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Deals but no steals: How your broker can provide meaningful insight

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The following words or phrases including, but not limited to distress, foreclosure, bargain deals, and discounts have been utilized in every hospitality periodical, press release, conference, and general conversation among industry participants over the past two years at an astounding frequency. However; the lack of significant opportunity to purchase distressed hotel and golf real estate is even more astounding. The transactions have been few and far between albeit the number of loans coming due this summer should increase transaction activity at a moderate level. The broker opinion of value provided, in most cases free of charge, has prevented both owners and lenders from making rash and quick decisions. Selling at a discount to debt has not been the norm, and the buying frenzy anticipated a year ago at this time has yet to come to fruition in a significant capacity. This article brief will detail how your broker can provide meaningful insight for both the lender and owner, and help understand why the transaction market and investment opportunities have been limited.

According to the Mortgage Bankers Association the level of outstanding commercial mortgage debt decreased by 1.7% in the fourth quarter of 2009, to $3.4 trillion, $99 billion lower on a year over year basis. The declines can be attributed to the halt in construction loans and reduction in loans held by banks and thrifts. Of the $3.4 trillion of outstanding debt, approximately $150 billion is in default. Furthermore, the CMBS market's specially serviced loans increased to $74 billion by the end of 2009, up from $4.4 billion at the end of 2007. It has been estimated that there are approximately 400 hotels and a similar number of golf course projects that are in "trouble." There should be a significant opportunity for forced sales due to the trillions of outstanding debt, lack of new funds or loans being deployed, and the volume of debt in default for being transferred to special servicing.

As of May of 2010, the industry has probably experienced only a handful of quality assets brought to market by a foreclosure, deed in lieu, or auction situation. Transaction activity in the hospitality/resort sector has been estimated at $1 billion through the first quarter of 2010, this represents a 72% increase over the same period last year. The bulk of this transaction activity stems from several strategic acquisitions "not distressed" including the Hyatt Regency Boston, Hotel Sofitel Washington DC, and the Embassy Suites Tampa Florida totaling a gross volume of approximately $300 million. The points below provide several reasons why the industry has not yet experienced distressed selling in a significant capacity.

* There is a lack of qualified personnel available to workout complex financial quandaries facing hotel owners. The workout process is slow or remains in limbo while servicers and lenders utilize hotel appraisers and brokers. Servicers and lenders are truly overwhelmed with approximately 40 assets being valued on a weekly basis; it is estimated that only 1 of every 15 assets is then foreclosed on.

* Brokerage firms have valued $billions of hotel loans and hard assets free of charge assisting both lenders and borrowers in capital preservation. Brokerage firms benefit from valuable information received from both lenders and owners, and can effectively aid in strategic planning as a true intermediate.
* Valuations provided by brokers are generally more telling than appraisals because they are based on suitable bids and pricing, marketing strategy, and realistic expectations based on recent transactions (which have been few and far between). The real estate underwriting sciences applied since the last recession never accounted for the unprecedented macroeconomic events that have happened since the fall of 2008. This recession has lasted far longer than most experts predicted.
* In some cases, hospitality that have been taken to market through 2009 and 2010 after lender foreclosure or at auction have sold at prices equating to 30 to 50% of the principal loan balance. Lenders are more inclined to work with the existing borrower towards capital or asset preservation. The "extend and pretend" philosophy in some cases has paid dividends. Selling debt back to borrowers has also been a viable alternative to foreclosing. The current industry sentiment is that we have reached bottom and recent RevPAR increases provide optimism for this next leg of the real estate cycle; thus, both lenders and borrowers are hesitant to sell at discount.
* Buyers still anticipate grave de-leveraging issues with both lenders and owners bringing quality assets to market at discount pricing. The lack of debt capital to purchase quality assets will continue to hamper pricing. Banks do appear to be more willing to lend than last year with very conservative underwriting and more equity needed to secure debt.
* Borrowers who have laid out preemptive plans with special servicers and lenders prior to default have been successful with loan modifications in the form of extensions. There have been limited situations of principal write downs; early intervention and engagement is critical to the borrower. Lenders do not want to take back assets.
* More distressed selling is likely to come from the borrowers who are more comfortable with where the market is and will accept a loss to move on and acquire more attractive assets that come to market in a distressed situation.
* Hotels experience the steepest declines in comparison to other property sectors and hotel revenues are directly tied to the state of the economy through leisure and business travel.
* The special servicing sector is not strategically holding on to assets for the receipt of fees; these fees are support fees administrative in nature and are not significant.
* The FDIC remains the only real seller; however, the FDIC wants to participate in the upside in the form of structured deals.

In light of the aforementioned factors preventing distressed transaction activity, it is O'Connell Hospitality Group's contention that it will be 2011 to 2012 before there is significant increase in hotel real estate values in conjunction with an overall uptick in the industry as a whole. The performance of the hotel industry is directly tied to economic indices including unemployment and consumer confidence, and recovery appears to be long in term. At this point the market will experience further confidence in operating projections and stabilized values. Debt maturities in the near term will continue to present major challenges for owners and lenders, and a successful workout is dependent on borrower intervention and engagement prior to default.

Matthew LaBarre is the managing director at O'Connell Hospitality Group. LaBarre, hospitality investment veteran and Dartmouth College graduate, brings to O'Connell Hospitality Group extensive experience, primarily in hotel/real estate finance and operations. He has operational experience working for Marriott International and Ocean Hospitality as well as analytical and transactional experience after completing four years with Pinnacle Realty.

His experience includes efforts to raise equity for several hotel acquisitions exceeding $100 million and has acted in an advisory role to clients' disposition projects with single asset values that exceed $50 million. LaBarre spearheads the effort to work closely with private equity groups and institutional investors assisting with acquisitions and disposition of both hard assets and debt.