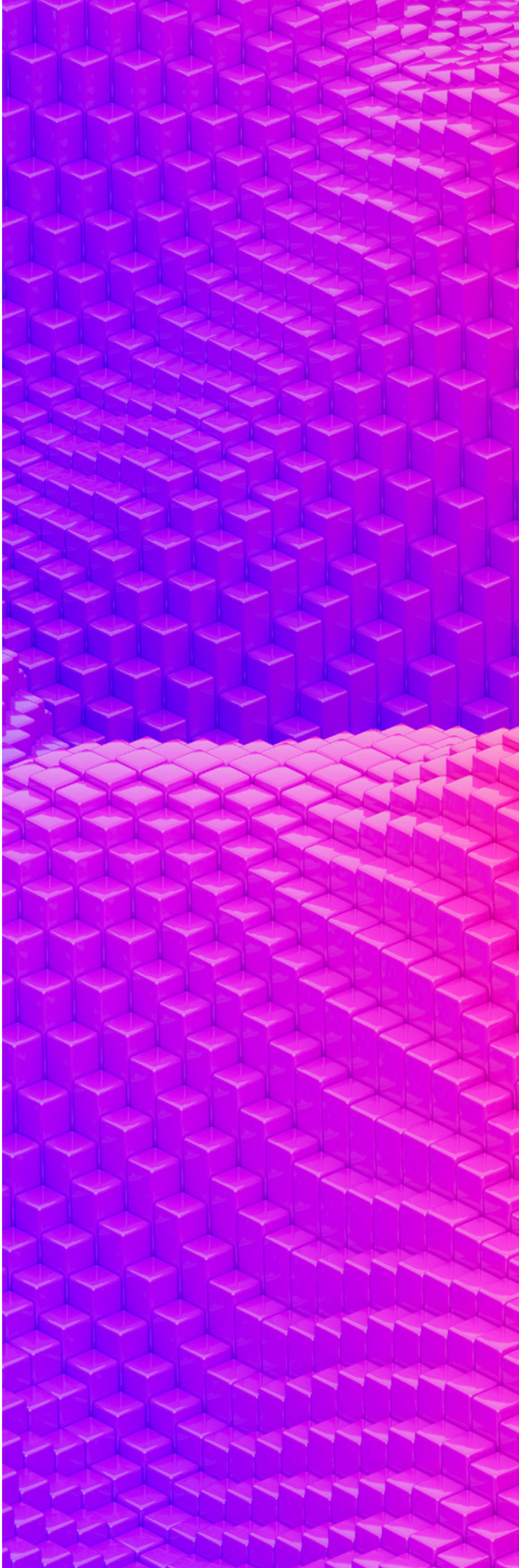
For me it always needs to be aligned with ROI of course, if we can have ROI in 3-4 years, I would be able to convince the owner to make the investment. And still, our budgets are primarily ROI-driven not yet ESG-driven in that sense. Usually, the projects with the highest return get the highest attention, so I am not really sure if ESG is already playing that huge role, but there will be a greater focus on it in the next few years. It is becoming less optional, it's just expected especially by the institutional investors, who already focus on ESG-compliant hotels.

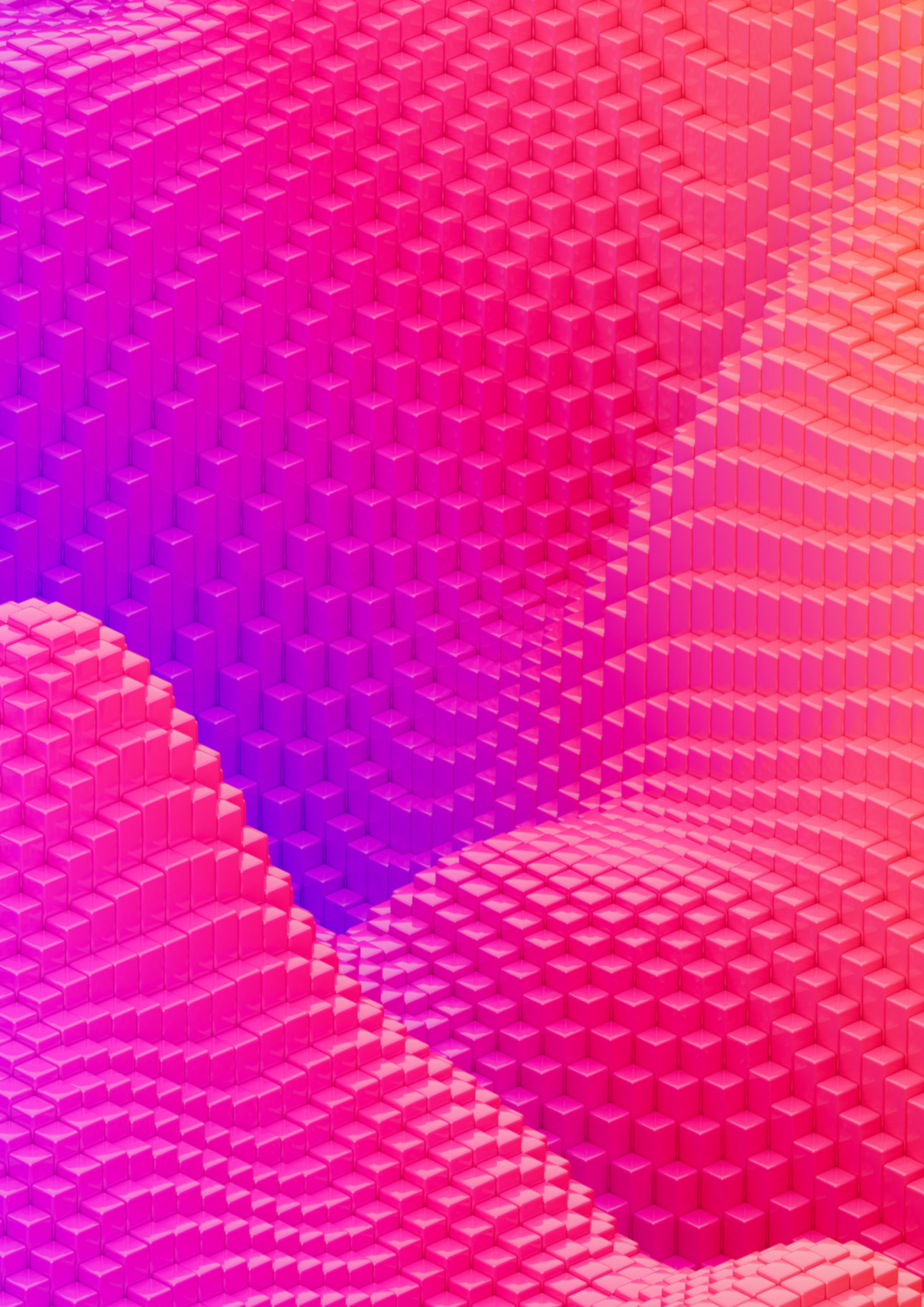
T.P.

My last question refers to the 2023 outlook for the industry in general, what are the biggest headwinds and positive opportunities you see over the next 12 months?

M.C.

Hotels worldwide achieved 2019 levels already last year, maybe not necessarily in terms of occupancy, but in terms of rates most destinations have already recovered. I believe this trend will continue. Most hotels will make more profit next year, maybe with less occupancy volume but a better bottom line. Of course, this is always the game of balancing volume and rates, we do not want to drop the rates to achieve higher occupancy. From the headwinds, I would again mention the challenges of the labour market but also the supply chain issues that may affect any industry.





Sustainability and climate action… checking in for the long term

It has never been more important for those operating in the hotel and leisure industry to anticipate and adapt to the ever-changing environmental and sustainability landscape. IPCC Reports on Climate Change are informing legal and market change around the world. Regulatory changes at EU level and in the UK mean that a holistic approach is needed for all stakeholders.

