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Hospitality Investment Case 2022-2023

The Italian Economy

The Pitfalls

It is no secret that during the start of the COVID pandemic Italy was hit hardest. It has therefore also impacted the Italian economy the most, this can be shown by the fact that the GDP fell by 8.9% compared to the average of 6.2% across the other European member states. On top of this, Italy has also suffered the highest death toll compared to other EU countries, with a total of 120.000 deaths linked to the COVID pandemic.

The Italian economy was already fragile before the pandemic hit, mainly due to its low productivity growth. From 1999 to 2019 GDP per hour worked in Italy grew by 4.2% compared to France and Germany with 21.2% and 21.3%. The total factor of productivity actually decreased by 6.2% between 2001 and 2019.

Due to the structure of the economy, Italy has had trouble keeping up with the digital revolution taking place in other European countries, most medium sized enterprises on which the economy is built, are slow in adopting new technologies.

The main weaknesses of the Italian economy are:

- Lack of technological innovation
- Lack of productivity
- Lack of public and private investment
- Slow pace of the implementation of structural reforms
- Lack of investment and innovation in infrastructure

NGEU

The COVID pandemic shed a strong light on the vulnerability of the Italian economy. Thanks to the Draghi government and support from the EU however, a change is on its way. The two main NGEU instruments are: the Recovery and Resilience Faculty (RRF) and the Recovery Assistance for Cohesion and the Territories of Europe (REACT-EU). The RRF will allocate a total of 191.5 billion Euros to be spent between 2021 and 2026, of which 68.9 billion Euros consist of non-refundable grants.

The Italian National Recovery and Resilience Plan (NRRP) made a plan that consisted of 6 policy areas and 16 actions, these have been submitted in order to take part in the RRF. The plan covers multiple areas of NGEU and meets the parameters of EU regulation. The areas of focus include:

- Digitalisation
- Innovation
- Competitiveness
- Culture
- Green revolution
- Infrastructure
- Education
- Inclusion and cohersion
- Healthcare

The plan is aimed at fixing the economic divide with southern Italy and reducing unemployment rates for young adults.

The government also intends to implement multiple structural reforms, these are: public administration, justice, simplification of legislation and promotion of competition.

The Italian Economy

Public administration reform

This reform aims to improve administrative capabilities both at a local and central level, as this has historically been a big weakness of the Italian government, creating unnecessary amounts of bureaucracy. The reform aims to counter this issue by modernising the procedures for selection, training and skilling of civil servants and encourage the simplification and administration of civil procedures. This will essentially cut down the burdens for businesses and citizens in terms of costs and time.

Reform of the justice system

On average it takes 500 days for a civil procedure to be completed in court. This causes a lot of unnecessary costs and wasted time. This reform aims at fixing this by simplifying trial procedures and making use of digitalisation. The government is also committed to reforming the criminal justice systems, investigation and preliminary hearing phases, by encouraging the use of alternative procedures. This also aims at making the prosecution and access to trial debates more selective and fix the terms of duration for these proceedings.

Fair competition and investment

The Italian government can play an effective role in the identification of unfair competition like cartels and abuse of dominant positions. Fair competition has a positive impact on the national economy and social justice, the Italian government is therefore committed to ensuring it. The Government has submitted to Parliament an annual Bill on Market and Competition. This is aimed at approving enterprise-friendly regulation for the most strategic sectors: digitisation, energy and ports

The Italian government has also prepared a plan which entails a central coordination structure at the Ministry of Economy. This shall be tasked with the supervision of the implementation and will be responsible for sending payment requests to the European Commission. Evaluation and control units will also be put in place, each administration will be responsible for its own investment and reform plan and will be held accountable to the central task force. In addition to this, local support units to help territorial administrations improve their investment capacity and cut administrative bounds will also be set in place. The expected GDP growth by 2026 is estimated to be 3.6%.

> "Italy must combine imagination, design capacity and concreteness, in order to deliver to the next generations a more modern country within a stronger and more supportive European Union."
>
> **Mario Draghi**

What will happen after Draghi?

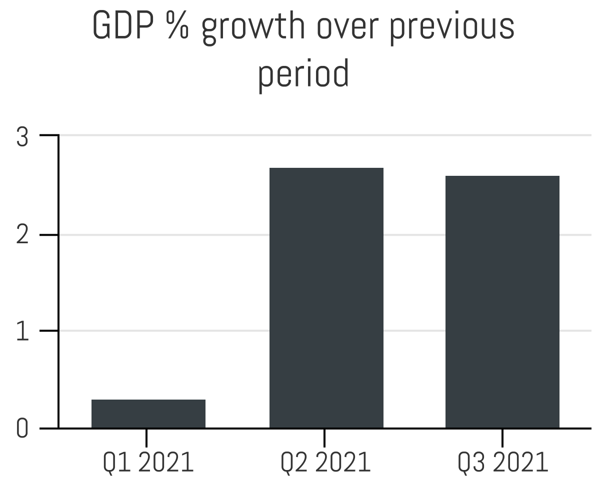
Thanks to Mario Draghi, Italy has been able to achieve stability in these crucial times. Draghi offered his resignation after the five star movement (one of the parties making up the coalition) refused to back a law that would help Italian citizens who have been dealing with a higher cost of living. This law however, was approved anyway and President Sergio Mattarella rejected Draghis resignation. Draghi stated that the reason for his resignation was the fact that he "trusted this was a national unity government", After the boycott from M5S against his policy he felt that it was becoming impossible to enact his program. After his "resignation" hundreds of mayors had signed a letter pleading him to stay.

