



# LODGING CRISIS STRATEGIES

A SERVICE OF THE PLASENCIA GROUP

## Evaluating Hotel Loans: Questions Lenders Should Be Asking

The impact of the COVID-19 pandemic on the hospitality industry has been well documented to date. While most hotel borrowers are presently enjoying a brief period of liquidity relief in the form of mortgage forbearance, Payroll Protection Program (PPP) loan proceeds, and access to reserve accounts, it is likely an industry-wide reckoning is quickly approaching as traveler demand for many of these hotels and resorts will remain significantly depressed for the foreseeable future.

**To assist lenders of all types in confronting challenges relating to their hotel portfolios, we have compiled the following lists of factors lenders should consider.**

For lenders with hotel loans, the challenges of the lodging industry mean that an asset-by-asset evaluation will be necessary to determine whether their collateral remains viable in today's operating environment and the pandemic's immediate aftermath. Due to the unique characteristics of hotels, including the combination of real property with a management-intensive operating business, a distinct set of performance metrics and terminology, and multiple stakeholders at a property (owner, lender, manager and brand), navigating these troubling times requires not only specialized technical knowledge, but also familiarity with the industry's pacesetters and supporting players.

To assist lenders of all types confront challenges relating to their hotel portfolios, we have compiled the following lists of factors lenders should consider, whether in the context of discussing additional forbearance, modifying a loan, or taking a more active and direct interest in the investment itself.



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### How well do you know your borrower?

In addition to the multitude of property- and market-level factors impacting lender decisions, a candid evaluation of the borrower can impact many loan decisions. The level of relationship between you and your borrower, their current financial wherewithal, and the positioning of your loan within their overall asset portfolio are all critical factors in determining the best course of action in times of crisis.

#### Relevant questions to consider:

- ▶ What is the history of the relationship with the borrower?
- ▶ What is the relative size of their specific loan compared to your overall loan portfolio?
- ▶ How would you describe the borrower's creditworthiness and financial wherewithal today?
- ▶ Have they been a "good borrower" in the past, including during past downturns and in this time of crisis?
- ▶ Where does your specific loan fit into their larger portfolio? Is the asset securing the loan a "crown jewel" for them, or simply a commodity amidst many?
- ▶ How is the balance of the borrower's portfolio holdings positioned in light of the pandemic? Do they have drive-to, leisure-oriented properties that should be outperforming, or large group boxes that are likely struggling? How do those holdings impact their approach to your loan?
- ▶ What does the full capital stack for the asset consist of, and is there an additional component beyond equity that is financially constraining the borrower?



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### How has the subject hotel fared thus far?

A review of year-to-date performance is essential. Deep dives into monthly P&L statements and STR reports for the subject property will be illustrative. We recommend not only a line-by-line review of each revenue and expense item, but also a topline study of the broader market, the subject hotel's competitive set, and similar properties in various locales nationwide.

#### Relevant questions to consider:

- ▶ When compared to its competitive set, how have the subject hotel's Occupancy, Average Daily Rate (ADR), and Revenue per Available Room (RevPAR) indices fared? Has the property's market share suffered more or less than the competitive market performance?
- ▶ How steep has the decline been at the bottom line? Has recent performance required the borrower to inject cash to shore up operations?
- ▶ Has the operator made aggressive reductions in variable expenses?
- ▶ What sort of property staffing changes have been made to cut costs?
- ▶ Has the operator appealed to the brand for relief in requirements or brand standards?
- ▶ Has the operator contacted all vendors, negotiated discounts, or renegotiated terms?
- ▶ Do payables, especially major fixed items like payroll taxes, property taxes and insurance, remain current?
- ▶ What was the hotel's trajectory heading into the COVID-19 crisis? Were market share, revenues, and profitability improving or declining?
- ▶ Did a large amount of new supply recently enter the market, worsening recovery prospects?
- ▶ Did the market lose any demand generators? Are there new demand generators as a result of the downturn that may be coming into the market?
- ▶ Is there a different market segment or type of business that is now feasible to take on that may not have been desired in the past?
- ▶ Has the borrower received PPP funds? If so, how have they been deployed?