In both the EU and the UK, reforms are likely to have far reaching consequences economically and operationally for all businesses in the sector and it is crucial that their impact is understood. The potential financial and reputational risks and missed opportunities associated with any failure to plan for and adapt to such changes could be significant, particularly amidst the growing pressure from consumers and investors alike and wider society. The introduction of sustainable finance requirements is accelerating disclosure and asset appraisal. The hotels and leisure sector has an important contribution to make to harnessing and achieving positive environmental change.

Keeping abreast of policy and legislative developments is key, as is participating in consultations on reforms to ensure that they are workable at an operational level. A snapshot of some of the main developments is outlined below.

The European Green Deal and UK Net Zero

The EGD is the overarching umbrella for initiatives facilitating the EU to become climate neutral by 2050 and to reduce greenhouse gas (GHG) emissions by 55% by 2030. It is informing all EU policy and law on a transformative basis so that adaptation and mitigation are brought forward and the assessment of opportunities and asset valuation appraisals are informed through the lens of the climate crisis. The UK's Climate Change Act which establishes legally binding net zero target by 2050 and a 68% reduction by 2030 is leading to new measures and a raft of policy proposals.

Taxonomy and the Sustainable Finance Disclosure Regulation

The EU taxonomy is a classification system, establishing a list of "environmentally sustainable" economic activities. It is intended to provide companies, investors and policymakers with appropriate definitions for which economic activities can be considered environmentally sustainable to attract financial investment. On a mandatory basis certain large financial and non-financial companies are obliged to disclose to what extent the activities that they carry out meet the criteria set out in the EU Taxonomy. Financial market participants (such as asset managers) will have to disclose to what extent the activities that their financial products fund meet the EU Taxonomy criteria. On a voluntary basis others can use it to inform investment decisions.

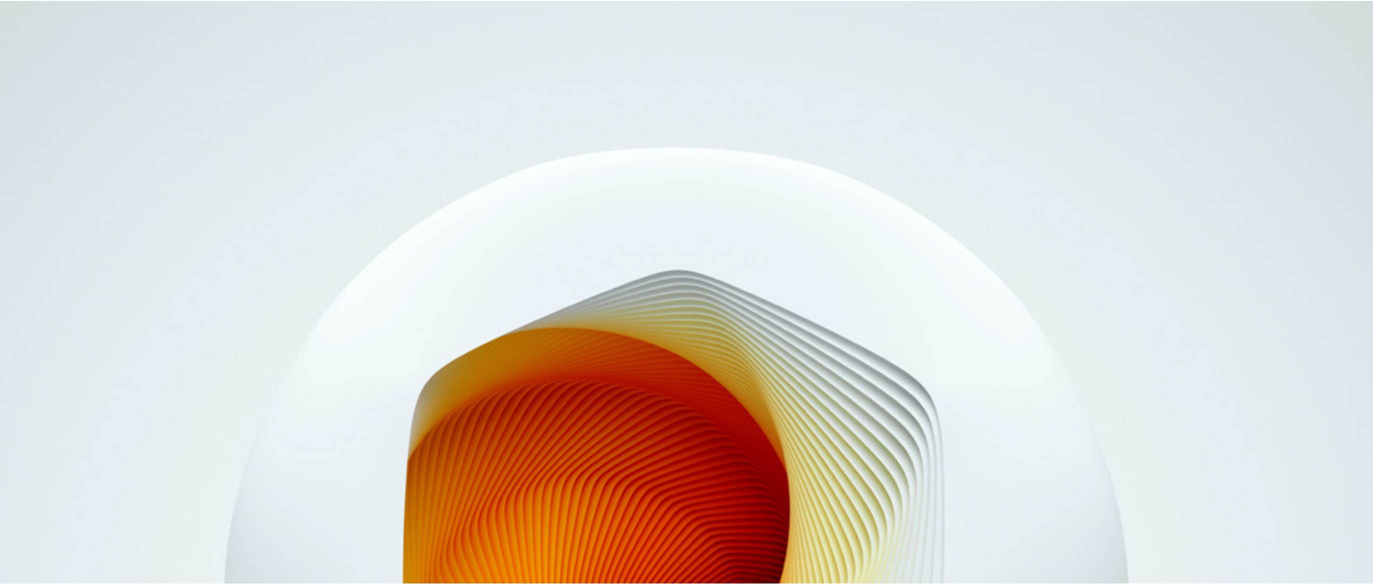
The SFDR creates a comprehensive reporting framework for financial products and financial entities. Compliance with sustainability-related disclosures is expected to have considerable behavioural effects on financial firms, and indirectly on the business models of companies that are being invested in.

A consultation on an UK Taxonomy is expected in Autumn 2023.

Sustainability Reporting

Corporate Sustainability Reporting Directive ("CSRD")

The new EU measure significantly extends the rules on the mandatory disclosure of sustainability information by certain organisations. The law will be implemented individually by Member States. In-scope companies which can include non EU entities meeting certain thresholds associated with business in the EU will need to include a dedicated section in their management report disclosing information necessary to understand the company's impacts on sustainability matters and how sustainability matters affect the company. These obligations will be introduced in a phased manner from 1 January 2024 with more organisations falling in scope thereafter. This is a significant change and will require analysis of corporate groups, assessment of criteria and gathering of appropriate data now in order to plan for and meet reporting requirements.



In the UK certain mandatory climate related disclosures apply depending on the type and size of organisation and transition plans for listed companies and asset managers may extend to large businesses in the near term. Nature related financial reporting is also anticipated to become more widespread and potentially mandatory for certain organisations.

Supply Chains

Proposed Corporate Sustainability Due Diligence Directive ("CS3D")
The CS3D will impose a sustainability due diligence duty on large EU companies and non-EU companies with significant EU activity to address specific adverse human rights and environmental impacts in their own operations, their subsidiaries, and their chains of activity. Companies in scope of the CS3D must take appropriate measures to prevent potential adverse impacts where possible (and mitigate impacts where not) and to end or minimise actual adverse impacts.

Proposed Forced Labour Regulation
The proposal prohibits the placing and making available on the EU market and the export from the EU of products made with forced labour, including forced child labour. The prohibition covers domestically produced and imported products. In addition to the CS3D this measure will require businesses to consider their due diligence processes and agreements with suppliers to ensure that the prohibition is not violated.

In the UK various requirements exist under the Modern Slavery Act which is due for review.

Forest Risk Commodities
The EU is finalising a new Regulation on deforestation-free products which aims to curb deforestation and forest degradation driven by the expansion of agricultural land to produce certain commodities, namely cattle, cocoa, coffee, palm oil, soya and wood. The proposal would impose due diligence obligations on operators placing these commodities and some derived products on the EU market, or exporting them from the EU.

The UK will introduce legislation to prohibit large businesses from using "forest risk commodities" (beef, leather, cocoa, coffee, maize, palm oil, rubber and soy) in their UK commercial activities unless relevant local laws on that commodity have been complied with. The aim is to ensure that UK businesses do not contribute to illegal deforestation by importing products which are produced on land which is used illegally. In-scope businesses will also be required to establish and implement a due diligence system for any forest risk commodity used in their UK commercial activities and report annually on their due diligence. The specific due diligence requirements are anticipated to prompt changes throughout the supply chain and will need to be reflected in relevant contractual documentation.

Waste

Mandatory electronic tracking of waste
In 2023 UK regulations are anticipated introducing mandatory requirements for all those involve in the production, movement and management of waste to enter details electronically in order to facilitate regulatory checks, traceability and to inform waste policy.

Deposit Return Schemes
A new deposit return scheme ("**DRS**") is scheduled to be introduced in Scotland in August this year, with further DRSs likely to be introduced in England, Wales and Northern Ireland in 2025. Similar schemes are applicable in various Member States. DRSs are a means of encouraging the recycling of drinks containers, such as bottles and cans. They work by charging the

customer a small deposit for the qualifying drinks container on purchase, which is refunded to the customer when they return the container to a collection point for onwards recycling.