The political parties making up his coalition (since February 2021) face uncertainty. Current polls suggest that a victory would be of the opposition parties, this would mean that the current Draghi coalition would lose national unity. Current polls suggest that if the democratic party and the M5S don't form an alliance, the opposition coalition would easily win. Only a very broad coalition including the democratic party, M5S, and the smaller left-wing, centre left and centrist parties would stand a chance against the opposition. A centre left coalition with the democratic party at its core would guarantee the continued implementation of the reforms set out by Draghi.

The next election will be critical in determining what Italy after Draghi will look like. Many of the reforms introduced by Draghi cannot be implemented without years of hard work.

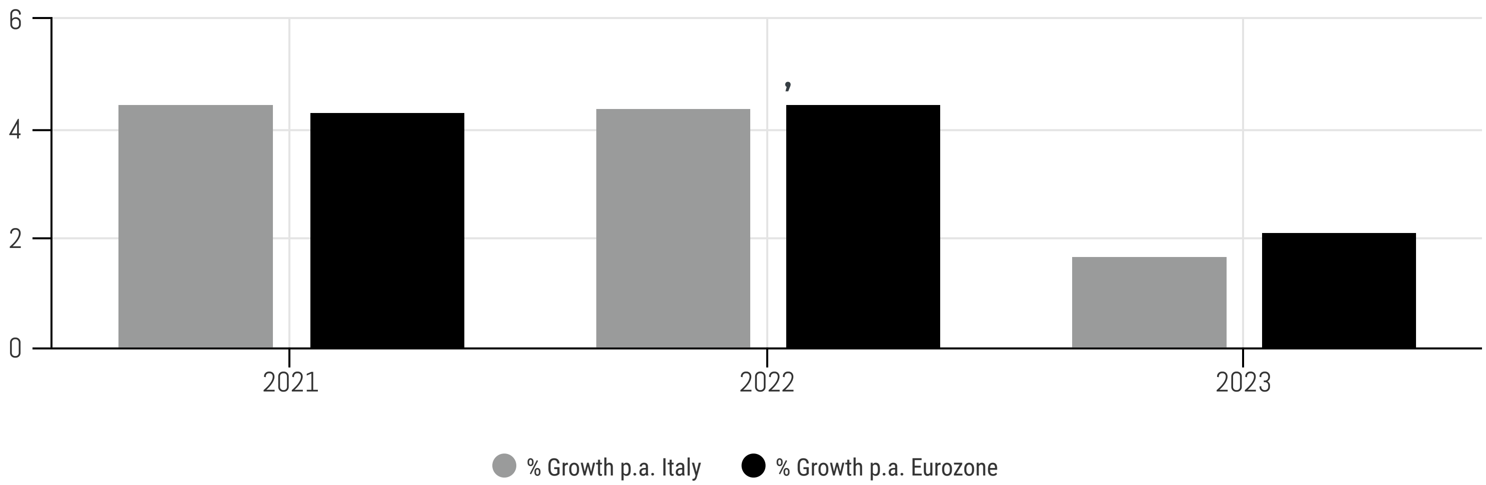
The reforms pushed by Mario Draghi have been very beneficial and popular in the Italian business community. Some argue that the most important job Draghi had was to design and implement a sustainable plan in order to secure the EU post pandemic funds. This was the most important step towards a recovering Italy and many argue that after this was secured, it was less important for Draghi to stick around. Italy’s recovery funds and policies are now baked in until 2026 and Brussels will maintain a tight hold on Italy due to the structure of the funds. Draghi has also set in place the structure that will ensure that this process runs smoothly in the foreseeable future.

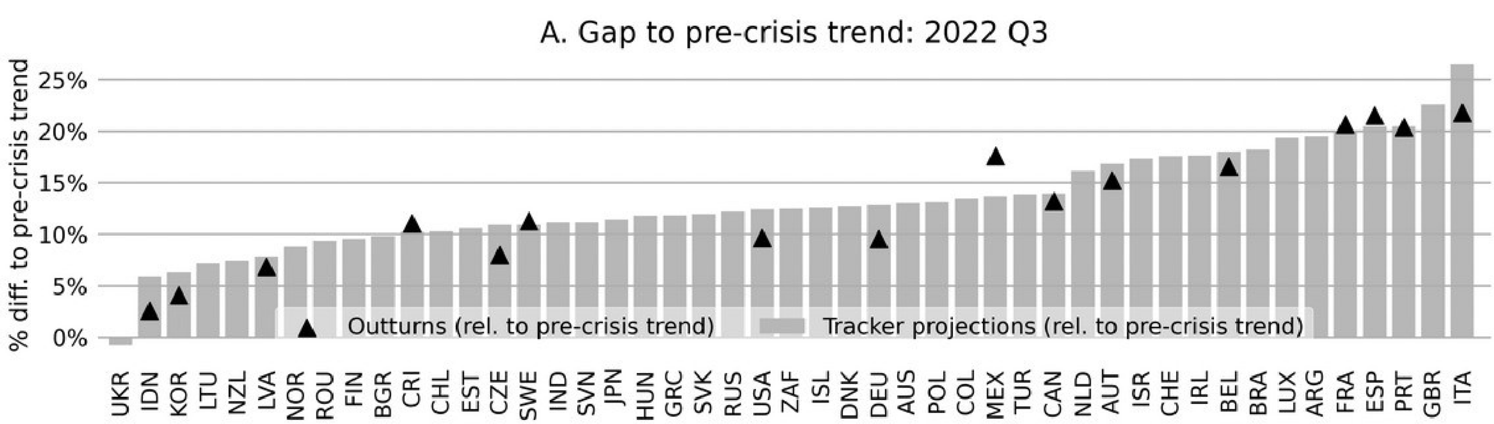
Despite the usual pre-election rhetoric, a new government will still be strongly incentivised to meet the conditions (set up by Draghi) in order to obtain money from the EU recovery fund. Furthermore, the strong support of the business community for the Draghi reforms will all but ensure compliance of any new government, especially if it would be a centre-right coalition. No significant anti-EU noises have been detected during the campaigns of any party.



