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Lodging's financial gurus retain cautious approach

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LOS ANGELES-Meeting the money has never been easier. Actually taking it home is another story.

Mike Cahill delivers LIIC's Top 10 list during JMBM's Meet the Money. See story, page 14.

Speakers during Jeffer, Mangels, Butler & Marmaro's 14th annual Meet the Money conference at the Sheraton Gateway LAX Hotel had different views about whether lenders are beginning to loosen the purse strings for new hotel-development loans as the lodging industry continues to dig out of a three-year freefall.

"I'm not sure the discipline you heard at last year's conference is being shown," said Michael Levy, executive director of Morgan Stanley. "That's having a significant effect on valuation levels."

Jerry Earnest, executive v.p. of the specialty lending group for GMAC Commercial Mortgage Corp. said development financing has yet to reach widespread acceptance.

"The lenders generally aren't there yet," he said. "The fundamentals for projects haven't come together yet. As this year goes on, we will see some of that coming together."

Private companies have had more access to capital during the downturn-a fact that wasn't lost on conference speakers.

"The private buyer can leverage up a lot higher," said Bruce Wiles, c.o.o. for MeriStar Hospitality Corp., which is publicly traded on the New York Stock Exchange. "When somebody's playing with 70-percent first debt and then puts some [mezzanine] money in ... we have to back away from the table."

"The private buyer has taken on high leverage," said Joseph Green, president and c.f.o. of Winston Hotels, which is publicly traded on the Big Board. "In many cases, they're skating on thin ice. On the public side, we just can't leverage like that."

Green said Winston's maximum level of debt on a deal is 60 percent because the covenants of its credit facilities require the company to keep it low.

Bruce Wardinski, president and c.e.o. of Barcelo Crestline and chairman of the board of Highland Hospitality, agreed.

"The private buyers can put on levels of debt that public companies can't touch," said Wardinski, who last year guided Highland through its initial public offering on the NYSE.

However, the perceived financing advantage for privately held companies isn't curtailing a rash of companies that are filing for IPOs. CNL Hospitality, Strategic Hotel Capital, Capital Lodging and Eagle Hospitality are among the lodging companies that have filed for-or are exploring filing for-IPOs.

"There is an appetite for more public offerings," Wardinski said.

"Is there enough demand for the stock that's coming? We're about to find out," Wiles said. "Bruce Wardinski's timing [with the Highland IPO] was immaculate. When the markets allow you to raise equity, you have to take advantage of it."

Green said companies must seize opportunities for funding.

"Even in this environment, companies that don't have tremendous sponsorship will get [deals] done," Green said. "When the window is open, take the money."

Hotel companies-private and public-are finding ways to purchase hotels, and in some cases entire portfolios. CNL late last year acquired KSL Recreation Corp., and early this year The Blackstone Group acquired Extended Stay America.

Speakers urged caution about a possible acquisition frenzy.

"I worry about the last few buys," said Barry Olson, managing director of Archon Capital. "A lot of buyers are paying for the upside of the industry and it hasn't happened yet."

"There's still a risk to consider, especially if you're thinking about selling in three to four years," Wardinski said.

Levy said there is robust asset-level merger-and-acquisition activity and much of that is moving into public markets.

"There is a large number of hotel companies in Europe and the U.S. who want to be in each others' back yards," Levy said. "I would expect an explosion of brand consolidation in the next year or so."

The types of available capital also were a frequently discussed topic.

Earnest said mezzanine financing has never been more prevalent in the lodging industry.

"In the search for yield, these mezzanine lenders are underwriting quite aggressively," he said. "The line between equity and mezz is more blurred."

A major dynamic in the hotel-loan industry is that lenders are beginning to revert to loaning money based on future expectations rather than past performance, which was a common industry trend before 9/11, according to C. A. Anderson, executive v.p., development & acquisitions for Interstate Hotels & Resorts.

"There are [many] lenders taking a forward look on deals," Earnest said. "This recovery's feeling good-much better than six months ago."

Mark Lanspa, managing director, specialized industries-hospitality for GE Real Estate, said using trailing 12 months or projections for a deal depends on the market conditions.

Lanspa GE Real Estate

"Most people are using projected cash flows [hoping] new owners will put pixie dust on [a hotel] and turn it around."

Lanspa said the only time a disciplined investor is going to feel comfortable is when a company buys an undermanaged property and aggressively manages it.

"The realism of that turnaround that's being projected is that [lenders] have to buy into the story why [the property] is underperforming," said Peter Ans-comb, corporate director, leisure and head of travel and hotels for The Royal Bank of Scotland.

"Over the last two years, people have been looking more for stability and safety rather than yield," said Patrick Deming, senior v.p. for Secured Capital Corp.

Wardinski Highland Hospitality

Deming said the No. 1 driver of future deals is the improved lender perception of future performance of the industry

Most speakers said the industry is in a recovery mode:

"We're two to three years-maybe more-until we get to the peak," said Mark Rosinsky, senior v.p. of hotel investments for The Dow Hotel Co. "The rise to get to the peak will be very rapid."
"Our industry is poised to have some good numbers over the next three to five years," Wardinski said
"We're in pretty good shape," Wiles said. "The level of supply growth the last 18 to 24 months will help."

- "A lot of people have expectations that the next six or seven years are going to be pretty good," said Robert Rauch, president of R.A. Rauch & Associates.

But overall, there was caution against the industry banking heavily on a full recovery.

"The last couple of years hotels have underperformed by far and lenders have stuck by the assets," said Christof Winkelman, v.p. of international hotel financing for Aareal Bank AG. "What if 2005 doesn't meet expectations?"