The year of crushing debt

Hotel industry experts say the recovery will continue in 2012, but new builds are on hold, banks will call mature loans and debt restructuring will be tough for even fiscally healthy properties...

The US hotel industry is about to face a severe credit squeeze in the next six to 18 months, and an overall recovery is still two to three years away.

So say a number of experts in economics, hospitality financing, banking and development interviewed by Asian Hospitality to get a reading on what lies ahead for the 2012 hotel investment and lending environment.

Here is what we’ve learned:

• Bank financing is scarce, and almost all lending will be guaranteed by the US Small Business Administration or the deals won’t get done.

• Little to no money for new construction is in the pipeline, as existing hotels will upgrade on design and amenities to attract new customers.

• Brand parents that were holding back on PIP requirements for the past few years are now demanding that franchisees pony up on improvements to take advantage of the increase in occupancy rates.

• Banks will start to call on its mature debts, and even if a property is current on its loan, a commercial lender will look for a way to unload the debt, so great is the pressure from the FDIC on banks with portfolios heavy in commercial real estate loans.

• The European debt crisis is influencing US lenders to lower their sails as the winds of economic uncertainty cross the pond.

The outlook is not totally dark and cloudy, however, as lower property values are attracting private-equity investment; and hotels that are part of a healthy portfolio may be in line for a significant influx of cash. So far this year, there have been 172 deals in the US dining and lodging sector, valued at $13.1bn compared to 129 deals for 2010, valued at $14.9bn, according to Dealogic, New York.

‘From the private equity perspective, I have seen a lot more interest in the sector,’ said Ashish R. Parikh of Hersha Hospitality Trust of Philadelphia. Some of the largest buyers include Starwood Capital Group, Noble Investments and those that have been backed by private equity.

‘Looking at the overall market, stock prices have come down 25 percent from their peak,’ he added. ‘The industry fundamentals are good, but the macro-environment still gives investors trepidation.’

Because the private equity market is not homogenous, it’s hard to have general answers, said Dr. Bjorn Hanson, dean of the The Preston Robert Tisch Center for Hospitality, Tourism, and Sports Management at NYU. The big investment picture features a variety of profiles ... and there are more than 100 private equity funds that have either past, current or expressed interest in hospitality,’ said Hanson. ‘So we are highly likely to see an increase in 2012 over 2011.

Banks, too, are lending, said Nitin Shah, president of Imperial Investments Group and chairman and CEO of Embassy National Bank, as the SBA financing programs continue to offer some hope to hotel owners seeking to refinance. The reason being the SBA program allows banks to hold on to their capital reserves because an SBA loan requires the use of less capital than a conventional loan, said Shah. ‘For example, a bank set to loan $1m to a hotel owner will use up $100,000 in capital on that deal, but a bank working with an SBA guarantee will spend only $25,000 on the same size loan. This means, with SBA programs, we can lend four
times more than with conventional loans.’

Shah said although the US hotel industry is forecasted to recover by 7 to 9 percent in RevPAR this year and although many hotels are in good positions to borrow, the lending environment for banks is not in concert with the uptick in hotel revenue. ‘Every bank wants to preserve their capital for future losses.

‘As long as the $1.2bn in SBA programs is not the victim of (congressional) budget cuts, we should be fine. The SBA programs are the best routes for banks and for hotel financing right now.’

What’s the overall message for hotel owners big, medium and small? Be prepared.

A hotel owner in search of refinancing or equity borrowing ‘will have to do extra leg work,’ said Rajeev Dhawan, director of the Economic Forecasting Center at Georgia State University’s Robinson College of Business. ‘Do not take it for granted that just because your loan is good and your property is good that you will get the loan. You will have to prove to the lender that you are worth it.’

Parikh of Hersha Hospitality Trust, agreed. ‘Talk to your lenders early and often. Explain your situation and prove that you are the best owner of that asset, prove that you’re an integral part of the business’ success and that you are working very hard to pay them off.’

Both Dhawan and Parikh said a bank may require a cash-strapped hotel owner to bring some ‘fresh equity’ to the table as a further sign of the borrower’s commitment. If the property holds equity, bring that or ‘bring in new partners with fresh financing,’ said Parikh.

A rule of thumb in attracting private investment, said Hanson, is a hotel’s cash flow should be twice its RevPAR. ‘They want to see good, current returns from cash flow and capital appreciation. Private equity firms are scouring for companies with the best management, current returns and capital appreciation.’

Hotels under mandates to upgrade to brand standards may have no choice but to find a lender. Shah of Embassy National Bank said: ‘One move a hotel owner can make is to refinance the existing loan (with a bank) and include renovation money in the deal. If you want to refinance a $2m existing hotel loan but also wish to make $300,000 to $400,000 in renovations, then arrange a loan for $2.4m or $2.5m. Another option is to arrange an FF&E loan; indeed several lenders are making such loans,’ Shah said, ‘but these loans can be expensive due to higher interest rates.’ A $100,000 loan for a lobby remake, for example, can carry a 9 to 10 percent rate.

The lending market will be crazy with refi and reno activity, predicts Steven Siegel, head of Hospitality CPM, a wholly owned subsidiary of Paramount Hotel Group. ‘Hotel owners have squeezed back on spending in an