GDP forecast

The impact of all the described factors can be shown in relevant data. Italy is expected to recover substantially faster in the third quarter of 2022 compared to other EU member states, it has also recovered more efficiently than other countries in the Eurozone in 2021.





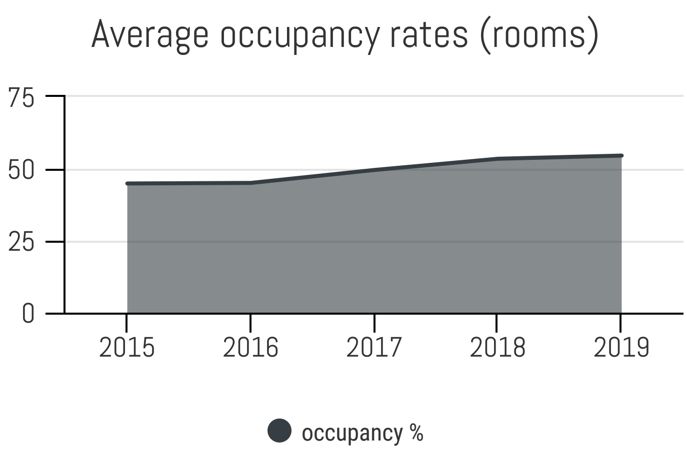
SOURCE: OECD

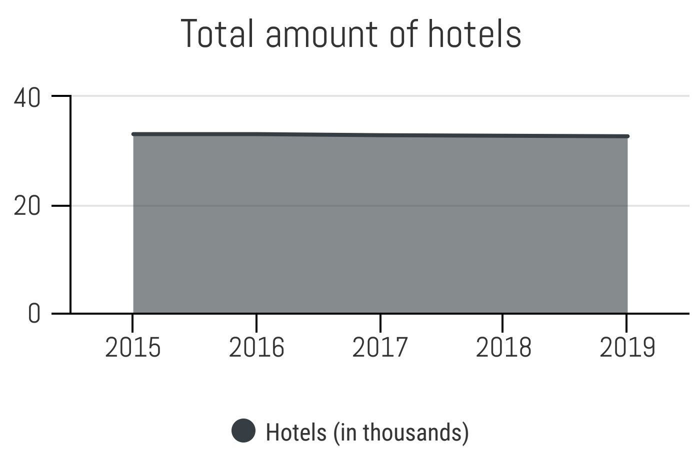
Tourism in Italy

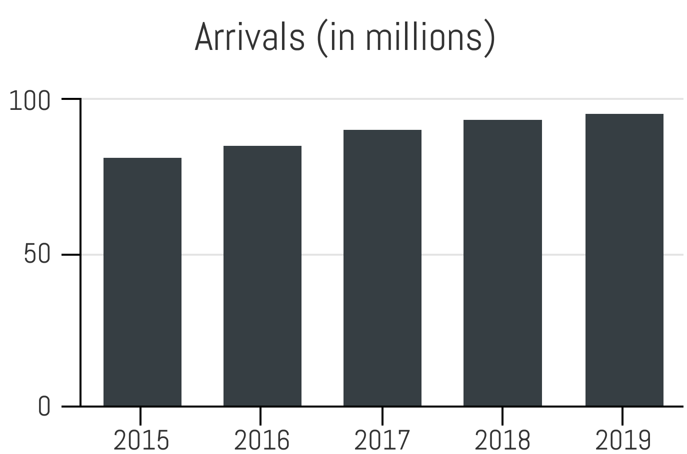
Italy is the fifth country in the world and third country in Europe in terms of worldwide international tourist arrivals. People from all over the world visit Italy due to its fascinating landscapes, amazing cuisine, hospitable culture and history. There are over 100.000 historical monuments all over the country, many of these date back to the roman empire and over 50 of them have been listed as UNESCO world heritage sites. Many tourists therefore describe cities like Rome and Venice as "open air museums".