Under the Scottish DRS, a 20p deposit will be payable by consumers buying a single-use drinks container made from PET plastic, glass, steel or aluminium with a volume between 50ml and 3l, which can then be redeemed on return of the empty packaging. This will have implications for importers, producers and anyone marketing or offering for sale in-scope drinks containers in Scotland. Hospitality businesses will have different obligations depending on their operating model. For example, those businesses that sell in-scope drinks containers for consumption off-site of the premises of sale must also comply with obligations imposed on retailers which will include charging the deposit on each in-scope drinks container and operating a returns-point, unless exempt.

A DRS in England, Wales and Northern Ireland has a provisional start date of 1 October 2025. Under the current proposals, the English and Northern Irish regimes will exclude glass containers, leading to divergence from the schemes in Wales and Scotland.

Extended Producer Responsibility ("EPR") Measures

Extensive changes to the UK producer responsibility regime for packaging are being introduced in a phased manner over the next couple of years. The aim of EPR is to incentivise producers to use less packaging, encourage better design of packaging and to change to using packaging materials which are easier to recycle. The UK has proposed the introduction of (amongst other things): (i) payments for household packaging waste and packaging in street bins managed by local authorities; (ii) modulated fees based in recyclability of packaging (from 2025); (iii) mandatory labelling of packaging recyclability; and (iv) annual packaging waste recycling targets.

In essence, obligated packaging producers (defined widely) will be required to collect and report packaging data and meet the full net cost of dealing with household packaging waste (in addition to complying with recycling obligations imposed under the current packaging waste regime). Currently, packaging producers pay only around 10% of the cost of dealing with packaging waste.

The data collection and reporting obligations are in effect now, whilst it is anticipated that the waste management fees will be payable from 2024. In summary, large producers will be required to report data covering January to June 2023 by 1 October 2023 while small producers will be required to report their data by 1 April 2024. The rules concerning payment of the waste management fee have not yet been published but are expected shortly.
EPR for textiles is anticipated post packaging EPR.

Single-use Plastics

From October 2023 in England the supply of single-use plastic plates, trays, bowls, cutlery, balloon sticks, expanded and extruded polystyrene foods and drinks containers will be prohibited to align more closely with the ban that applies in Scotland and in the EU. Likewise, the Welsh government has introduced legislation to restrict the sale and supply of those categories of single-use plastics - in addition to stirrers, drink straws and plastic-stemmed cotton buds, which have already been banned in England and Scotland – from autumn 2023. A UK plastic packaging tax is already in place.

Food Waste

In the next few years there will be increased momentum in the effort to tackle the issue of food waste across various sectors, including hospitality. DEFRA has proposed that large food businesses in England (including hospitality businesses) will be required to report their food waste data from April 2024 with large businesses being required to measure food waste from that point and to report the first set of data at the end of the 2024/25 financial year.

Scotland's Circular Economy Bill also contains a proposal to make public food waste reporting food mandatory. Further details of how this will be implemented are awaited.

Meanwhile, the EU will adopt a Directive containing legally binding food waste reduction targets in Q2 2023 to apply by the end of 2023. The precise nature of those targets is not yet known.

Energy Efficiency in Property

Minimum Energy Efficiency Standards ("MEES") for commercial property

From 1 April 2023, landlords are prohibited from continuing to let most commercial property with a sub-standard energy performance certificate ("**EPC**") rating of F or G, unless a valid exemption applies. MEES has already applied to the grant of new leases since 1 April 2018. Importantly, where a property is let (or continues to be let) in breach of MEES, the lease remains valid and in force, but the landlord will be in breach of MEES and exposed to potential penalties, unless an exemption applies.

It is anticipated that MEES obligations will become stricter in forthcoming years with government proposals for requirements of a minimum EPC rating of "C" in 2027 and "B" in 2030.

Biodiversity

It is expected that businesses will increasingly be required to consider how their activities impact upon biodiversity and to take those considerations into account in their strategic planning, risk management and in the reporting of non-financial disclosures.

The biodiversity net gain requirement introduced by the Environment Act 2021 will require developers to provide a biodiversity net gain plan with their planning permission application demonstrating how the development will provide a "biodiversity net gain", which will be achieved where the biodiversity value of the development exceeds the pre-development biodiversity value by at least 10%. This plan must be approved by the local authority before the development can lawfully commence. The new regime is scheduled to be introduced in November this year. However, significant gaps remain in the detail and further consultation and guidance expected over the next few months.

Preparing for the future

The sheer number and range of measures scheduled to take effect in the coming years makes it important to integrate sustainability planning into all aspects of a business' operations. Consideration should also be given to how key contracts across the supply chain and hotel management agreements should be adapted to ensure compliance with sustainability developments and incorporate due diligence checks, data collation and reporting and the implementation of ESG action plans, as necessary.

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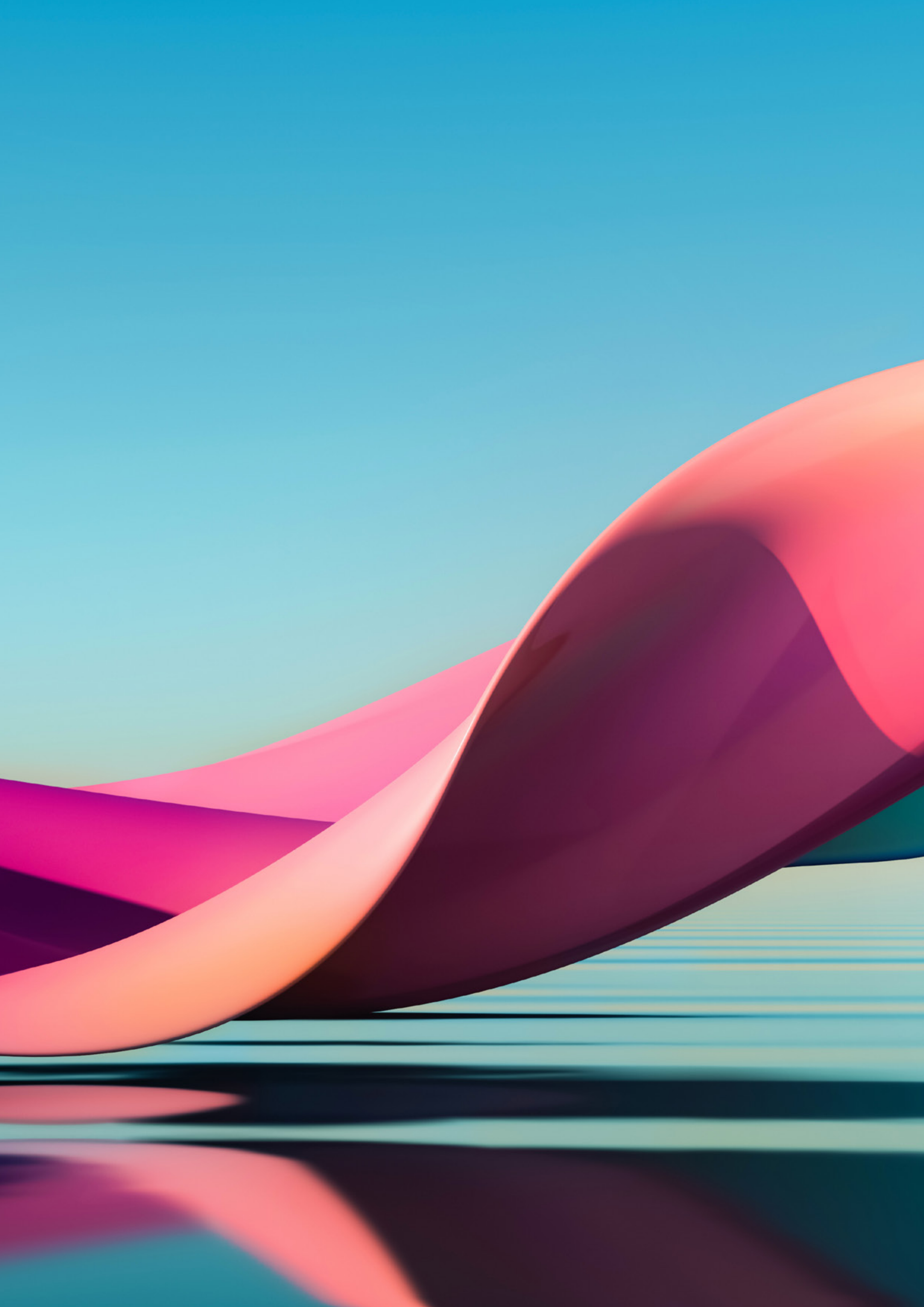

