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Hotel owners! Its time to become partners with your lender - "N.O.I. - It's all that matters"

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"N.O.I. - It's ALL that matters." I received a button with that phrase while working in the Hotel Group assisting other work-out officers and lenders at the Bank of New England in 1990. It came from my boss, Bob Crawford, head of the group and long time hotel industry expert. Nineteen years ago he said, "the hotel industry is experiencing a crisis with credit, capital and confidence." The fundamentals that combined to create that same crisis in 1990 have reformulated in 2009.

The important issue to remember is that since this crisis is not the fault of the owner, a dialogue with the lender must be opened and a strategic value recovery plan must be developed so that all parties will work together to weather this downturn. Lenders don't want to foreclose. Owners don't want to toss in the keys. If a plan is in place well before maturity dates appear on the calendar, it doesn't have to be a gunfight at the OK Corral. A renegotiation, restructuring or at least an extension of the loan can be worked out and what's best for everyone's interests can be achieved.

The need to actively plan for loan maturity has never been clearer. The CMBS market is long gone. Securitized debt for real estate, much less long misunderstood operating businesses such as hotels, is nonexistent and won't ever be back in a form as we knew it. Certainly it won't be back with the same underwriting criteria that financed hotels over the past 5 years.

Our credit markets for loans over $25 million will remain stalled until life companies and pension funds get a handle on their cost of funds and return as direct lenders. Smaller loans on a very selective basis are being satisfied by healthy, regional and local banks. After a 10 year hiatus, direct lending is back, but the biggest concern is the capacity of these lenders to satisfy borrower's demands.

Compounding our credit problem is the fact that hundreds of millions of dollars of CMBS debt for hotels, underwritten and sold during 2005 and 2006, the peak of the real estate cycle, matures in 2010 and 2011. Declining revenues have decreased debt coverage ratios placing many hotel loans in technical default. Direct Capitalization Rates have risen 150 to 200 basis points for the same cash flow. Equity contributions which got as low as 10% for non-recourse CMBS debt, has risen to 35 or 40% loan to value, with full guarantees. The reality of this is that owners face a whole new world when looking to refinance their hotels and many will be required to contribute additional equity in order to keep the property.

The full service, urban hotel that enjoyed a $2.5 million, net operating income for Year End 2007, would have traded for a 6% direct cap or $41.67 million with a 90% first mortgage of $37.50 million. Today, that same hotel would trade for a 7.5% direct cap rate of $33.33 million, with a (65%) first mortgage of $21.45 million. The property dropped 20% in value with no change in cash flow available for debt. Upon closer scrutiny, after applying debt coverage ratios of 1.4 or higher, the value would be reduced further. Factor in risk associated with downward pressure on projected RevPAR in 2009 and the value drops further still. OHG believes that the overall value for hotels in general may have dropped as much as 30% in the past twelve months.

The table above tells two stories and each proves why borrowers and lenders have to work together in order to succeed. The investor looks at the table and shudders to think that he bought the hotel 12 months ago at a 6% cap and he's lost over $10 million in value. Remember, that the lender provided a note with a mortgage of $37.5 million and he stands to lose over $6 million if the property is foreclosed. Plus there will be cash required for legal fees and a cost to clear away any liens and the risk of stepping into an ownership position.

Tough times call for tough measures. It's time to call your lender to say "cum-by-ya" and develop a credit recovery strategy which works for you as the investor and your fellow partner, the lender.

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