Brexit – Hospitality Sector Analysis

The upcoming referendum on the UK’s membership in the EU is likely to have a significant impact on the hospitality sector. With many travellers reliant on the EU freedom of movement, London being a centre for hotel investment and location for the EMEA headquarters of several global hotel operators, there are likely to be consequences for the hospitality business if the Brexit occurs. This note considers some of those consequences and considers possible contingency plans.

The consequences of a vote to remain in the EU are likely to be minimal (although a narrow yes vote could also lead to uncertainty). In contrast, a vote to leave may result in several scenarios all of which present uncertain consequences. This uncertainty will likely continue for several years after the referendum, as a leave vote will not result in an immediate exit from the EU, but it will instead trigger at least two years (most likely more) of further negotiations.

Given the potential short term and medium term impact of a leave vote, players in the hospitality industry may wish to consider new structures for their investment and contractual activities. Additionally, they may wish to start contingency planning for both the immediate and (at a high level) long-term risks of a Brexit and to identify the consequences and how they might be mitigated. These include:

- immediate consequences, such as market disruption, a depression of Sterling and Euro (and consequently on investments and capital positions) and the impact of the resulting uncertainty;
- longer term consequences of loss of market access to the EU and potential regulatory change following a Brexit.

Planning for Day 1

Although a vote to leave will not immediately trigger a Brexit, there may be significant implications for the hospitality industry in the immediate aftermath of such a vote. If no specific contingency planning is in place, investors in hotel real estate and hotel operators may wish to consider prior to the referendum, as part of their risk management framework, the immediate risks of a Brexit and to prepare appropriate plans to mitigate said risks. Immediate implications are likely to include:

- market disruption, including a depressed Sterling and Euro and possible credit rating downgrades for investments into UK real estate. Investors and Operators should consider the potential impact of market volatility on their investments, capital position, liquidity and identify where it may be possible to implement strategies for mitigating risk, such as hedging;
- in the case of hotel real estate investments by funds, the funds may wish to inform their investors about possible impacts of a Brexit;
- withdrawal of investment capacity. Whilst hotel real estate funds may need additional capital to respond to volatile market conditions for UK investments, such conditions may make it difficult to raise capital. In particular, foreign investment in UK real estate is likely to reduce pending clarity on the position of UK as to remaining in- or outside the EU.

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1 We have set out an in depth critical analysis of the possible outcome of a vote to leave in our Britain and Europe thought leadership page.

2 The Bank of England announced on 7 March that it will offer three additional Indexed Long-Term Repo (ILTR) operations in the weeks around the EU Referendum to assist banks with liquidity which may alleviate some of the risk to liquidity within the financial service industry.

3 Note that the regulator has raised concerns about hedging around the Brexit risk and this should be considered.
Planning for Medium to Long Term Impacts

Since the exact impact of a vote to leave is as yet unclear it is probably too soon for the industry players to be making detailed plans. However, it would be appropriate to identify the key aspects of the industry which may be affected by the UK being outside the EU and the issues which will need to be addressed in more detail as the likely relationship with the EU after a Brexit becomes clearer. The key long-term consequences of an exit from the EU for the hospitality sector may include:

- changes in the recruitment strategies and potential for UK based companies, as freedom of movement is part of the EU Article 45. This would no longer apply to EU citizens working in the UK and vice versa so that the necessity of work permits arises. However, grandfathering provisions may be agreed to allow EU citizens to continue to work and reside in the UK and vice versa;

- having to take into account that a Brexit may cause difficulty in recruiting non-UK employees as the location UK may become less attractive to overseas employees due to increased formalities, possibly different social regimes applying, and a possibly depressed Sterling so that certain compensation measures, e.g. complementary flights home, increase in salaries for non-UK employees to compensate for potential repercussions may have to be considered;

- having to take into account that flexibility of hotel personnel and the possibility to move around within the EU will be limited in relation to the UK;

- review of and changes to supplier or operational contracts as the single market treatment will no longer have to be adhered to, if negotiable. On the other hand, the benefits of the single market will no longer apply for UK operators’ operations in EU countries;