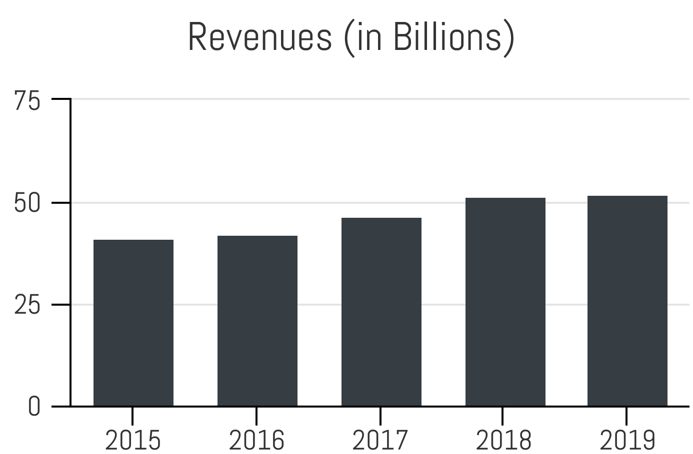
Despite the tremendous drop in arrivals due to the COVID pandemic, the tourism industry is expected to recover strongly this summer. This is partly due to the huge influx of American tourism. For the first time in 20 years, the Dollar has a higher value than the Euro, causing a big stimulus for US tourist arrivals. Domestic tourism is also up with 35 million Italians travelling in their own country.

Over 92 million arrivals are expected over the course of 2022, marking a 43% increase to 2021.









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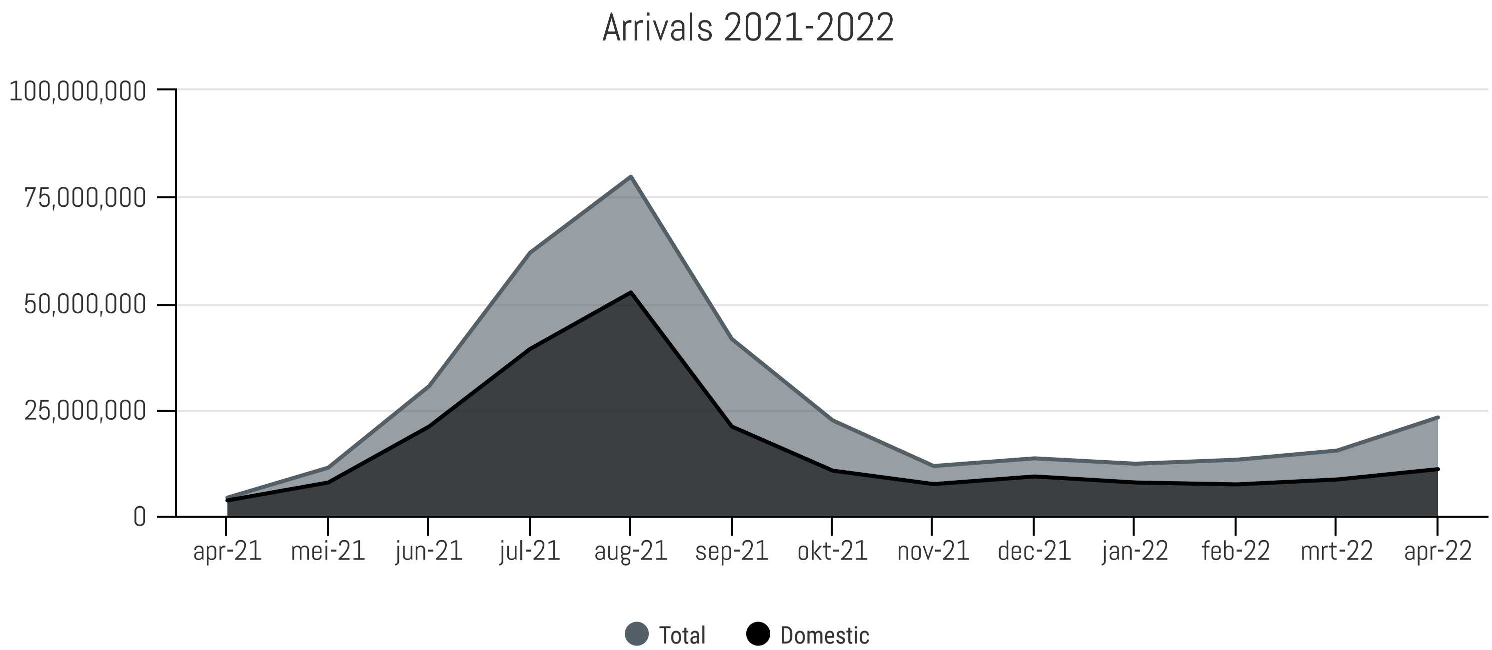
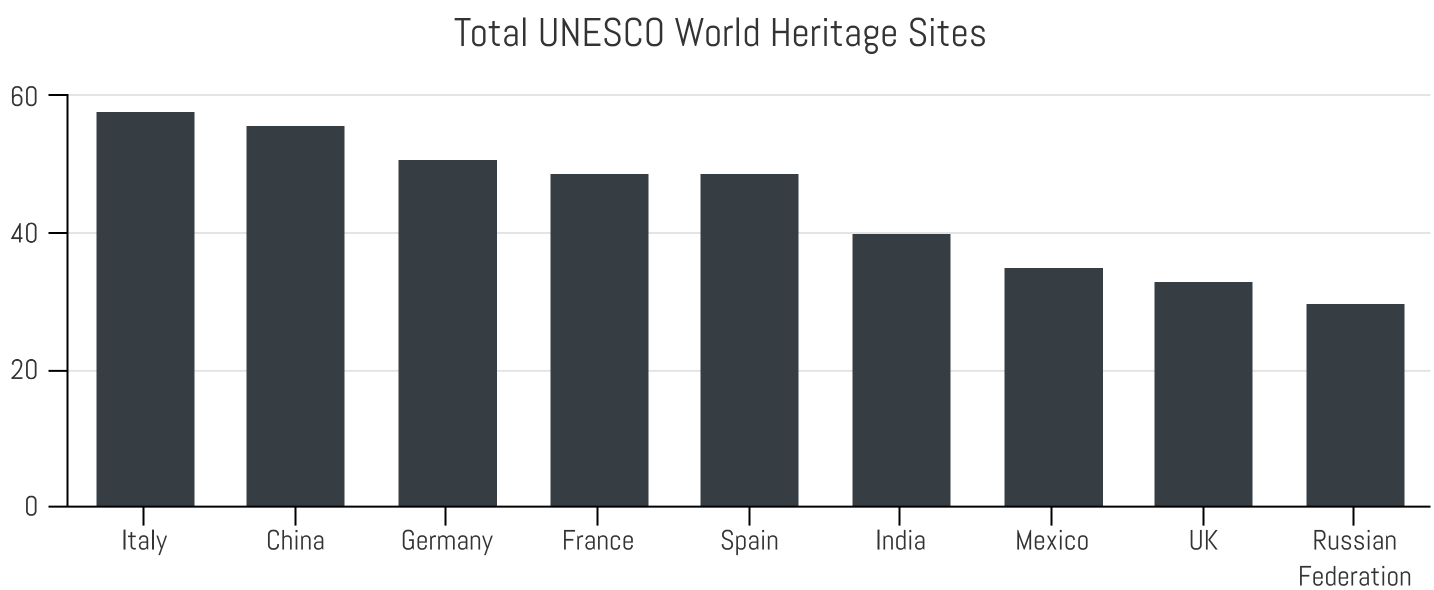
Tourism in Italy