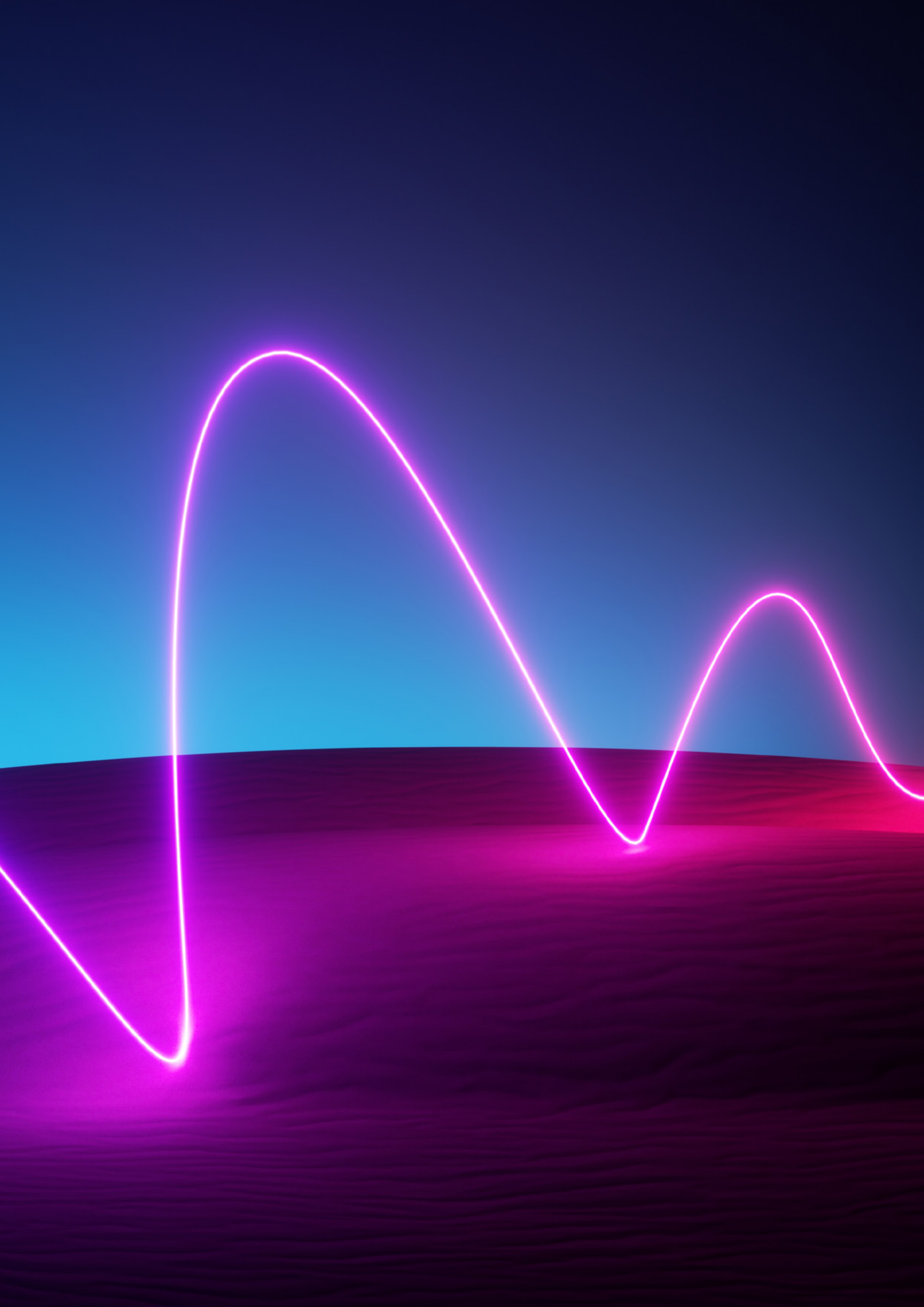

Future turmoil in the hotels sector

The travel industry is no stranger to turmoil. Having emerged phoenix-like from the ashes of the COVID-19 pandemic, last year started with a pent-up demand for global travel, and room rates generally soared to record levels. However, with rising inflation, squeezes in consumer spending and acute labour shortages plaguing the industry, what can asset owners and operators do to weather this next recessionary storm?

Key factors to consider will be profitability, cost structures, the affluency of targeted hotel guests and the size of any debt or loans.

Hotel Owners

Debt

Asset owners will no doubt be keen to ensure any debt and/or loans remain manageable in the wake of rising interest rates. Owners who are struggling to service their debt would be advised to approach their lenders to renegotiate sooner rather than later, as interest rates are predicted to continue to rise in the short to medium term. Conversely, owners who are locked into favourable interest rates may well find themselves at an advantage, shielded from costly fluctuations on the cost of borrowing whilst taking advantage of higher interest returns on other investments, which may actually increase their overall liquidity.

Construction/renovation

As global supply chains continue to face pressure, the costs of opening new hotels and renovating old ones has skyrocketed for owners. The cost of construction and raw materials has increased exponentially. There are reports of pressures beginning to ease in global supply chains, but increased industrial action, China's only recent emergence from its zero-COVID policy, Russia's war in Ukraine and military exercises in the Taiwan Strait point to continued congestion and disruption in the months and possibly years ahead.

Asset owners may sensibly cut back on conducting significant refurbishment projects in the near future, focusing instead on essential repairs. However, inflation may be further compounded by the postponement of large-scale construction projects. Delaying refurbishment may not be an option for all owners. Franchisors and operators will want to ensure their brands are being represented in the best possible condition, and many hotels may simply not be able to sustain the post-pandemic revPAR they have thus far enjoyed without refurbishment.

If refurbishment cannot be delayed, owners will have to consider their hotels' ability to increase room rates whilst looking for cost efficiencies elsewhere. Being in a position to attract affluent and business travellers, who may be less affected by the cost-of-living crisis, will be a key consideration.

Portfolio differentiation

Some hotel owners may seek to take advantage of the market instability to strengthen or differentiate their asset portfolio, to introduce more flexibility or to free up capital.

Others might choose to sell burdensome assets, focusing instead on lower cost, asset-light portfolios or "safer" assets. Selling can increase liquidity (to service debt, pay off loans or invest elsewhere). We may see an increase in sale and leaseback deals, an option which keeps the operation and brand at the hotel intact, such as Único's 20-year sale and leaseback of the Grand Hotel Central in Barcelona to Schroders (which contains an option to buy the hotel back).

Certain owner operators may look to outsource their hotel management to reduce their costs. Large scale operators often benefit from long term backing from their investors that will enable them to withstand volatility in a way that other market players cannot.

We may also see an increase in leading hotel management companies purchasing rival brands to bolster their global revenue share.

Hotels may still be an attractive investment for certain investors during an inflationary time, as their profitability and demand can be measured on a daily basis instead of less frequently. Some owners may choose to go on the offensive, looking for opportunities to buy depressed assets from owners under strain, weakened by the covid pandemic, in the knowledge that the short-term costs will be temporary, and that tourism will eventually rebound, particularly in city centres and resort locations.

Operator performance
Owners are likely to be keeping a close eye on operator performance, as we emerge from the covid pandemic. It will be important for owners and operators to maintain open lines of communication to ensure that performance tests and thresholds put in place to monitor or improve performance are realistic and achievable. Owners will also want to understand operators' rights of cure when faced with consistently underperforming assets. Owners and operators are advised to seek advice early, instead of waiting until things deteriorate beyond repair, in the hope that the relationship can be salvaged with some minor changes or a time-limited improvement plan.

