Hotel & Motel
MANAGEMENT
www.HotelMotel.com

Investment community warns of default risk

October 15, 2001
By: Jeff Higley
Hotel & Motel Management

National Report-The lodging industry's uncertainty after the Sept. 11 terrorist attacks could present problems for hotel operators who were struggling before the events in New York, Washington and Pennsylvania.


Cahill

Members of the Lodging Industry Investment Council, an organization comprised of 60 executives who work in the lodging industry investment community, said during a conference call in late September that there's risk of increased loan defaults because of the tragedies.

"We have to look at the smaller operators, the borderline operators, which are a vast part of our industry," said Morris Lasky of Lodging Unlimited. "The limited-service people who, each month, struggle to put together their mortgage payments and their real-estate tax payments-these are the guys who are going to suffer the most.

"I'm afraid that these properties are going to be pushed over the edge," he added. "The foreclosure rate from our point of view looks like it will increase. We've been tracking a lot of properties that the lenders have been concerned about with the reduction of business and long-term perspective. Lenders are going to be much more aware of these properties and probably become much more aggressive in the attitude about them."

That means that there could be opportunities for buyers to cash in, according to Mike Cahill of Denver-based Hospitality Real Estate Counselors. Cahill also serves as co-chairman of the LIIC.

"There are some hotels out there that have been teetering … and this whole situation may put some of them under," he said. "I hate to see anybody taking advantage of the situation, but I think some vulture buyers may find some opportunities."

Dana Ciraldo of Hodges Ward Elliott said some of his clients have expressed interest in acquiring assets that are in trouble.

"Since [the attacks] I've had two conversations with prospects [who] have asked me about the viability of raising money because they sense vulture opportunities in the lodging industry," he said.

"Certainly the ownership community is greatly concerned," said Mark Tobin of HREC Asset Management. "Fixed expenses do not go away, nor do they change, nor do I know a mortgage company that's providing hotel owners any relief. For our clients, who are predominantly owners, the real question is how do we get through what is the emotionally charged environment we're in and get back to an environment where we understand the nature of our business and what is the nature of that business with regard to actual demand vs. demand that is perceived by our managing agents."

Frank Nardozza, managing director, KPMG Consulting, which sponsored the conference call, said there are obvious buyers of troubled properties.

"The high-yield funds that bought up properties in 1992 just coming out of the last recession are going to resurface for similar buying opportunities," he said. "There may not be as many because it's not the same heavy debt-loaded property as a common profile. There'll be enough of them to take a look at."

Steve Kislelica of Strategic Hotel Capital said potential buyers might not be able to secure financing.

"Unfortunately, this current environment, particularly how lenders are approaching the transaction, it's just kind of a time out," Kislelica said. "From a buy perspective, we would take the same approach-at least through the end of the year and then re-evaluate at that stage."

Ben Matanga of Cornerstone Real Estate Advisors agreed.

"The acquisition/disposition model is sort of problematic at this point in time given the uncertainty of demand in the immediate future, but also structurally with the reduction/contraction of airlift capacity," he said. "You also have to be concerned with what's going to happen to the insurance market and how that's going to ultimately impact the value of the hotels. I think that's going to be a significant issue in terms of valuation and cash flows."

Mike Schiff of Cendant Corp. said his company recognizes the potential of increased default rates and is working to help its franchisees avoid them.

"We've redistributed some of our personnel to be available to assist our franchisees in evaluating what their challenges are and helping them get through these potential tougher times," he said. "While we do have other human resources to deploy as needed, we have not yet seen any need to do so."

The uncertainty in the airline industry, particularly the number of flights being cut from schedules, also is impacting decision-making in the lodging industry.

"Business travel is directly proportionate to what the airline industry sees happening in their markets. If they're forecasting such tremendous downturn in need, that probably interprets somehow into the need for hotel rooms in some of the major urban areas," said Ted Brumleve of Brennan Beer Gorman.

"What you need to weigh in a little bit with these airline layoffs and reduction in capacity is that it's not an even 20 percent across all markets. We're hearing that with Hawaii, the flights going out there have been cut back much more than 20 percent. It's going to have a huge impact on destinations like that," said Rich Niedbala, Lend-Lease Real Estate Investments.

Pat Culligan of The Hospitality Consulting Group warned that regardless of the region or segment a hotel is situated in, operators must refrain from offering bargain-basement-type room rates.

"In a declining market, that's one of the first responses for a lot of hoteliers," Culligan said. "A three-month heavy hit can take two or three years to recover in terms of real rate growth."