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LIIC members foresee mixed financing climate

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EDITOR-IN-CHIEF

LOS ANGELES—The need for hotels to change ownership will increase as the year progresses, but there won't be a glut of defaults and bankruptcies, according to members of the Lodging Industry Investment Council who participated in two HOTEL & MOTEL MANAGEMENT-sponsored roundtables held in conjunction with the Americas Lodging Investment Summit.

The roundtables, held in late January at the Los Angeles offices of the law firm Jeffer Mangels Butler & Marmaro, revealed that many LIIC members see 2003 unfolding as a year in which the lodging industry begins its return to normal. The capital end of the business will cause much of that turnaround.

"I'm anticipating [that] this year there will be a lot of friendly turnovers," said Frank Nardoza, chairman and c.e.o. of Fort Lauderdale, Fla.-based REH Capital Partners LLC. "You have the guy who's been reaching into his blue jeans trying to make debt service on the mortgage and struggling with some issues, struggling in some cases just to meet payroll in certain off-months.

"There will be some transactions where the owner and the lender just come to terms and say, 'It's better off that we give you the keys and take day-of-the-move foreclosure' or whatever it might be because it is very costly for owners to go through that bankruptcy process."

The much-discussed notion of

Coming in our April issues:

LIIC members say tension between hotel owners and management companies is natural, and the economic turnaround could be right around the corner.

lenders giving hotel owners a break when it comes to debt service still is lingering.

"The sense I get from investors is they realize [that] where room rates and occupancies are today is the base from which they're likely to grow," said Sean Hennessey, director-hospitality and leisure practice for PricewaterhouseCoopers in New York. "Maybe if the economy picks up in a couple of years, somewhere down the road we may have a spike in room rates that will accrue to the benefit of owners.

"Again, it's not anything you want to make plans around today and certainly not anything that's going to flow into the values in a bankruptcy court context."

Hennessey said his PricewaterhouseCoopers expects to see a moderate rise in the default rate this year, which currently stands at less than 6 percent.

Jim Merkel, managing director of Columbus, Ohio-based Rock-Bridge Capital, said his company has taken back two of the 175 deals it has financed. The company tries to identify problems before the situation escalates to default.

"One [of the hotels it took] was a market problem, and one was a sponsor problem," he said.



LIIC members Jeff McKee (left) of GE Franchise Finance and Robert Swerdling of US Bancorp Piper Jaffray and the rest of the group's members see 2003 as the year the lodging industry begins to return to normal.

"There's a big difference. The one group we took [a hotel from], we've done additional deals with. We're going to be reasonable, and we're not going to create a bigger problem by taking an asset back when management or sponsorship is not a problem."

Jeff McKee, senior v.p.-hospitality for GE Franchise Finance in Bellevue, Wash., said his company takes relief to borrowers facing delinquency or default on a case-by-case basis.

"If need be, we're willing and able to make some adjustments," he said. "We're looking a lot at how you evaluate ahead of time whether the loan goes to default. We think we're getting pretty good at that stuff, but for the most part, it's pretty tough to start pushing on people [if] you want [1.4

times] coverage and they're at 1.38 [times]. How hard do you push?"

Nardoza summed up the general feeling of most, if not all, hotel owners.

"The key will be the perceived equity in the project," he said. "If someone perceives that they have a lot of equity, then they will struggle hard [to keep a property from delinquency or default]."

Siegel offered advice to hotel owners, regardless of the health of their economics.

"If you're a low-leverage borrower and proceeds aren't an enormous challenge to you, it makes all the sense in the world to lock in fixed [interest rates] today," Siegel said. "If you have a debt-service issue, which actually applies to much of our business, or you have

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a proceeds challenge, which is also very common today, what we're advising and seeing is go ahead and float at origination with either a swap into a fixed or a cap that protects you from a moving rate.

"It's an extremely advantageous time to borrow now, not just to ride out the wave in expectations of recovery, but the cost of capital is exceptionally low on the debt side and even the equity side."

Interest rates

A huge influence on the current state of financing is interest rates that are hovering at or near all-time lows.

Bernie Siegel, managing director-hospitality division of Secured Capital Corp. in Denver, said interest rates in most cases were lower than what most of the roundtable participants had on their home mortgages.

"We're also looking at the convergence of the expected recovery in revenues and profits with what happens to the interest rate mar-

ket," Siegel said. "There's a very big need and hope on all of the owners' parts of our business that those go hand in hand, and we don't have a spike in rate prior to recovery and profits because then it will only exacerbate what [others] are seeing and these trends of fall pick-ups and maturities that will not be able to be refinanced."

"There's one sort of mathematical structural problem, that is if interest rates have been at 5 [percent] or 6 percent and the economy recovers or there's a big budget deficit, interest rates can go up one

LIIC's mission

The Lodging Industry Investment Council is an industry think tank that meets three times annually to discuss hotel finance, development and operations issues. Its 70 members include consultants, lenders, operators, developers, educators and legal professionals.

Co-chairmen for LIIC are Mike Cahill of Denver-based Hospitality Real Estate Counselors and Sean Hennessey of PricewaterhouseCoopers' New York office. Vice chairman is Jim Butler of Jeffer, Mangels, Butler & Marmaro, a Los Angeles-based law firm.



or two points, which means 10 [percent] to 30 percent in a very short period of time—much faster potentially than the economy can recover," said Steve Van, president and c.e.o. of Dallas-based Prism Hotels and Remic Hotel Management Co. "[Revenue per available room] cannot go up as fast in terms of jumps in interest rates. That's what concerns me."

The low interest rates are driving many deals, particularly those involving municipalities, according to Robert Swerdling, managing director-public finance for US Bancorp Piper Jaffray, which is based in Hermosa Beach, Calif.

"With the capital bar having been lowered for municipalities, many cities that could not entertain having a 175-[room] to 200-room small conference facility, those deals are working at a 5-percent interest rate," Swerdling said. "We're having lots of conversations with those folks, as well as larger facilities that take large subsidies. [We] look for them to guarantee a portion of the debt service on a contingency basis. That replaces a need for equity, and we're able to finance, for example, the Denver Convention Center Hotel at 100-percent financing, closing out at about a 5.2-percent interest rate."

Mike Blahosky, first v.p. and regional director for CB Richard Ellis in Southfield, Mich., credited the low interest rates for creating one of the busiest times in his career.

"Everyone likes the interest rates," Blahosky said. "Obviously, there's upside in most of the deals intrinsically because the worst has happened. . . . Not all of the deals are going to pencil out, but there's a lot of activity on the sales side, [and] there's obviously a lot of pent-up demand on the buying side. This is going to be a good year for buyers and sellers. The reality has kind of come back. There are always bad deals, but this is going to be a very, very good year."

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► **Online** For a look at the complete transcript of one of the LIIC roundtables, visit www.HotelMotel.com.