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David Roedel - The Roedel Companies: Purchasing and repositioning "distressed hotels" - Lessons learned!

May 05, 2011 - Owners Developers & Managers

I cannot recall the exact date when I first heard the term "distressed" hotel, but one early recollection is the one-day distressed hotel investment conference I attended in New York City in the fall of 2009. The room was filled with hotel owners, operators and investors eager to find life support for a flat-lining industry. Unfortunately, anyone looking for expert advice, divine intervention or a "pardon" from over-leveraging hotel investments limped out of the city sorely disappointed. Later that day, I remember descending the escalator at Penn Station to board my Boston bound Acela feeling a little like Mathew Poncelet, Sean Penn's character in the movie "Dead Man Walking."

Today, the Great Recession continues to cause widespread heartache throughout the hotel industry. Although market dynamics are improving, it is not quick enough for many hotel investors. Owners who owe their lender more than their hotel is worth are in a distressed situation. In these cases, cash flow from operations is insufficient to service the debt, and outstanding debt is greater than the asset value. When this happens, owners and lenders are forced to make difficult choices including but not limited to, modifying the loan agreement, investing new equity into the deal, "turning in the keys" to the bank, or forcing a foreclosure.

In 2010 and 2011 our company successfully purchased a hotel bank note, foreclosed on the asset and now owns the property in partnership with an investor. In addition, we are closing on a real estate owned (REO) hotel the first week of May. In both cases, the distressed hotels are in dire need for complete repositioning including brand changes, exterior and interior renovations, improved operating practices and a marketing, sales and public relations campaign that attracts customers. From an investment standpoint, we will purchase and renovate the hotels for roughly 40% of replacement cost and expect to achieve stabilization within 12-months.

Based upon our recent experiences of purchasing both a bank note and a REO hotel, we offer the following advice:

Recruit the Best Team:

Unless your company boasts veterans from the 1992 saving and loan crisis, purchasing a bank note is uncharted territory. Prior to doing so, consider recruiting outside your inner circle of experts and consultants. In our case, we sought the advice of a prominent bankruptcy attorney to assist us once we purchased the note. For us, neither negotiating with the guarantors of a hotel note in default, nor maneuvering through the foreclosure process is an everyday task, and therefore good counsel was especially prudent. Furthermore, access to essential underwriting information may not be available. Given these circumstances, you are often left to assemble market data, structural and building plans, environmental reports, bank documents, etc. in a very short period of time. Depending on your company's resources, you might be forced to recruit additional experts to expedite the process.

Due Diligence, Due Diligence and more Due Diligence:

Why emphasize the point three times, because we feel both note purchases and REO acquisitions carry three times the risk of typical hotel transactions. Obviously, we were intrigued by double-digit returns, but we recognized that the prior hotel investment failed, and presumably would fail again unless the issues were uncovered, addressed, and subsequently resolved. In our case, one hotel was run by a first time hotel investor/operator who spent millions on the interior but failed to address critical moments of truth on the exterior. Sadly, very few customers entered a hotel that featured very modern attractive rooms.

When you look at distressed opportunities, force yourself to look beyond the numbers for the reasons guests are no longer attracted to the hotel. Is it the brand, lack of amenities, cleanliness, location, guest service or a combination of reasons? Always trust your intuition, if the deal sounds too good... it is! When inspecting the hotel, pay particular attention to the roof and exterior envelope, life safety systems, HVAC and ADA compliance.

Summary:

Unlike Mathew Poncelet, those of us committed to the hotel industry lived to see another day. At Roedel Companies, we are expanding our hotel portfolio and increasing cash flow through acquisitions, strategic joint venture partnerships and third party renovations. In the future, hotel development will return, but not until market conditions eliminate the opportunity to purchase and reposition hotels for 40% of replacement cost. Last week, after reviewing optimistic Smith Travel (STR) data, I noticed a listing for a distressed hotel conference scheduled for the fall. After taking a second look at the STR numbers I could not help but think to myself: How many more distressed conferences must we suffer through before order is restored?

David Roedel is partner at Roedel Companies, LLC, Wilton, N.H.