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The New Reality of Hotel Financing

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Following two years of acute tightening, the real estate markets are showing signs of increasing activity. Since the beginning of the year, hotel brokers have witnessed a renewed interest in hotel investment and lenders are experiencing an increase in loan applications. Investors are feeling the time is right to get back into the market. But if you haven't financed a hotel within the last year, don't assume your past experiences will guide you through the process. Today's hotel lender market is vastly different than it was a few years ago.

According to a survey of hospitality lenders conducted by TransActions Data Services, the days of 10-20 percent down payments are gone for now. Lenders are looking for more cash. SBA lenders are requiring 20 percent or more down and conventional lenders are requiring 25-40 percent down. However, most acquisitions today are in some form of distress and borrowers seeking funding for turnaround properties should be prepared to invest 30-35 percent equity in the transaction. New construction loans are available almost exclusively through local and regional banks that are not yet tapped out in hotel loans. Fundamentals of the market must be there, i.e. occupancy, RevPAR, as well as 30-50 percent equity will most likely be required, even from strong borrowers.

Largely there are fewer lenders offering fewer loan programs. National lenders are seeing sophisticated owners and developers seeking funding for their hospitality projects outside of their usual sources as many local and regional banks have ceased originating hospitality loans. In 2009, local and regional banks originated approximately 65 percent of all hotel loans that number has now dropped to 37 percent. The market is seeing financial institutions making a comeback – originating 31 percent of all hotel loans so far this year. Conduit lending for commercial mortgage-backed securities (CMBS) for hotels, which for the most part were non-existent for the past two years, are now beginning to start up. Insurance companies are also beginning to look at financing hotels again basically because they perceive the bottom of this recession has passed.

Presently, government agencies are originating a very small fraction of hotel loans. The 504 program is nearly extinct; however, last year SBA set up a program to enable a better secondary market for the front side of the 504 loans and it has taken a year to get this program in place. The government is providing some guarantee for investors buying pools of first liens in front of 504s. As that market develops, and if it becomes a healthy market to sell those loans, then lenders will certainly get back into the 504 market. There are some costs to investors to get that government guarantee and those costs will have an impact on the prices they're willing to pay for those loans.

Government guarantee will be crucial; however, it will be interesting to see if costs to investors will trickle back to the borrower in the form of higher rates. As of now, it is too early to tell.

There has been an uptick of borrower interest in the USDA Business and Industry Guarantee Loan Program which is in place to encourage business development in rural agricultural communities. To qualify, the asset must be located in a market population of less than 50,000. The maximum percentage of guarantee is 80 percent for loans of $5 million or less and 70 percent for loans between $5 and $10 million. The B&I Loan amount goes up to $10 million and can go up to $25 million however the guarantee amount decreases to 60 percent for loans exceeding $10 million. These guarantees are encouraging to lenders.

One of the most dramatic changes of the last two years is the significant decline in the number of lenders originating hotel loans. Some lenders have chosen not to do so, others were deemed by Federal Bank regulators to be too heavily exposed to that property type, and still other lenders are simply out of business or were taken over by the FDIC, or forced to be sold to another bank by the FDIC. Reduction in the number of lenders making new hotel loans means those who are still active in hotel financing are being presented with many more loans than they can take through underwriting and close. This puts lenders in the unique position to cherry pick only the loans with the strongest borrowers, or hotels with strong debt service coverage ratios and those loans where all parties including borrower, seller and brokers are totally co-operative.

The underwriting process has become more thorough with an expectation to have your paperwork complete and in order. Would-be borrowers or sellers need a responsive, cooperative attitude. They may get frustrated with all of the lender's requirements for well written, organized and detailed documentation, but this is the new reality in hotel financing. Key information parties seeking hotel funding should have in hand includes: who is in the partnership group, a clear understanding of the group's hotel experience – good hotel experience is a must in today's market, personal financial statements and tax returns for each of the group's partners, financial statements and tax returns for other businesses in which the partners have ownership. Overall financial strength and experience are very important to lenders today. Lenders and brokers are working harder today than ever before to make a deal work and close on new loans for hotels.

In short, things have changed dramatically. There are far fewer lenders with much stricter underwriting documentation requirements. Capital markets are operating under closer government scrutiny and tighter regulations. There are fewer loan programs available requiring more cash down. With fewer lenders and fewer loan programs there are fewer dollars available for hotel financing. To achieve success in this new reality of hotel financing, borrowers should work with only very experienced hotel funding professionals – whether a hotel mortgage broker or a direct lender.

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