

*Real estate lending experts at this year's conference gave insights on factors that can wreak havoc on a hotel loan, as well as ways to move a distressed property back into the black.*



More than half a decade has passed since the end of the last recession, and the current climate for hotel values, performance, and transactions has improved distinctly on nearly all fronts. One of the harshest causes and consequences of the downturn, however, still poses a threat to the hotel and commercial real estate industry in the U.S., namely, non-performing loans.

The fourth annual Trigild Spring Lender Conference, held at Dallas's Hotel ZaZa in late April of this year, focused on educating a range of commercial real estate stakeholders (including hotel owners and investors) on the unique issues arising from non-performing loans. Conference host Trigild is a leading hospitality, real estate, and fiduciary services firm with 40 years of property management, asset management, receivership, and bankruptcy experience. Here are some of the key takeaways from the Trigild conference.

## What Sends Hotel Loans into Special Servicing?

Panels at the Trigild conference focused on topics such as characteristics of loan maturities, CRE loans, alternatives to bankruptcy, successful resolutions, and adding value to "tough" assets. Moderated by Alan Feld of Sheppard Mullin, the "Special Properties, Special Problems" panel discussion gave insight into the special servicer's perspective on hospitality loans. Panelists included Eric Pruitt (Baker Donelson), John Kapit (LNR Partners), Jackie Mahoney (Sabal), and David Bornheimer (PNC/Midland).

According to this panel of experts in hotel and hospitality lending, three events most commonly trigger the transfer of hotel loans to special servicing. The first is the expiration of a hotel's franchise agreement at or close to loan maturity, a situation that increased in frequency in the wake of the recession as hotel owners lacked funds to keep up with brand requirements. This led in many cases to a loss of flag and the downgrading of the property to a lower-tier brand or a transfer to independent status—which puts a property out of the valuable brand reservations system. Both outcomes can decrease a hotel's performance and value.

Other triggers were identified as problems in refinancing at loan maturity and new hotel supply negatively affecting performance. Hotel loans are often highly leveraged; hence, special servicers

closely scrutinize hotel valuations, particularly whether the valuation conclusion is based exclusively on peak performance parameters or whether it reflects other, less favorable performance scenarios like those described above.

## What Does Hotel Special Servicing Entail?

One of the first steps of the special servicing process is to secure a pre-negotiation agreement and a "Comfort Letter"—that is, a tri-party agreement between the owner, the lender, and the licensor. Special servicers then evaluate the collateral in terms of a hotel's location and product type. In addition to evaluating the vigor and competency of a hotel's management and/or ownership, special servicers look at the strength of brand, the status of property improvement plans and the borrower's ability to fund necessary renovations, market conditions and the hotel's competitive set, market seasonality, barriers to entry, and new product competition.



Approaches to distressed hospitality loans will also consider reserve requirements relative to required capital expenditures, the ability of the borrower/sponsor to recapitalize and mitigate franchise termination risk, the existing capture of cash flow and projections, and a net present value analysis. Strategic options include receivership, discounted payoff, modification, foreclosure, forbearance, deed-in-lieu, note sale, and borrower workout, representing a wide range of options that require considerable expertise to navigate successfully. Some routes prove more fruitful than others do when it comes to a given hotel's situation, but hoteliers were encouraged to investigate, with professional guidance, all available recourses to resolving a distressed loan.

Panelists reinforced that a key issue encountered with transferred hotel loans is expired or terminated franchise agreements. Extensive property improvement plans (PIPs) require owners to invest in significant upgrades. New and evolving brand standards mandated by the franchisor often come with significant capital expenditures. The risk of franchise/management agreement expiration and loss of flag is especially magnified for older hotels.

## How Performance, Lending Standards, and Oil Prices are Affecting Hotels

Current trends reveal a steady upturn in lodging performance over the past several years, and experts at the conference expect this to continue for at least another year or two. The strong standing and forecasts for U.S. hotel performance and values have eased credit underwriting standards for new hospitality CMBS loan originations. There is also significant liquidity in the current market and increased demand for hotel loans.



One discussion from a separate panel concerned how declining oil prices are affecting real estate values. With respect to hotels, the concern over oil prices has mostly to do with a decline in hotel demand in energy-rich markets that threaten to shut down exploration, drilling, and extraction operations. Markets in eastern Montana, western North Dakota, and throughout the Eagle Ford Shale in South Texas famously experienced a boom in lodging demand during the rush. Hotel rooms could not go up quickly enough; some oilfield workers were sleeping in the backs of trucks in wait for more comfortable accommodations at an under-construction limited-service hotel. While a dearth in demand since the fall in oil prices poses some challenges for hotel owners and lenders in these markets, the situation has not become as dire as many feared.

## Looking Forward

It is not easy to generate enthusiasm when the topic is distressed, multimillion-dollar property loans. Still, the constructive emphasis of the Trigild conference was on education—that is, what lenders and hotel owners can do to work out a loan and improve a property's positioning, as well as what mistakes to avoid as the industry moves forward. Much centers on hotel performance, on which the consensus is overwhelmingly optimistic. Experts also related encouraging cases involving alternatives to bankruptcy and examples of successful resolutions. The optimism should reign in the near term, giving struggling properties some points of promise.

## About the Author



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