



## **Advisers See Opportunity in Surge of Troubled Hotel Loans (Friday, 01 May 2009)**

By John Covaleski, Commercial Real Estate Direct Staff Writer

While special servicers scramble to keep up with a surge in troubled loans, hospitality-industry consultants and asset managers eye an expanding opportunity to sell their workout expertise for loans on hotels.

They claim that the servicers are particularly hard-pressed to handle workouts of hotel loans because of the sector's reliance on business income, as opposed to solely rents as in other sectors.

A total of 137 securitized hotel loans totaling \$1.7 billion are now delinquent, according to Realpoint, and account for 9.6 percent of all delinquencies. That's up sharply from 40 loans totaling \$368 million last November, when hotel loans accounted for 6.8 percent of all delinquencies.

Meanwhile, 147 hotel loans with a balance of \$2.6 billion are in special servicing, providing a solid indicator that hotel-loan troubles will continue.

Standard & Poor's expects the hotel loan-delinquency rate to quadruple to 8 percent by the end of the year.

"Hotels are not real estate, but rather a business housed in real estate," explained Morris Lasky, chief executive of Lodging Unlimited, a Chicago hotel consulting and management firm that is among those jockeying to get assignments from servicers. "Special servicers aren't necessarily going to know that much about the business," he said.

Hotels are more management intensive because of their daily turnover of guests, than traditional commercial properties, where space is leased to tenants for extended periods of more than a year.

Lasky theorized that servicers' lack of knowledge of hotel operations may be keeping them from reaching out to help owners of poor-performing properties determine ways to improve cash flows and avoid defaults.

"If you own a hotel whose loan is in special servicing and you want to have the servicer take a re-look at the loan, forget about it," said Richard Warnick, head of Warnick & Co, a Phoenix hotel asset manager and investment banker. "The only way to get special servicers' attention now is to stop payment and shift the loan from technical to monetary default."

"Workouts are not happening for hotel loans because the special servicers just have too much on their plates," Warnick added.

Indeed, Fitch Ratings recently determined that asset managers at special servicers are now handling an average of 14.5 loans each. That's up 54 percent over the past quarter. In total, \$24 billion of securitized loans are now in special servicing, according to Realpoint.

Meanwhile, \$17.2 billion of CMBS loans are more than 30-days late.

In an indication that troubled loans are multiplying faster than servicers' ability to handle them, the amount of loans that are more than 90-days delinquent grew by \$960 million in April. Servicers were able to move only \$330 million of loans to foreclosure and \$65.9 million to real estate-owned during the month.

"Servicers are definitely drinking from the fire hose when it comes to work - there's so much coming at them," said Ann Hambly, president of 1st Service Solutions of Dallas, which advises borrowers and represents them in dealings with servicers.

She said potential problems for troubled hotel loans include servicers' practice of managing or "sweeping" the available cash from properties taken in foreclosure. That's generally not too much of a headache for an office building, whose tenants are usually signed on for long-term leases. But hotels rely on day-to-day leases, and any degradation of service or amenities is usually felt immediately.

"A repositioning of an office or industrial (property) can be carried out over several months, but if it's not done right on a hotel, the property can end up shut down in a week. Their income is from daily guest not annual leases," she said.

Steve Van, president of Prism Hotels & Resorts, a Dallas hotel owner/operator and consultant that has provided workout services to several of the major loan servicers, concurred.

"Lenders and owners have never faced tougher times," he said, noting that with hotel performance weakening, lenders are less likely than ever to provide their borrowers with the cash needed to meet ongoing expenses, such as payroll.

He has warned that unless lenders and servicers become pro-active in helping troubled hotel operators work out their problems, there will be a surge of borrowers abandoning their properties.

To be sure, loan servicers all are staffed with hotel specialists.

CWCapital Asset Management, for example, has five people with hotel backgrounds, including property management experience, in its special servicing unit.

David Iannarone, managing director at CW, said that his office has not had any particular problems dealing with hotels loans, but noted that an uptick in that business has prompted him to have the group's five hotel specialists work on only those types of loans rather than handling all property types.

CWCapital is among five of the largest special servicers of hotel loans. It is the named special servicer of CMBS deals that contain 358 hotel loans with a combined balance of \$8.3 billion. A total of \$461 million is delinquent, according to Bloomberg (for function, type DQSP.)

LNR, meanwhile, is the top special servicer of hotel loans and is named on CMBS deals that hold \$18.6 billion of hotel loans. A total of \$621 million of that is delinquent.

Top Hotel Loan Special Servicers  
Servicer  
# Hotel Loans

Balance of Hotel Loans (\$Bln)

Delinq (\$mln)

LNR Partners

1,039

18.56

621.29

Midland Loan Services

404

6.60

303.66

CWCapital

358

8.29

460.69

Capmark Finance

290

5.07

64.67

Orix Real Estate Capital Markets

130

0.70

91.75

Source: Bloomberg

The expectation is that hotel delinquencies will continue increasing due to a steep drop in the sector's operating fundamentals.

In the first quarter, nationwide revenue per available room skidded 17.7 percent, according to Smith Travel Research. Occupancy dropped 6.3 percentage points from last year to 51.4 percent, while the average daily room rate fell 7.7 percent to \$100.13. It projected a RevPAR drop of 9.8 percent for the full year, thanks to a hoped-for uptick in business during the second half.

The Plasencia Group, a hotel broker and asset manager, has predicted that a RevPAR drop of just 7 percent this year could be devastating to the hotel sector's ability to meet debt obligations. It also said that kind of RevPAR drop would reduce income levels to the point of creating debt-service shortfalls on a hypothetical loan on a property generating \$1.27 million of net operating income.

There's also the general sense that many hotel loans written in 2005 to 2007, like those on other property types, were based on projections of future income growth that has and is not being realized during the economic recession.

Problems on hotel loans are compounded by the fact that in most cases, their collateral is tied to long-term management contracts that cannot be voided or rewritten if the property changes hands through a sale or loan foreclosure.

"Lenders really like hotel properties with brand names," said James Butler, a partner in Jeffer Mangels Butler & Marmaro, a Los Angeles law firm with a hotel practice that provides asset-management services. There was a point, he said, "where you could not get a loan without a brand name attached to it. The problem now is that the contracts are complex and the managers are not always the best fit for a property."

He added that terminating those contracts can be difficult. The process of re-branding a hotel and changing management takes a fairly high degree of hotel-management expertise.

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