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### What are the subject hotel's prospects?

A thorough analysis of how the subject property will fare in the COVID and post-COVID operating environment will be critical in determining the viability of the collateral. The pandemic has brought about transformational shifts in demand, which have at least temporarily crippled group and corporate transient travel and elevated leisure demand, especially related to regional drive-to locations.

#### Relevant questions to consider:

- ▶ How much transient and group business is already on the books for this critical period? What do property pace reports look like, and how tight is the booking window? Is there a strategy for securing business that does not drive ADR down considerably?
- ▶ Is the property traditionally reliant on group or corporate business? How possible is it to shift to a leisure-oriented operating strategy?
- ▶ Are there new segments of demand that can be secured because of the crisis (e.g., medical staff, National Guard)?
- ▶ What are the subject hotel's prospects for protecting revenue by maintaining as high an occupancy rate as possible without dropping rates for the balance of 2020 and 2021?
- ▶ Is it possible to fundamentally shift the property's operating structure to a more streamlined and efficient model by shuttering meeting spaces and even some guestroom floors or wings?
- ▶ What is breakeven RevPAR for the hotel, factoring in current reductions in operating expenses?
- ▶ What are the capital needs at the property? Has the hotel been recently renovated, or does it require significant capital expenditure to adequately capture market demand?
- ▶ How extensive are outstanding payables?
- ▶ How reliant is the hotel's profitability on food and beverage (F&B) operations? What are the prospects for the hotel's F&B revenue in the COVID operating environment?
- ▶ How well is the hotel set up for social distancing? Is it vertically configured, requiring usage of confined spaces (e.g., small lobbies, elevators, enclosed hallways), or does it allow for adequate space between people?
- ▶ How is the operator marketing the hotel as safe and sanitary, ensuring that guests feel secure?
- ▶ How is the operator using social media and web marketing to increase communication to the regional, driving-distance markets?



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### What is the impact of the subject hotel's market?

A thorough understanding of the subject property's market is essential in determining the viability of an asset as collateral. The COVID-19 pandemic continues to disparately impact regions and cities across the country, creating clear winners and losers at a given point in time. Public perception of the relative safety of the subject market and its state and local governments' responses to the pandemic will have significant implications for the short- to medium-term profitability of the subject hotel.

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#### Relevant questions to consider:

- ▶ Is the local economy tied to one industry that has been fundamentally altered by the pandemic (e.g., energy, cruises, conventions, theme parks)?
- ▶ How dependent is the market on international travel?
- ▶ Is demand in the market seasonal? If so, how will shutdowns and quarantines impact the market's peak season?
- ▶ How accessible is the market to automotive travel? Is the market within driving distance of large population centers?
- ▶ If the market currently a hotbed for COVID-19 caseload growth, how is property management dealing with the impact in the short term?
- ▶ Is the market conducive to outdoor, leisure oriented activities? Is there a potential return on investment for wise modifications to support outdoor activities (e.g., pool area seating and improvements, tents for outdoor functions)?
- ▶ Are state and local governments likely to temporize reopening, or have they been quick to get back to business as usual?
- ▶ What are the characteristics of the labor market? How easy or difficult will it be to restaff the hotel once the pandemic passes?
- ▶ Can the local visitors bureau, chamber of commerce or other business organizations assist in messaging to help drive demand?



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Our firm has a long history of assisting lenders and servicers with their challenged loans. We have become increasingly active with a number of lenders—including national and regional banks and credit unions, private debt funds and life insurance companies—as we approach the end of the first round of temporary COVID-related forbearance. We take pride in our thorough understanding of hotel operations, our personal relationships and extensive experience in the hospitality industry, and our creativity in fashioning productive solutions for lenders and owners alike. We stand ready to be of assistance should the need arise.



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Contact us today if our experienced advisory team can assist you in evaluating your hotel loan portfolio or charting a plan for owned assets.

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