SOURCE: OECD

COVID and the hotel sector

The last few years have had a strong impact on society. The pandemic has impacted our social lives, business and the economy. The impact on the Italian hotel industry has also been dramatic. Overnight stays in 2020 have dropped by 56.9% compared to 2019, tourism hotpots have been hit the most with Venice by 83.8%, Rome by 81.3% and Florence by 74.8%.

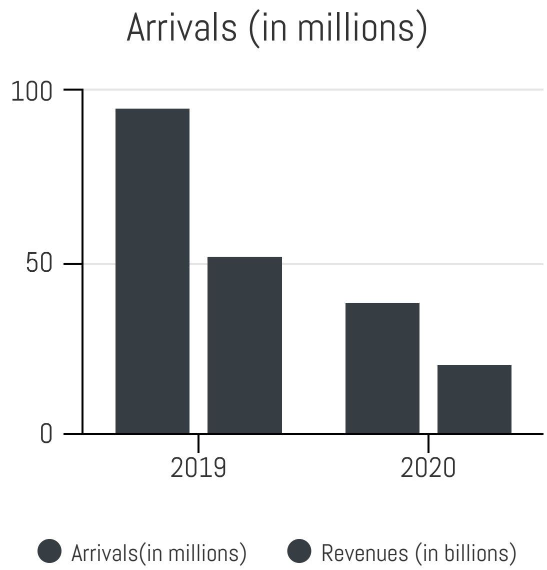
Foreign expenditure in Italy in 2020 has also dropped by 60.6% compared to 2019 and operating revenues for hotels have dropped by 60%.

There has been a clear difference in the response towards the COVID pandemic between business and leisure hotels towards.

While business-oriented hotels (mainly located in main Italian) cities have been hit very hard, more leisure-oriented hotels in top tourism destinations have been hit a lot less. This is because these areas typically receive a lot of domestic tourism. The Ligurian region for example has not suffered a lot due to the COVID pandemic, because more than 50% of tourism in this area is domestic. **Hotels that are heavily dependant on international travel have therefore suffered the most.**

Because of this, a significant number of hotels have run into debts and are forced to sell their assets. Bank loans taken by hotel companies have also increased by 8 billion Euros (according to the centro studi confindustria).

This bridge finance has mainly helped the medium-sized and bigger hotel chains during the crisis. However, **many family-owned or smaller hotel chains have not had the same access to finance.**



> "We see that a lot of family owned hotels are in need of help and investment, with the proper repositioning they can flourish. We aim to facilitate this."

Stable recovery

Italy has long seen a trend of increasing demand from tourism, which has led to an increase of revenues in the industry. The key driver of this demand has been from domestic and EU countries, accounting for over 60% of tourism in Italy.

Investment has also seen a stable increase. While having dropped by 75% in 2020 compared to 2019 (3.3bn - 1bn). However, in the first half of 2021 hotel investments reached 510 million, which is 20% above investments from the same period in 2020. The majority of these hotel transactions were carried out by international private equity investors. **This trend shows that investment is expected to recover at least to the levels of 2018.**

While inland and city hotels were hit the hardest, seaside hotels received mostly positive demand during 2020.

Research has shown that the leisure segment should reach pre-pandemic domestic spending levels in 2022, expenditure by international tourism is however expected to reach above 2019 levels in 2023.

For business hotels the outlook is more negative, full domestic expenditure recovery in this segment is said to be around 2024, for international expenditure this is expected to take longer.

On top of this, the National Recovery and Resilience Plan (NRRP) has allocated a total of 2.4 billion. 0.8 of this will be used to stimulate digitalisation and modernisation of existing hotel structures. Incentives such as tax credits will be used to stimulate local investment.

Furthermore, tax credits, incentives for the aggregation of leisure businesses, the National Tourism Fund and the Fund for Sustainable Tourism are four major instruments used to relaunch the Italian tourism industry.

