IHG's Race to Avoid Defaulting on More Than 100 Hotels: What's the Fallout?

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An IHG default on hotel payments in July could lead to the first large opportunity in North America for another brand to take over those properties, all directly a result from the coronavirus pandemic.

IHG defaulted on $8.4 million in guaranteed property returns this month across 103 hotels owned by suburban Boston-based Service Properties Trust, the real estate firm claims. The portfolio — three InterContinental properties, five Kimptons, 11 Crowne Plazas, three Holiday Inns, 20 Staybridge Suites, and 61 Candlewood Suites — is spread out across the U.S., Canada, and Puerto Rico.

But if Service Properties Trust terminates its franchise agreement with IHG, the smaller Sonesta International Hotels Corp. stands to benefit.

"If IHG is not prepared to continue paying us our returns on these important assets, we believe that the rebranding of these hotels with Sonesta will benefit SVC [Service Properties Trust] as an owner of Sonesta, create greater flexibility in managing these hotels through these challenging market conditions and may have a positive impact on these hotels' performance during their expected recovery," SVC CEO John Murray said in a statement.

SVC, which owns a 34 percent stake in Sonesta, sees a greater upside in a management agreement with the smaller hotel brand. While coronavirus dampened performance at all 329 of SVC's hotels, the 53-hotel Sonesta division has "been among the least negatively impacted," Murray added.

Sonesta is also based in suburban Boston and includes the Royal Sonesta, Sonesta, and Sonesta ES Suites flags. While a bulk of Sonesta's portfolio is in North and South America, the company also has a presence in Egypt.

"The Sonesta brand has been around for a time, but they have been challenged with growth," said Evan Weiss, chief operating officer at LW Hospitality Advisors. "This may be a bit of an opportunity for SVC to come out of their shell from a branding perspective and supercharge their overall unit count."

Sonesta referred Skift's request for an interview to SVC, which did not respond to multiple requests for comment beyond the default announcement.

Hotel executives from Marriott to Hyatt all touted brand conversions — where a hotel owner changes brand affiliation from one flag to another — on earnings calls at the start of the pandemic as a key source of short-term growth during the downturn. But most of those projections were tied to independent hotels taking on the flag of a bigger brand.

A potential 103-hotel conversion deal involving IHG would almost certainly become the highest-profile kind of North American transaction directly tied to the pandemic. SVC's Sonesta conversion push comes as a more than 400-hotel division of UK-based budget chain Travelodge weighs converting to a different flag — likely either Accor, Magnuson Hotels, or Oyo.

"I think you'll see weaker brands and/or independents convert over into the big branded players," IHG CEO Keith Barr said during a first quarter earnings call earlier this year. "So I think that will be something to help us. But it's really hard to have any visibility on what growth is going to look like in the next 12 months until we have more sense for how countries reopen and how construction reopens."

IHG's Deal to Lose

IHG can still save the portfolio, but Weiss noted it is unusual to see such a large payment guarantee across market sectors like the IHG-SVC agreement. Usually bigger brands will limit guarantees to more high-end segments like InterContinental rather than more economy chains like Candlewood Suites.

IHG has until August 24 to make a payment plus interest to avoid termination of its franchise agreement, Service Properties Trust said in a release. SVC's agreement with IHG calls for yearly minimum property returns and rents of nearly $217 million. IHG has another $17.4 million payment due Saturday, SVC claims. If that payment is missed, SVC plans to issue a separate default notice.

"I can confirm that we have received notification of default and termination from SVC," an IHG spokesperson said via email to Skift. "Given this is a commercial matter we cannot provide any further comment."

Given the uncertainty in future travel demand due to coronavirus, IHG's lack of payment could be strategic. The global hotel brand may want to cut its losses while in survival mode rather than get stuck with a widespread payment guarantee eating into cash reserves during a volatile industry recovery.

"This severe drop could last another 12, 18, or even 24 months, and then what? How much more capital does this end up costing IHG?" Weiss said. "Those annual returns and guarantees in rent may grow into a significant liability over time. I don't know if that's precisely what's happening here, but it would make sense if it was."

Should IHG default and not make a payment, the franchise agreement would end at the end of November. SVC would be able to maintain IHG branding for a year following termination.

"SVC and IHG have had a long relationship and we are in regular dialogue with them," Murray said in a statement. "We hope IHG cures this default so that we can move forward without a termination and rebranding. However, it is important to SVC that we enforce our agreements and seek to protect our bargained-for cash flows so that we can pay SVC's operating costs and other obligations without interruption."