Evaluating Hotel Loans:
Questions Lenders & Servicers Should Be Asking

Unlike other real estate asset classes, hotels are truly operating businesses, as opposed to pure real estate. They employ an army of on-site employees, are subject to rent rolls of only 24 hours, generate a daily inflow and outflow of funds, require extensive preventive maintenance requirements, necessitate aggressive and proactive marketing efforts, and are subject to rigid brand oversight. Therefore, it's crucial to regularly and thoroughly evaluate hotels to ensure they continue to serve as sufficient collateral for their respective loans.

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

For lenders and servicers 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. 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 uncertain times requires not only specialized technical knowledge, but also familiarity with the industry's pacesetters and supporting players.

To assist lenders and servicers 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.

Relevant questions to consider:

- What is the history of your relationship with the borrower?
- How would you describe the borrower's creditworthiness and financial wherewithal today?
- Have they been a "good borrower" in the past, including during the COVID-19 pandemic?
- 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?
- What is the relative size of their specific loan compared to your overall loan portfolio?
- What does the full capital stack for the asset consist of, and is there an additional component beyond equity that may be financially constraining the borrower?
- What is the present likelihood of a full payoff at maturity?
- Are key documents in the file? Specifically, does you have a franchisor comfort letter (which ensures the hotel's flag will remain in place post foreclosure) and a subordination, non-disturbance, and attornment agreement ("SNDA", which governs the relationship among lender, borrower, and third-party operator)?

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How is your hotel performing?

Hotel values are directly driven by their performance. Deep dives into monthly P&L statements and STR reports for the subject property are essential. 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:

- How does the subject property's in-place trailing-twelve bottom-line performance stack up against historical performance and performance when the loan was originally underwritten?
- Will the property achieve its budget this year? If not, why not?
- When compared to its competitive set, how do the subject hotel's Occupancy, Average Daily Rate (ADR), and Revenue per Available Room (RevPAR) indices compare? How has the property's market share trended lately?
- Is the hotel's margin increasing, decreasing, or remaining constant? If the margin is shrinking, is it because revenues are declining or expenses are creeping up?
- What do forward-looking property pace reports look like, and how tight is the booking window?
- Is the property being managed in line with proper industry operating standards, or are service levels deteriorating?
- Did a large amount of new supply recently enter the market, worsening performance prospects?
- Is the hotel in good standing with its brand? What are the hotel's guest satisfaction scores (GSS)? Has the hotel been placed in its respective brand's punitive "red zone," potentially triggering a default under its franchise agreement?
- For loans that are not in default of financial covenants under existing loan terms, what sort of debt service coverage would the collateral provide if the loan were repriced with current market terms?

What is your property's physical condition?

Because hotels are much more CapEx-intensive than other real estate asset classes, a hotel's capital needs can have a massive impact on value. Brand-mandated items bear most of the scrutiny, but elements like a hotel's roof, HVAC system, pool, and back of house also warrant attention to obtain a complete picture of a hotel's physical health.

Relevant questions to consider:

- What is the age and current physical condition of the property, and will the physical asset be properly preserved for the balance of the loan term? Are there major deferred maintenance items outstanding?
- Is there a brand-mandated Property Improvement Plan (PIP) outstanding? If so, what does the PIP cost, and how will the borrower pay for it? If not, how recently was the last PIP completed, keeping in mind that soft goods renovations are usually due every seven years and case goods renovations are usually due every fourteen years?
- Has management consistently kept up with property upkeep and necessary preventative maintenance items?
- Are reserves for replacement being collected, and if so, what is the reserve balance? What rights or assurances do you have with respect to those reserve funds in case of default?
- Has the borrower conducted an analysis to determine if there will be a return of, and on, the capital necessary to get through the next two to three years (includes operating capital needs, debt service, brand capital requirements, etc.)?
- How do guests review the asset on sites like TripAdvisor? Is there a recent trend of negative comments?

Partner with an Experienced Hospitality Advisor

Bringing in experienced counsel and advisors to preserve and enhance the lender's position and the value of the collateralized hotel is always prudent. For over thirty years, The Plasencia Group has worked alongside some of the hotel industry's most active lenders and servicers, particularly during times of market and economic uncertainty. Our firm is prepared to actively work with you to evaluate your current loan collateral and make recommendations on the best course of action.

Services we offer include:

- Valuation analyses (opinions of value)
- Sale of notes and loan instruments
- Strategic critique of hotel portfolio and identification of potential problem assets, borrowers and operators
- Negotiation of brand or operator management agreements
- Asset management pre- and post-takeover
- Contract compliance review and monitoring (borrower, manager/operator and brand)
- Identification and implementation oversight of revenue engagement and expense reduction actions
- Review of capital expenditure plans
- REO dispositions, short sales and Section 363 sale processes

We would love to partner with you! Contact us today if we can assist you in evaluating your current portfolio and strategizing for the weeks and months ahead.

THE PLASENCIA GROUP
Passion. Access. Certainty.

National Presence. Local Knowledge. Exclusively Hospitality.

Contact us today if our experienced advisory team can assist you in evaluating your current portfolio and strategizing for the weeks and months ahead. We look forward to the opportunity to serve you.

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