> "Investors remain interested in the Italian hotel market because of how resilient it was during the pandemic."
>
> **CBRE Italy**

Hotel Chain Presence in Italy

Due to the fact that most hotels in Italy are traditionally family-owned, which has long formed an obstacle for foreign investment, hotel chains have yet not made major inroads into the market. In fact, quite the opposite.

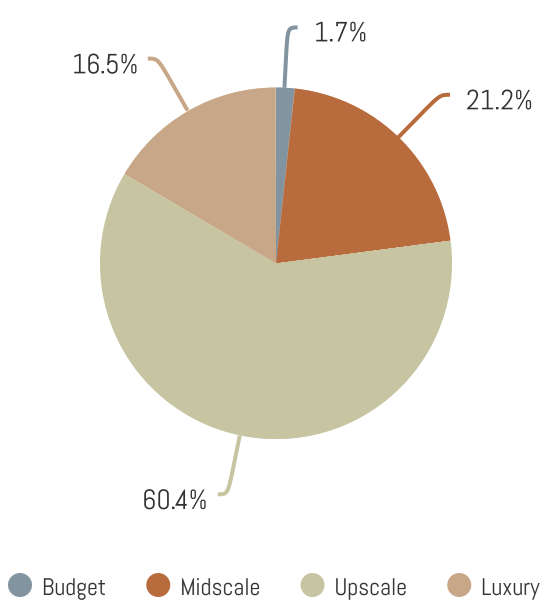
2021 shed a light on the affects of the pandemic, while the hotel stock declined by 528 hotels, only 3 were lost by hotel chains, proving them to be more resilient to the effects of the pandemic. Domestic branded hotels also showed a stronger loss compared to international, with a loss of 15 hotels.

in 2021 72% of new keys added to the market belonged to the Upscale tier (72%) while the luxury market saw a growth of 14%, midscale saw a growth of 13% and the economy segment 0.2%.

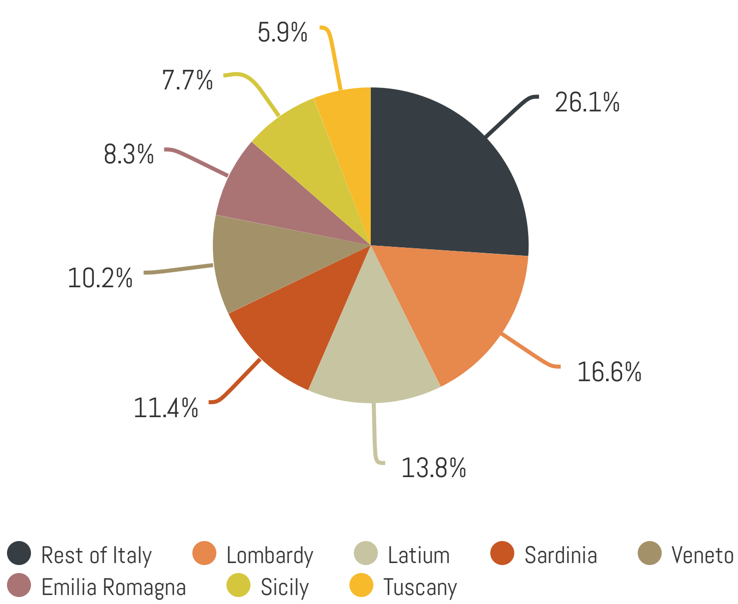
The most common business models executed by international hotel chains in Italy are lease and ownership, accounting for 41% and 34% of the total chain hotels. Furthermore, 19% is composed of franchising, and 6% is composed of management contracts.

The presence of hotel chains is most dominant in Lombardy, Latium, Sardinia and Veneto. The strongest presence at the moment is in Rome. However, compared to last year, Venice and Genoa recorded an increase in terms of rooms and hotels showcasing the preference of hotel chains to enter into the upscale/luxury market. General interest is also shown in the development of secondary midscale and business hotels.

Composition chain hotels



Presence of chains in Italy



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The post COVID opportunity

Many hotels assets currently on the market can be divided into three categories: COVID distressed, unsuccessful generational change and poor management . The reason for sale may also be a mixture of those.

COVID distressed: these are hotels that typically have been in the family for decades, due to poor management and lack of CAPEX, which affected potential ADRs and ORs, these hotels have run into debts over the years. The final blow has been the COVID pandemic. These hotels are usually relatively cheap since the asset is purchased from a forced seller. One may consider investing in these assets as high risk - high reward. This is due to the excellent repositioning opportunity and low price, but there is obviously development risk involved.

Unsuccessful generational change: These hotels, again, have usually been in the family for decades. They typically have fairly healthy balance sheets, as they have been fairly well run in the past. The owner wants to retire but has no obvious successor, so wants to liquidate the business. These hotels are usually not cheap, but are also not in need of a lot of additional CAPEX. Therefore the risk is lower, but so is the ROI.

Poor management: These hotels are usually owned by a firm or individual who has more experience in construction than hotel management. The hotels are usually fairly new and well-maintained. They however have not been well positioned and marketed. These assets can be relatively expensive since the owner is trying to minimise capital loss. However, they offer an excellent repositioning opportunity.

The post-Covid situation in Italy provides a unique opportunity for value added real estate investments in the mid-market hospitality sector, all the three different types of categories mentioned come together and provide an opportunity that is rarely seen in Europe.