Hotel Operators

RevPAR and performance thresholds
With room rates soaring in Europe, the first summer season after COVID has seen high demand for travel. However, with a recession on the horizon and inflation hitting a 40-year high, top room rates are unlikely to be sustainable, and occupancy levels will continue to be hampered by ongoing labour shortages, both of which leave operators facing a perfect storm.

Operators may, understandably, have concerns about achieving the performance thresholds in their hotel management agreements, which were likely paused or renegotiated during the COVID pandemic and are now looming large. Again, early communication with owners will be key to navigating a sustainable path through these challenges. Performance indicators may need to be discussed and, ultimately, renegotiated to avoid any breaches in performance tests.

Changes in competitive set
The competitive set of any particular hotel is likely to have been affected in some way by the COVID pandemic, with hotels changing ownership or brand, M&A deals bringing hotels under shared ownership and/or hotels closing down for good. Operators would be advised to approach owners about revisiting the competitive set for any given hotel to ensure it is still reflective of comparable hotels in the area, so that performance thresholds measured by reference to that are set at a fair and meaningful level. Parties should consider all relevant factors when adjusting the competitive set, such as location, size, facilities, quality, seasonality and the mix of business (i.e. tourists, families, business and group travel) as well as the core identifiers such as occupancy, ADR and RevPAR.

Relying on a less than optimal competitive set will lead to other adjustments in performance targets being necessary so that the management agreement can remain in place and is, ultimately, in neither party's interest. Consulting early with relevant experts during the annual budgeting exercise in relation to the competitive set is recommended.

Focus on the consumer and market
Operators will be considering where to focus their marketing efforts. Attracting US tourists to Europe whilst the dollar is strong may be a worthwhile pursuit for European operators, particularly as consumers in the UK and Europe continue to feel the pinch of energy and goods price inflation. Although increasing airfares may be a barrier for consumers across the pond.

Luxury operators and hotels may not see a marked drop in demand as compared with more affordable brands. Those consumers with above average spending power are, of course, less likely to be affected by the cost-of-living crisis. Business travel may find itself adversely affected as businesses look to reduce costs as we enter recession, which will include reining in travel expenses. Redundancies may hurt leisure demand too.

Countries and hotels dependent on Chinese tourism may also continue to be affected through much of next year, as China's pause on international tourism is anticipated to last until at least mid-2023. Russia's war in Ukraine will continue to affect hotels in those regions. And hotels in countries with high debt loads may find themselves vulnerable as interest rates spike, e.g. in Italy, which is at risk of default.

Millennials and Generation Z represent huge markets with high potential spending power. Savvy operators will be considering ways of engaging with these consumers via social media platforms, using influencers as a way of boosting brand exposure at minimal cost.

Technology
Major players in the industry have already recognised and embraced the use of technology in the sector. Many are looking to create a broad and connected ecosystem across all brands and touchpoints for the benefit of their customers. Online purchasing, contactless technologies and food delivery services have grown exponentially during the covid pandemic and are here to stay, an expectation of the millennials and Generation Z consumers that are becoming a real focus point.

By the same token, online visibility and brand recognition through social media platforms is key for future marketing strategies. However, brands must find a way to distinguish themselves in order to develop deep customer loyalty which drives repeat custom and the all-important word of mouth recommendations.

Labour Shortages
Hospitality staff shortages, caused by an exodus of workers during the COVID pandemic, have hit a record high in the UK and are similarly being felt across Europe. This is hampering the industry's ability to trade at a level that meets demand. Understaffed resorts and gridlocked airports are also beginning to have a negative effect on consumer appetite for travel.

Operators will be devising recruitment strategies in order to attract and retain the best talent, including through offering better pay and conditions, more holidays, health insurance, career progression and meaningful training programmes including around mental health and wellbeing.

Thousands of UK workers, including a small number in the hospitality sector, are currently trialling a four day working week. It remains to be seen if the trial will result in greater productivity and increased staff welfare and retention as hoped. However, a focus on flexibility, and an acknowledgment that staff likely have other commitments which need to fit around their shift patterns, would appear to be a key message to relay in any recruitment drives.

Climate Change and ESG
Climate change is adversely affecting tourist destinations across Europe. With temperatures soaring above 40 degrees in many European cities this summer, tackling climate change has become ever more urgent.

Consumers are also becoming more and more aware of the environmental impact of their choices, and some consumers, particularly millennials and Generation Z, will choose hotels which are seen to be making a positive environmental impact. Restoration of natural habitats, wildlife protection, energy and water conservation measures, the fight against single use plastic and the use of local and sustainable produce are all attractive concepts to these consumers.

Similarly, social drivers such as anti-racism initiatives, mental health awareness and diversity and inclusion measures are likely to become ever more important considerations for younger consumers.

Disputes

It is inevitable that, even in the most amicable of partnerships, owners and operators may clash in their approach to weathering the current storms. Operators may ask owners to refurbish or invest in the infrastructure of the hotel in order to attract the most affluent clientele who are less likely to be affected by the cost-of-living crisis. At the same time, owners will be looking for ways to reduce overhead costs in order to continue to service any debts or loans as interest rates rise and will be looking to their operators to maximise the profitability of the hotel. This conflict will inevitably lead to disagreements. Outside forces such as labour shortages and supply constraints may simply add fuel to the fire. Communication and, where appropriate, compromise will be key to navigating these challenges, as well as understanding and enforcing rights where necessary.

An inflationary environment is not all bad news for the hotel sector. Inflation can be a positive for hotel pricing power and ADR, provided the hotel can continue to attract consumers with spending power. Whether hoteliers push for growth or apply the brakes will largely depend on their target market. But even for those more affordable hotels, there is a wealth of market potential.

There has never been such demand for wellness and escapism from the stresses and strains of 21st century life. Market players who are no strangers to entrepreneurship will no doubt find their way through these challenges and will innovate in order to service the needs of tomorrow's consumers today.

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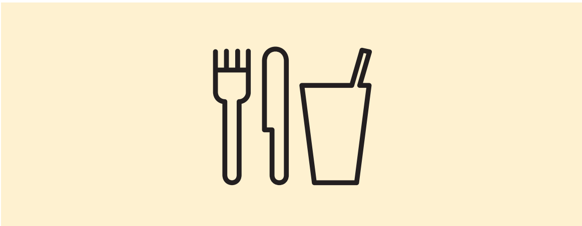
Leisure Deals

State of Play Hospitality
CMS has advised State of Play Hospitality (“SOP”), the owners of the concepts including Bounce and HiJingo, managers of golf concept Puttshack and US licensee of FlightClub Darts, on a US $35m fundraising from UK family offices and US PE.

Swingers
CMS has advised on back to back fundraising rounds for UK-based crazy golf concept, Swingers, primarily from UK investor Cain International and management. With two London sites, Swingers recently opened in NYC following its first opening in Washington and the funds will be used to continue the group’s UK and US expansion ambitions.

Mowgli Street Food Group Limited
CMS has advised leading restaurant brand Mowgli on its sale to TriSpan, a global Private Equity firm with extensive restaurant expertise.

Respite Management Limited
CMS has advised Respite Management Limited, the hospitality operator of Town Hall Hotel in Bethnal Green, Da Terra Restaurant and 196 Bishopsgate apartments, on its £23.4m refinance with United Overseas Bank and a corporate restructure of its group operating structure and re-gear of its operating leases.

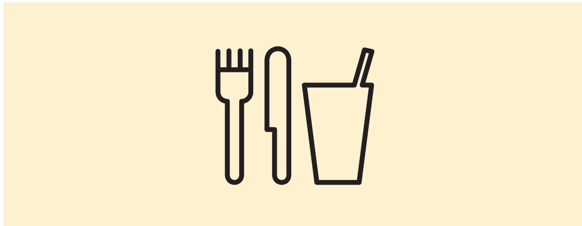


Tortilla Mexican Gril
CMS has advised long-term restaurant client and Quilvest backed, Tortilla Mexican Grill plc, on its successful listing and admission to trading on the AIM market of the London Stock Exchange, by way of a placing of new and existing ordinary shares at a price of 181 pence per share.