- in light of transactions, it is yet unclear whether there will be a long-term impact which would need to be taken into account in transactions involving UK hotel businesses as the UK would no longer be part of the EU regulations coverage on working time regulations and transfer of undertakings;

- investments in UK real estate by EU based investors or in EU countries by UK based investors may become more difficult and costly due to regulations set in certain countries regarding the obtaining of property by non-nationals. Denmark is an example for such restrictions on land acquisitions by non-EU nationals;

- the possible change in attractiveness of property in the UK for investment funds and especially the attractiveness of hotels already available in the UK if it were outside the common market of the EU;

- the processes involved in acquiring or selling a hotel in the UK once it is outside the common market;

- the possibility of relocation of head offices and individual businesses from the UK into the EU to return to the common market for simplicity and the thus resulting loss in travel to said head offices and businesses.

In relation to changes in business and leisure travel behaviour some changes in connection to air travel, travelling in general and travel requirements may potentially occur following a Brexit.

The key changes in this area can be confined to the following:

- rise in air fare due to the possible expulsion from the European Common Aviation Area (ECAA) and the possible resulting loss of competition as a Brexit could limit the effects of the ECAA allowing for airlines of all member states to operate unlimited in Europe and the UK. Additionally, the ECAA requires airlines to operate under the same regulations in all European countries. If this would no longer apply in relation to the UK, this could reduce competition further;

- as an effect of the expulsion from the ECAA, European countries would be in a position to levy higher fees on UK airlines. This would also change for the UK in relation to non-UK based European airlines;

- The risk of an immediate reduction in the value of Sterling could result in a continued devaluation as against the Euro and so impact the hospitality industry in two respects. The first being a potential increase in travellers from EU countries into the UK due to reduced prices and the possible adverse effect of UK citizens decreasing their travel into EU countries for the same reason. The effect would be reversed if a Brexit were to cause a long-term depression of the Euro;

- end of freedom of movement leading to the likelihood of stricter border controls.

Suggested steps for the hospitality industry to prepare for the possibility
of a Brexit are set out below. Industry players may need to:

1. identify whether work visas and permits may have to be renewed or specifically obtained, depending on the country, and consider possible changes in regulations and standards which may have to be met to secure said visas or permits;

2. take into account potentially necessary work visas and permits which may be applicable to some of the staff. Additionally, identify possible delays for said work visas and permits to ensure that they are available if and when they become necessary;

3. consider if a loss in guests from either the UK or the EU or specific clients such as business guests may affect the respective hotel in a manner that makes re-orientation necessary;

4. evaluate the position on investments in UK real estate from a fund regulatory point of view;

5. evaluate the impact on prices of real estate in the UK and specifically London as these may be subject to fluctuation. This could make an adjustment of portfolios and funds for risk mitigation necessary.

OTHER ISSUES TO CONSIDER

- Employees – uncertainty about status of EU citizens employed in UK and UK citizens employed in EU and possible changes in employment law.
- Supply networks – depending on UK import taxation it may be necessary to find alternative sources for certain goods and services and costs for those may increase.
- Data Protection – UK may choose to implement a less stringent data protection regime.
- Real Estate investments may become more difficult during the period of uncertainty and certain investors may not be as active in the UK after a Brexit.
- Enforcement of judgments – the UK may need to negotiate new treaties on enforcement or potentially risk creating enforcement issues for English judgments in the EU.
- Consequences for Gibraltar whose access to EU is dependent on the UK and for Scotland which may try to stay in the EU.
- Loss in EU wide applicable health care. Meaning that travellers to the UK will have to apply for a travel health insurance or travels from the UK may face increase insurance premiums as UK insurers would not be able to recover the cost of certain treatment, but would need to provide cover.
- The possibility of a layover period in which the UK is preparing for the Brexit but still has the rights of

Other Brexit Publications by Clifford Chance

We are at the forefront of developments regarding Brexit and are continuously providing analysis and insight, examples of which can be accessed here:

- Brexit – assessing the first draft of David Cameron’s European Union deal
- Brexit: The UK Referendum on EU Membership
- Brexit – Insurance sector analysis
- The New EU/UK Deal: The impact on UK banks and the Brexit debate
- Brexit – assessing the impact on asset managers
This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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