The result is an interesting supply of assets in prime tourist locations that either need redevelopment of the entire structure, or at least of the hospitality concept applied.

Many structures have been run in a very traditional way, providing mainly bed and breakfast services. If these structures are acquired at reasonable prices (reflecting the state of the asset and past performance) and redesigned to accommodate new concepts of hospitality, the upside potential is very interesting. Next to increasing the average daily rate (ADR) and occupancy for rooms, additional revenue streams linked to entertainment can provide a strong boost to the overall returns on investment. Many concepts of more holistic experiences are readily at hand in Italy (culture, gastronomy, nature) and some may be developed further in collaboration with local and regional authorities and entrepreneurs. The NGEU support facilities are already being used to enhance tourist infrastructure in many places in Italy, which dovetails well with the development potential of hospitality assets.

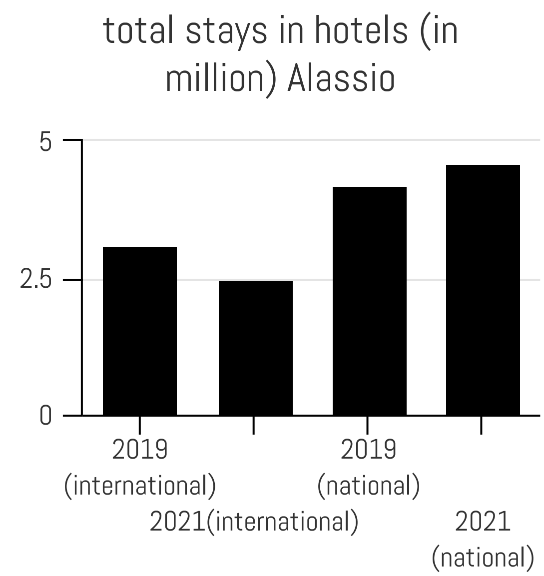
In short, we are at the beginning of a new era for the Italian hospitality sector, the time is right for the next generation of hospitality services in a country that provides all the opportunities required for solid returns on investment.

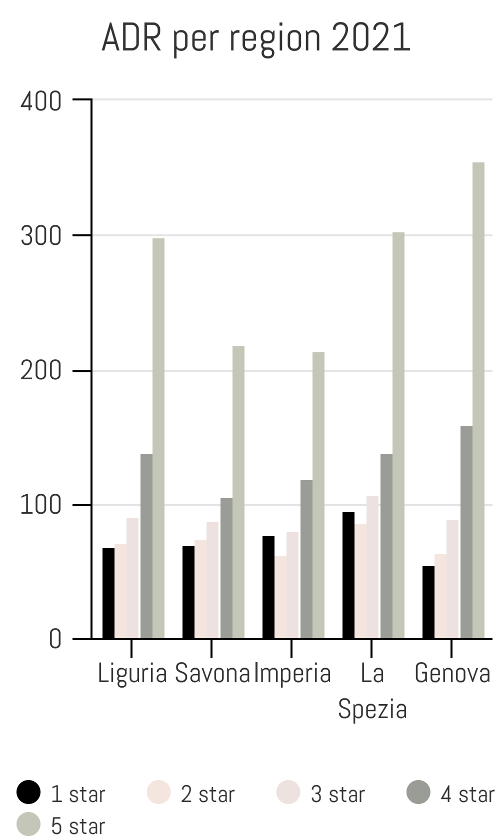
Dare to be different

Italy has long had a culture of family owned hotels, this can be traced back to the period after world war 2 when the Italian economy experienced a boom and became on of the main powerhouses of Europe. This tradition is still present to this day, with most hotels in Italy being owned by a family and only about 1600 (of the total 33k) hotels being owned by hotel chains . This has long been the biggest obstacle for foreign investment. The post-covid pandemic economy and unsuccessful generational changes will however alter this situation and make the market more accessible for foreign investments.

Successful investment is based on value for money and a clear vision of future trends. Institutional capital is entering the Italian hospitality sector in the most crowded segment (Rome, Milan, Venice, Florence), which is perceived to be the safest as well. But given the prices charged, the of margin of safety is lost. Currently a lot of tourism in concentrated in these cities. This also means that the hotel markets for assets in these regions is quite concentrated, demand is very high, supply however; is quite low, entailing overpriced assets and medium to low returns. We believe that the best investment opportunities can be identified by doing thorough homework, by zooming in on very specific assets in very specific places.

It should be noted that there is a lot more to Italy than these main cities, there are many more upcoming regions. For example, the Liguria region. This region sees an average of 4.787.820 arrivals a year, which has been growing by an average of 3% over the years (pre-COVID). The most common places for overnight stays for this region are hotels (29.5%) and in 2019 there was a total expenditure of over 915 million Euros in the tourism sector.
An example of a rapidly growing coastal town in this region is Alassio, which is currently recovering from the COVID pandemic in a healthy way. With tourism visits already expanding by 25% between 2021-2022. In growing places like these, assets can be bought quite cheap, while ADRs and revenues are bound to increase each year.