Punch Pubs
CMS has advised on the £900m acquisition of Punch Pubs by Fortress Investment Group.

Hollywood Bowl Group
CMS has advised Hollywood Bowl Group as issuer in respect of a £30 million cash-box placing by way of an accelerated bookbuild. Hollywood Bowl Group plc is the UK's market leading ten-pin bowling operator.

NewRiver REIT
CMS has advised on the £222.3m sale of Hawthorn Leisure REIT, the entity that holds NewRiver's entire community pub business, to AT Brady Bidco Limited (Admiral Taverns), a wet-led community pub operator with approximately 1,000 pubs across England, Scotland and Wales.



Chilango
CMS has advised Tortilla Mexican Grill Plc (Tortilla), on the acquisition of all the issued shares of Chilango Limited (Chilango) for a total of £2.75m from investment firm RDCP Group.

Nobu Hospitality
CMS has advised Aldar Properties PJSC (Aldar) on its exclusive partnership with Nobu Hospitality to develop a new luxury hotel, branded residences, and a fine dining experience to anchor Aldar's Mamsha Al Saadiyat in Abu Dhabi.

Hospitality hot topics

A slippery issue – liability on board an aircraft

The High Court has considered once more the thorny issue of what constitutes an "accident" for the purposes of the Montreal Convention and has provided at least some clarification.

Read more: **bit.ly/aslipperyissue**

Last call for registration of producers under the Scottish DRS for single use beverage containers

Drinks producers must register with SEPA for the Deposit Return Scheme for Scotland ("**DRS**") by **28th February 2023** if they sell drinks in Scotland in single use containers which are included in the DRS.
The DRS is set to launch on 16th August 2023 and will mark a key milestone for the Scottish Government's ambitions for a circular economy and extended producer responsibility.

Read more: **bit.ly/Lastcallforregistration**

Not Upheld – Sports betting ads that do not have a strong appeal to under 18s

On 08 February 2023, the Advertising Standards Authority ("**ASA**") issued two rulings in respect of the new gambling advertising rules that came into force in October last year.

Read more: **bit.ly/notupheldsportsbetting**

Hotel Industry Jargon Buster

From A&G and half board to opaque bookings and VR – the Hotel Industry Jargon Buster provides you with a comprehensive list of the most current terms in the hotel industry. The list was compiled by CMS experts with the aim of providing you, whether you are an owner, investor, lender or operator in the hotels and leisure sector, with easy access to the latest information.

Read more: **bit.ly/hotelindustryjargonbuster**

Repurposing Real Estate: The future of the world's towns and cities

A radical rethink for global property – and where we live, work and play. As the real estate world emerges from the pandemic it is clear that all around us the urban landscape is changing. Many properties are obsolete but also have exciting futures with new uses. Our town centres and cities are undergoing fundamental change – which all adds up to a world focused on Repurposing Real Estate.

Read more: **bit.ly/repurposingrealestate**

The Register of Persons Holding a Controlled Interest in land

The Register of Persons Holding a Controlled Interest in Land (the RCI) came into effect in April 2022 pursuant to the Land Reform Scotland (Scotland) Act 2016 (Register of Persons Holding a Controlled Interest in Land) Regulations 2021 (the Regulations). The RCI is a public register which is intended to help show the true controlling interest in various land ownerships in Scotland (which includes leases of over 20 years or leases featuring an unconditional tenant's option to extend the durations to over 20 years). The deadline for applications to the Register to avoid criminal penalties is 1 April 2024.

Read more: **bit.ly/registerofpersons**

Further restrictions to hotels as Amsterdam adopts new legislation to cap overnight stays

Further limitations may apply to hotels in Amsterdam as a result of a new legislation capping tourism numbers.

Since 2017, the municipality of Amsterdam has applied a strict overnight stay policy (Overnachtingsbeleid). This means that in almost all parts of Amsterdam no room will be given to new hotel initiatives that do not fit in the existing zoning plans. Additional restrictions have been implemented by way of the municipality, in principle, not cooperating with amendments of leasehold contracts to allow additional hotel initiatives.

2021: Tourism in Balance regulation

In 2021, the city council of Amsterdam has adopted a new regulation "Tourism in balance" (the "**TiB Regulation**") imposing a bandwidth of a minimum of 10 million and a maximum of 20 million annual overnight stays and including 12 million and 18 million stays as signal values. The TiB Regulation is the outcome of a successful citizen initiative calling the city to rein in the numbers of tourist staying in Amsterdam. The TiB Regulation has been imposed to, amongst others, reduce the 21.8 million pre-Covid-19 annual overnight stays, which dropped to approximately 7 million stays in 2020 and 2021.

Further to the number of overnight stays, the TiB Regulation also aims to regulate the:

- daily touristic visits;
- capacity per city area; and
- effects of tourism on the quality of life in areas of the city.

According to the TiB Regulation, the municipal executive has to inform the city council every year prior to 1 June as to the expected number of overnight stays in the current year and the subsequent two calendar years. In the event that the expected number of overnight stays exceeds the signal values, the city council has to prepare within six months a policy document setting out the manner in which it aims at keeping the number of overnight stays within the 10 and 20 million bandwidth. Such policy document needs to include, at least, the possibilities of:

- regulating the short-term rental of residential properties (e.g. AirBnB);
- regulating the amount of tourism tax to be levied; and
- other measures to be taken by the municipality to regulate the number of overnight stays.

The explanatory notes of the TiB Regulation provide that the bandwidth and the signal values may be amended, subject to approval of the city council, in the event that the bandwidth or the signal values do not correctly represent the experience of the effect of tourism by the citizens of Amsterdam.

Contrary to the number of overnight stays, the TiB Regulation does not set specific values with respect to daily touristic visits, the capacity per area, and the effects of tourism on the quality of life the city.

Expectations 2022-2024

Based on a recent prognosis of the municipality, the signal values and bandwidths of the TiB Regulation are expected to be exceeded in the near future, with a substantial set of measures to be imposed. In a publication of April 2022, the municipality has estimated the overnight stays based on three scenarios depending on the growth of tourism. The "low" scenario assumes that Covid-19 restrictions will temper the recovery of tourism. In this scenario the overnight stays are projected to be 19.4 million in 2024. The "middle" scenario assumes that tourism to Amsterdam will recover based on the economic growth and the mobility possibilities and results in a projection of 20.4 million overnight stays in 2024. The "high" scenario assumes an alternative situation where the demand of tourism is fully accommodated and no Covid-19 restrictions apply and projects 22.8 million overnight stays in 2024.

All three scenarios show a number of overnight stays exceeding the signal values and nearing, or exceeding the maximum number of overnight stays as included in the TiB Regulation. As a consequence, additional measures are likely to be imposed.

2022: Visitor Policy

In response to these numbers and as further elaboration of the TiB Regulation, the city's municipal executive has presented in November 2022 the "Visie Bezoekerseconomie in Amsterdam 2035" (the "Visitor Policy"), a policy document setting out the vision of the municipality on the tourism sector, which policy document has been approved by the municipal council. Key element of the Visitor Policy is to restore the balance between the tourist pressure and the liveability in the city by limiting the number of tourists and converting the tourist economy to a more sustainable concept.

An important element of the Visitor Policy is a selection of the type of tourist visiting the capital. By aiming for "a more respectful visitor", Amsterdam aims to discourage visits of large groups, city-centre backpackers and stag parties while focussing on tourists visiting the city for its historical and cultural attractions. In order to facilitate this diversification of tourist, the city will actively start a "stay-away campaign" discouraging certain "undesirable" tourists to visit Amsterdam. In connection therewith, opening hours of bars and mooring docks for canal cruises in the red light district will be limited and a ban on smoking cannabis outside in the city centre will be implemented. Furthermore, the city is exploring the options to, in cooperation with European partners, tighten the number of budget airlines being permitted to land at Schiphol airport.

