What Hotel Stakeholders Need to Know about the Other Side of the Financial Meltdown

December 5, 2008 / By Russell S. Rivard, MAI

The collapse of the commercial-mortgage-backed securities market has choked the lending environment with its dust, and not much will happen on the hotel transactions front until it clears. Tight credit, combined with tougher lending practices and regulatory scrutiny, has resulted in reduced borrowing opportunities for hoteliers. There has been a dramatic slowdown in the total number and size of hotel deals due to the starved debt environment, and the rationing of funds will likely last well into 2009. Like most discretionary-consumer-oriented businesses, the U.S. lodging industry is particularly susceptible to the shaken foundations of financiers, and hotel owners, operators, and developers face some daunting challenges over the next several quarters before the credit markets gain some footing.

Hotel development usually progresses by means of short-term construction loans that later must be rolled over to a more fixed or permanent loan. The ability to gain long-term permanent financing for the construction or purchase of a hotel requires evidence that the hotel can maintain certain debt-service coverage and loan-to-value ratios. "Loan spreads have gone up and LTVs (loan-to-value ratios) have gone down: from as high as 80 to 85 percent a few years ago to 60 to 65 percent today." [1]

The headwinds created by tightening credit requirements and revised loan pricing are even harder to cut through given the economic pressures on a hotel's operation. Consumers beset by deteriorating home values, job cuts, and an overall lack of confidence are spending less on travel and accommodations—or just not traveling at all. According to Bernard Baumohl, chief global economist at The Economic Outlook Group, "People are now sufficiently scared about their jobs and future income that they are shutting down all spending and hunkering down. Many simply want to hibernate through the recession winter." [2]

The sharp declines in consumer confidence and available credit combine to depress both recreational and business travel, leaving occupancy levels in the lurch. Even increases in average rate couldn't overcome the recent declines in occupancy, and overall RevPAR (Revenue Per Available Room) subsequently declined in the third quarter of 2008. [3] The decline in RevPAR can have calamitous effects on an owner's ability to meet loan thresholds for loan-to-value and debt-service coverage.

The hotel industry has suffered such dramatic downturns before. With the right tools from industry experts, disciplined, proactive hoteliers stand to gain the most in the eventual upswing. Hotel stakeholders can take steps to mitigate the challenges they face from today's unsettling conditions and find themselves on surer ground on the other side. Here are a few things to consider.

--**Expect the coffers to reopen.** Once the constricted credit markets relax, a large amount of equity capital, which has been building up on the sidelines, will again re-enter the market. "In the hotel sector there is a significant amount of short-term debt, senior and mezzanine, with two to three years remaining. With no change in the hotel lending markets expected over the next six to eight months, many owners must consider de-leveraging with new equity for needed capital. This offers an opportunity for commercial real estate investors interested in entering the hotel market." [4]

--**Understand the shifts in hotel supply.** As several operators are forced into bankruptcy or liquidation, and construction opportunities diminish with the lack of available credit, the hotel industry's supply and demand fundamentals should become well balanced. The right advice now will be key to good positioning on the future

Summary

The lending climate in the U.S. will remain tough as we head into 2009, but certain opportunities lie in wait.

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--**Prepare to host more foreign visitors.** Tourist travel will increase as worldwide economic pressures diminish, and the U.S. should continue to be a major tourist destination as the creation of a new middle class gains momentum in countries around the world. Enormous potential for U.S.-bound tourism exists in India and China, and the addition of seven Asian and European countries to the Visa Waiver Program is expected to encourage another million travelers per year to the U.S. [5]

--**Keep perspective.** The hotel industry successfully climbed out of another recessionary period earlier this decade and went on to reach record revenues and profits over the past several years. Thus, the recent declines are from historic highs, and the industry should once again resume a profitable ascent.

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[1] "Lodging Hospitality" Maximum Fear Grips Credit Markets, Ed Watkins, October 7, 2008

[2] "International Herald Tribune" Consumer caution is crimping loan effort, Emily Kaiser, November 16, 2008

[3] "Hotels" U.S. Occupancy, RevPAR Drops In September, October 22, 2008

[4] "Commercial Investment Real Estate" The Lodging Market Looks Ahead, Robert Eaton September/October 2008

[5] **http://www.tia.org/pressmedia/pressrec.asp?Item=922**

About Russell S. Rivard, MAI

Russ Rivard, MAI, a Managing Director and Partner with the HVS Dallas office, oversees site inspections, analyses, and valuations of hotels throughout the South Central U.S., with a special emphasis on limited- and select-service properties and portfolios. Russ earned his master's degree in Operational Management from the University of Arkansas. He is a certified general appraiser in Texas and surrounding states. Contact Russ at (214) 766-5394 or .