Case Study: Distressed

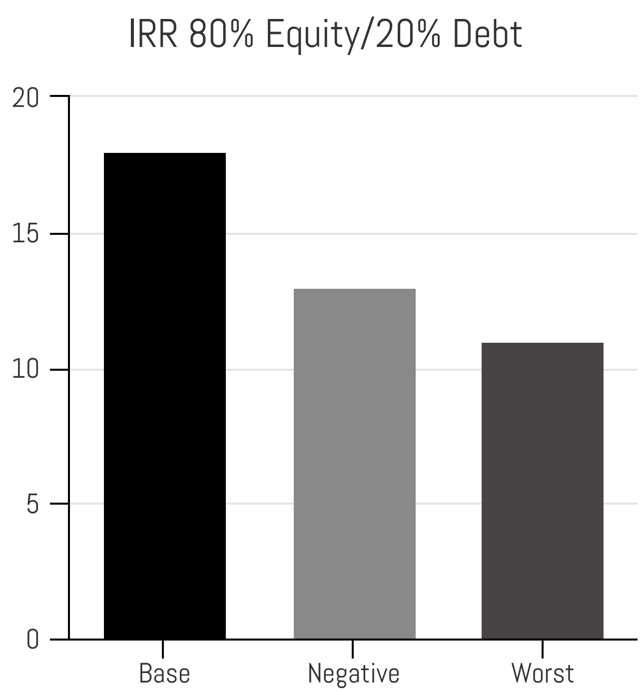
An interesting project we got involved in last year was a boutique hotel in the Amalfi coastal region. This asset had been run by a family for over a century. Over the years, the hotel was treated with neglect whilst the family focused on the famous restaurant within the property. Due to a structural lack of capital expenditure over the years, the hotel was left in a relatively poor state.

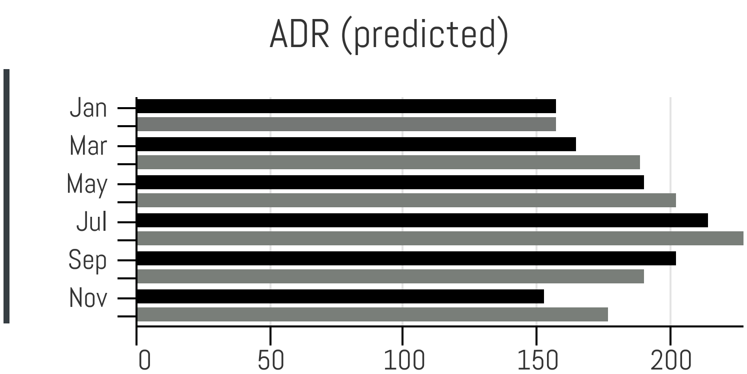
This of course had a huge impact on the ADR, the hotel however still remains very popular, despite the conditions of the rooms and overall building. How is this possible?

People visit the Amalfi area for its culture and excellent gastronomy, this asset is the very embodiment of typical Amalfi culture. The restaurant is amazing, the location beautiful and the family very welcoming of its guests. This combination can keep attracting guests from all over the world. This means that even with a relatively low ADR and a clear disconnect between the level of the hotel compared to the restaurant, the asset still generates an IRR of 8%. What would happen if you modernise this, whilst maintaining the authentic Italian atmosphere that makes it especially attractive?

Unfortunately, due to poor management of finances, the family has been involved in a debt restructuring process. COVID was the final blow and their assets are being sold to cover the debts. This is where we came in. We involved our local team and started to design a relaunch of the structure, with the end goal being an attractive investment case coupled with detailed architectural restructuring plans to lift both the hotel and the restaurant to the level it merits (4 stars).

The end goal was an IRR of 18%, more than doubling the current level, with a solid balance sheet and a future-proof hotel concept, coupled with an exquisite dining experience.This example showcases the current state of part of the Italian hotel market. There are many underutilised assets that have suffered from years of underinvestment and poor management practices. With the proper repositioning, these can flourish and represent excellent long term investment opportunities.





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What do we offer?

Our service offering is based on the unique opportunities we see for Italian hospitality assets. We see a shift in foreign investment towards more targeted upcoming areas and we want to facilitate this process by being the bridge between foreign capital and high quality opportunities in the Italian hotel market.

We believe that now is the best time to step into the Italian hotel market, due to a strategic change in the dynamics of market. We however believe that strong guidance is needed in this complex market, we therefore provide a team of specialists to offer a turnkey solution for every transaction we are involved in.

Our turnkey solution offers:

- Due diligence
- The structuring of the acquisition
- Legal guidance
- Project design
- Financial guidance
- Project execution
- Matching the right hotel operator to your asset

We stand behind every asset we represent and want to enable a transaction that adds value for both the seller and buyer. With our background in finance, investment banking, law and accountancy, we can provide the proper expertise required to achieve this goal.

Our work method

1

Sourcing

We use our broad network to source potential assets. We are very selective in our sourcing and do not accept all assets we find or receive.

2

Due diligence

Once we have identified an interesting asset we conduct a thorough background check on the financial history and owner(s). We also make sure that there are no legal issues involved with the asset.

3

Commercialise the asset

Once the due diligence process is completed we start to market the asset. We work selectively and make sure that the right asset is marketed to the right firm.

4

Transparency

Once we are in contact with an interested party we provide a business case, presentation and any other legal or financial documentation the party requests. We pride ourselves on full transparency.

5

Execution

Once the green light is given to execute the project we offer our dedicated Turnkey solution to make sure an investor receives the proper guidance. We offer Legal, Financial, Management, Architectural and construction support.

Our Team

Founder
Cor Dücker

Consultant & Analyst
Felix Dücker

Associate
Cruiz Llupa

Senior Architect
Boris Van Eijsden

Senior Lawyer
Francesco Pingitore

Advisor & Business Consultant
Marco Marzorati