Another important feature of the Visitor Policy is the desire of the municipality to apply a geographic spread of tourist activities over the city, whereby tourists are prompted to move away from the crowded city centre to alternative, upcoming locations in the city where new tourist centres and attractions need to be (re)discovered. The Visitor Policy focusses on a cooperation with local entrepreneurs and businesses active in such areas.

An important aspect of the Visitor Policy concerns measures to limit the total number of overnight stays. For example, further investigations will be conducted to explore the possibilities to further restrict the short-term rental of residential properties. This would be in addition to the current strict regulations which allow for an annual maximum of 30 nights per homestay, subject to a required permit and registration system. Other measures include the active promotion of converting hotels into residential or office space and consolidating hotel rooms, allowing for more quality as opposed to quantity of hotel rooms. Lastly, the municipality is considering raising the tourist tax based on a yet to be conducted research regarding the economic effects of tourist tax. The tourist tax in Amsterdam (current revenue approx. EUR 135 million) is subject to ongoing debate and critics from the hotel sector. Research from ABN AMRO shows that it remains uncertain whether an increase in tourist tax will have a significant effect on the number of tourists stays in Amsterdam. After all, tourists might spend the night in surrounding municipalities. Other critics point out that the tourist tax in Amsterdam is already one of the highest in the world, which has apparently not prevented masses of tourists visiting the city.

The Visitor Policy follows the general principle of the municipality to further restrict the overnight hotel stays, which is also evident from the coalition agreement between the three left-wing parties currently in charge of the municipal executive. The current coalition parties are intending to:

- impose a complete ban on short term rental of residential properties in certain areas of the city;
- keep the moratorium on new hotel rooms in place; and
- strictly enforce the rules regarding illegal hotels.

It should be noted that the aforementioned overnight stay policy includes specific exceptions for special hotel initiatives which provide a quality boost to the existing hotel facilities and their surroundings. Although the Visitor Policy does not specifically introduce the "quality over quantity" principle, there are some measures which are inspired by this principle, such as the consolidation of hotel rooms and the search for a different type of tourist. This may give some perspective for hotels aiming for the more high-end tourist visiting Amsterdam.

The exact consequences of the Visitor Policy on for the hotel sector in Amsterdam are unknown yet. We, nonetheless, expect that given the political climate and the recent variety of policies adopted by the municipality, hotels will be subject to additional scrutiny by the city and additional restrictive measures are likely to be imposed.

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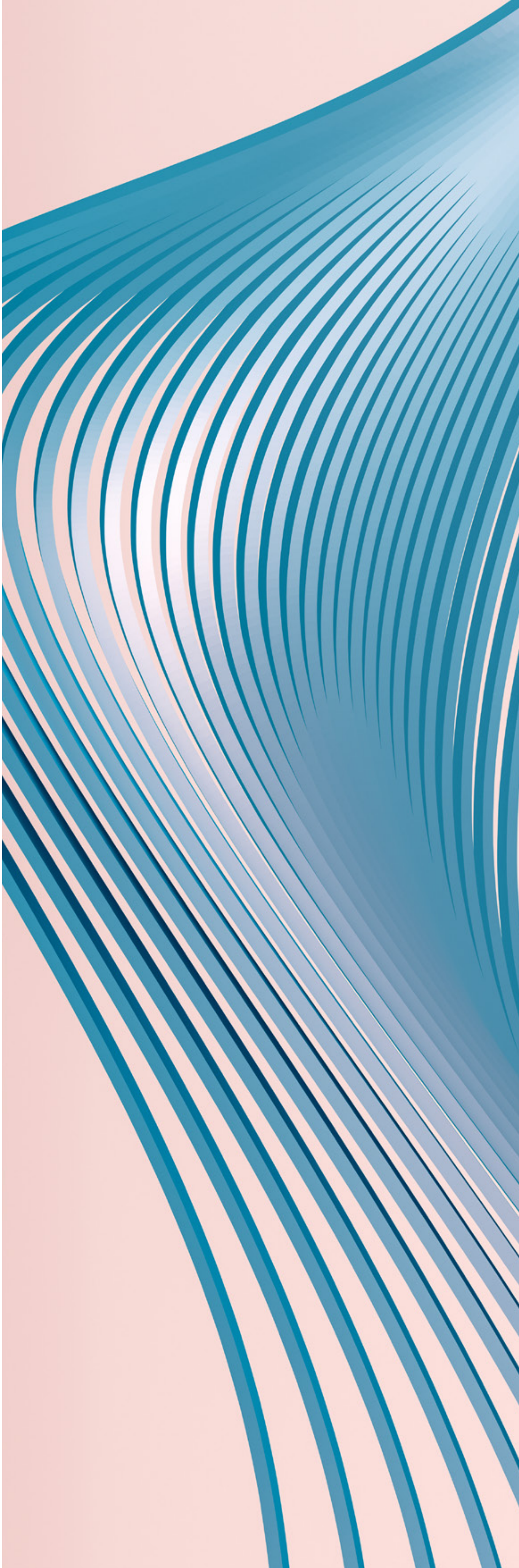
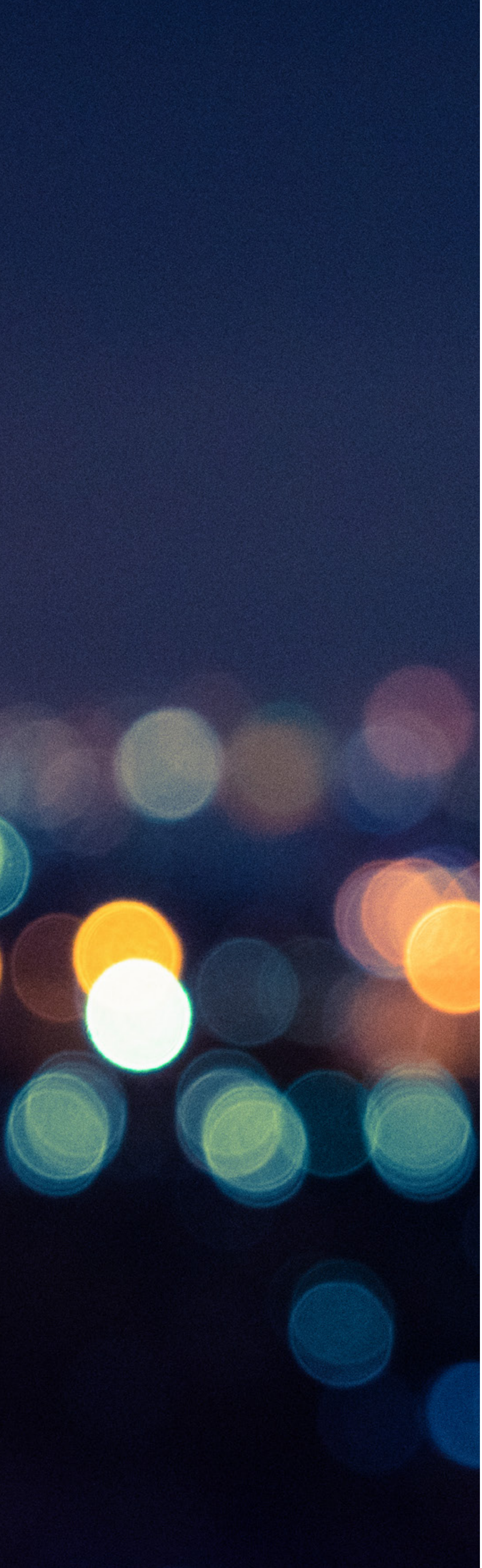




Hotel Deals

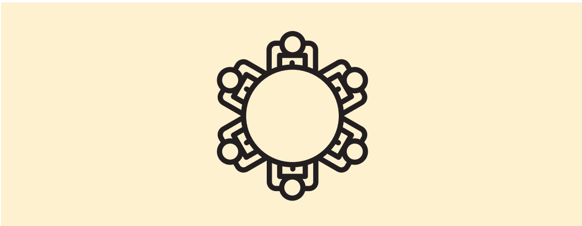
LFPI Hotels
Advised LFPI Hotels Deutschland on the acquisition of ibis Dortmund City. The hotel, which enjoys a central location, will be extensively refurbished, and added to the existing LFPI portfolio.

easyHotel
CMS has advised easyHotel on its acquisition and financing of eight franchised Benelux hotels from real estate and private equity fund manager Crossroads Real Estate for €145m, as part of its European growth drive.

Sofitel Grand Amsterdam Hotel
CMS advised Schroders Real Estate on the acquisition of a 50% interest in the Sofitel Grand Amsterdam Hotel from two separate sellers and a joint venture agreement with the other 50% shareholder.

Schroder Real Estate
Acquisition of a large hotel complex (Holiday Inn Hotel, Indigo Hotel, One80° Hostel) in Berlin by a hotel investment vehicle managed by Schroders Capital's Real Estate Hotel team and negotiation of the leases with Premier Inn and with the vendor.

QO Hotel
CMS has advised Invesco Real Estate on the sale of the QO Hotel in Amsterdam to Tristan Capital Partners' EPISO 5 Fund for a consideration of EUR 92.1m.



Tribe Hotel
CMS advised a syndicate of private investors on the financing and development of the 412 key Tribe Hotel at Manchester Airport. The advice has required input from across our multi-disciplinary team including real estate, corporate, energy and finance.

The Standard
CMS has advised Schroders Capital on the purchase of the luxury hotel "The Standard" in Ibiza, Spain, after having previously advised Standard Hotels on its management agreement with the seller.

City of Edinburgh Council
CMS advised on the letting of a pioneering new hotel and hospitality school development to be built at Haymarket, Edinburgh as part of the £350m Haymarket Edinburgh development.

The Bankside Hotel
CMS advised on the acquisition and financing by Vertiq UK Holdco Limited of the companies which own and operated the Bankside hotel, being Clapton R2 (GP) Limited, Clapton R2 (Jersey) Limited and Clapton R2 Limited Partnership (and Clapton R2 London Limited as a subsidiary) from Clapton R2 (JV) Limited.

Corendon Hotels & Resorts
CMS advised Corendon Hotels & Resorts on various agreements, including franchise agreements, in relation to the rebranding of five hotels in and around Amsterdam to Marriott brands. The five hotels will be operated under four Marriott brands: Autograph Collection, Tribute Portfolio, Residence Inn by Marriott and Fairfield by Marriott.

Understanding EHRC powers to prevent sexual harassment in the workplace

While harassment can take place in any workplace, it is recognised that factors exist within the hospitality sector which increase worker exposure to sexual harassment. The recourse for an employee who experiences this type of behaviour is a tribunal claim, with all the challenges and stresses that brings. However, there are other ways that an employer may be called to account for their actions (or lack of action) in this area. In February the Equality and Human Rights Commission (the EHRC) announced that it had used its legal powers to reach a legally binding agreement with McDonalds Restaurants under which McDonalds committed to taking steps to protect staff from sexual harassment.

It is a stark reminder for employers in the hospitality sector of the importance of being proactive around preventing harassment of staff and having effective systems in place to respond to complaints. In this article we discuss the powers of the EHRC and why employers in the hospitality sector should act now to take steps to reduce their exposure to risk in this area.

A legal agreement with the EHRC

The step taken by EHRC to use its powers to reach a legally binding agreement with McDonalds under section 23 of the Equality Act 2006 (known as a section 23 agreement) is relatively rare and therefore not on the radar of many employers.

An EHRC press release explained that the agreement was put in place in light of concerns about the way sexual harassment complaints from staff were handled. For a s23 agreement to be put in place it is sufficient that there is evidence that an organisation may have breached the Equality Act. A s23 agreement will normally include an action plan which an employer agrees to implement over a period of time. If an employer fails to effectively implement the plan the EHRC can initiate court action to enforce it. Equally if an employer does not engage when EHRC approaches it about entering into a s23 agreement, the EHRC has the power to go further and carry out a formal investigation and make a finding of unlawful behaviour.

What steps did the EHRC agree with McDonalds?

The press release explains that the s23 agreement commits McDonalds to:

1. communicating a zero-tolerance approach to sexual harassment
2. conducting an anonymous survey of workers about workplace safety
3. enhancing policies and procedures to prevent sexual harassment and improve responses to complaints
4. delivering anti-harassment training for employees
5. introducing specific training and materials to help managers identify areas of risk within their restaurants and take steps to prevent sexual harassment
6. supporting the uptake of policy and training materials by franchisees within their independent organisations to support reporting of sexual harassment
7. monitoring progress towards a safe, respectful and inclusive working environment

It is increasingly recognised that more needs to be done to prevent sexual harassment in the hospitality sector. In June 2022, the EHRC, working with UKHospitality, published a detailed checklist and guide to help employers tackle sexual harassment in the workplace.

Our Law-Now, [Preventing sexual harassment at work in the hospitality sector] discussed this in more detail.

For any organisation entering into a legally binding action plan, such as the McDonalds s23 agreement, it is an onerous commitment. As noted above, s23 agreements are still fairly rare, but it is clear to see that employees and unions can get the attention of EHRC where there is sufficient volume of complaints. Equally, as the EHRC is a prescribed organisation under whistleblowing legislation, workers are able to report concerns directly to the EHRC provided they can satisfy the legal tests which involve a reasonable belief that the complaint is substantially true.

To avoid workers complaining to the EHRC, the risk of a s23 agreement and negative publicity, employers in the hospitality sector should be reviewing their approach to tackling harassment. Franchisors, who may historically have taken an arms' length approach to treatment of staff by their franchisees, should also assess their approach given that harassment is an issue that goes direct to brand reputation.

The solution goes beyond having policies in place. A good starting point for action is to both consider whether all of the steps outlined in the McDonalds s23 agreement are in place in your organisation and to review the EHRC hospitality checklist.

Any attempt to refresh an approach to tackling harassment also has to sit within a framework of understanding what behaviour amounts to harassment. That is where good quality training on preventing workplace harassment is incredibly important. Updated policies and processes will have little impact if the employees themselves have no self-awareness of what harassment is and when they may be offending someone.

New regime in the pipeline

Employers should also bear in mind that legislation is in the pipeline that will create a new duty on employers to prevent sexual harassment and create liability for harassment at the hands of third parties; an issue that will have a particular relevance for hospitality employers where abusive customers could potentially harass workers. The new duty and third party liability were discussed in our Law-Now. The Bill containing the new rules on harassment, the Worker Protection (Amendment of Equality Act 2010) Bill has recently been amended to reduce an employer's liability for harassment if a worker overhears a conversation which is not directed at them. We expect to see the final legal provisions by the summer, although there is no date for implementation at this stage.

The message is clear. The overall direction of travel is a more robust legal regime, with greater expectations on employers to tackle sexual harassment, and the scope for increased compensation where employers fall short of the new duty.

If you would like to discuss how we could help you with your approach to tackling workplace harassment, please get in touch with your CMS contact in the employment team.

Upcoming events

Future Hospitality Investment Summit (IFHIS)
7-9 May 2023, Al Faisaliah Hotel, Riyadh

International Hotel Investment Forum (IHIF)
15-17 May 2023, InterContinental Hotel, Berlin

The Annual Hotel Conference
11-12 September 2023, Manchester Central Convention Complex

Hospitality Investment Forum
19-20 September 2023, Marriott Hotel, Prague

Future Hospitality Investment Summit (FHIS)
25-27 September 2023, Hilton Abu Dhabi Yas Island

OpRE Festival
26 September, Pullman London St Pancras Hotel

CMS Restaurant Conference
28 September, Cannon Place, London

CMS Scottish Hotels Conference with Avison Young
TBC September or October 2023, Edinburgh

CMS Hospitality Conference
TBC October 2023, Cannon Place, London

Hotel Investment Conference Asia Pacific (HICAP)
23-25 October 2023, Grand Hyatt Singapore Hotel

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