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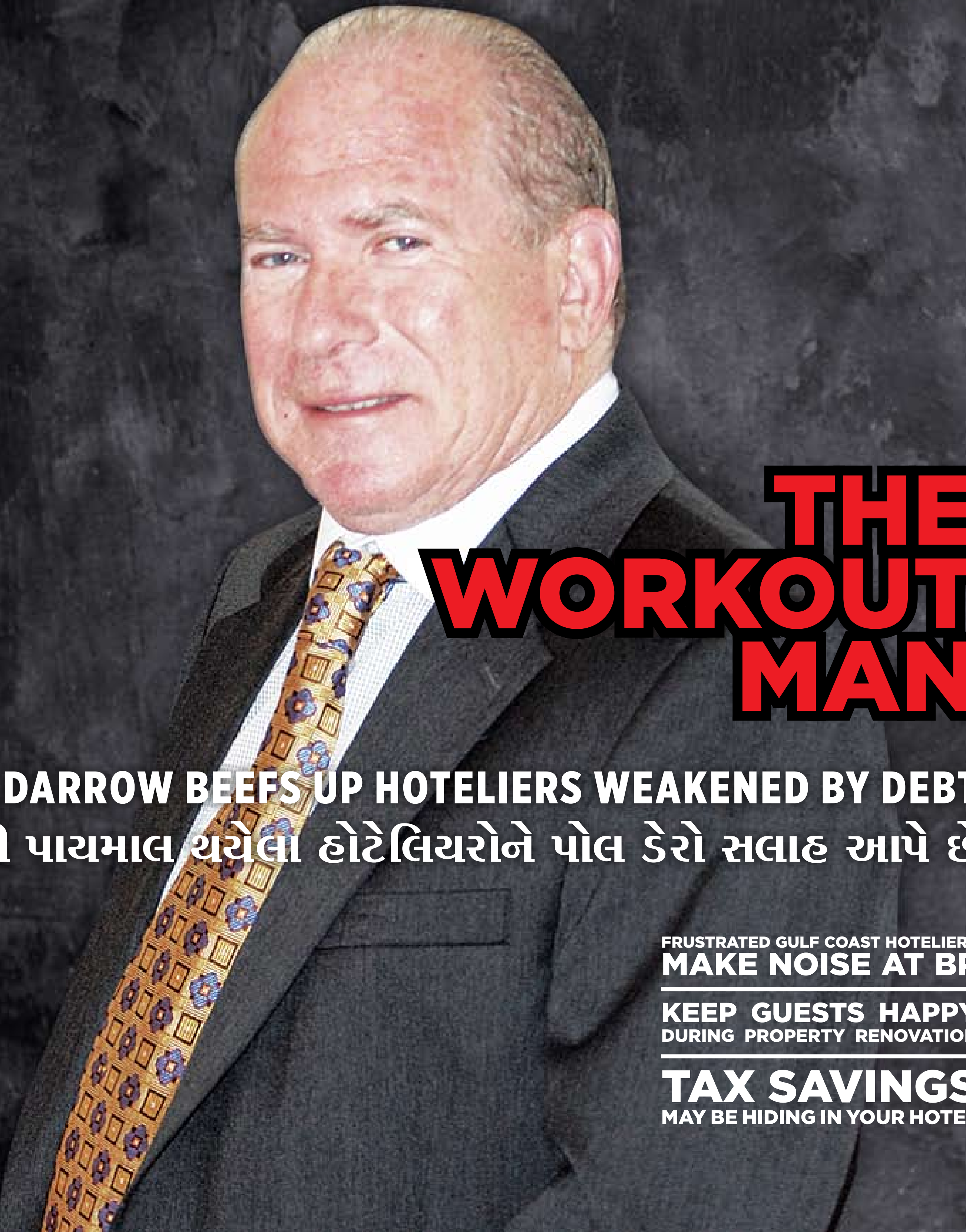

THE WORKOUT MAN

PAUL DARROW BEEFS UP HOTELIERS WEAKENED BY DEBT

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FRUSTRATED GULF COAST HOTELIERS
MAKE NOISE AT BP

KEEP GUESTS HAPPY
DURING PROPERTY RENOVATION

TAX SAVINGS
MAY BE HIDING IN YOUR HOTEL

Righting the ship

Workout specialists capitalize on the US hotel industry's debt crisis. 'Hope is not a strategy.'

When Paul Darrow ends his presentation on distressed hotel loans, it takes a long time for him to leave the room.

Darrow, a former hotel owner and now a debt-restructuring specialist based in Scottsdale, AZ, is often surrounded at the door by hotel owners – most of them limited service – worried about the state of their outstanding debt.

That's because they can hardly believe what they've heard. They are aware hotel properties have plunged underwater, losing 50 percent of their value in some markets, and revenues dropping by an estimated 20 percent. Meanwhile, Darrow tells them, the most favorable way to save their lodging business? Stop paying the bank.

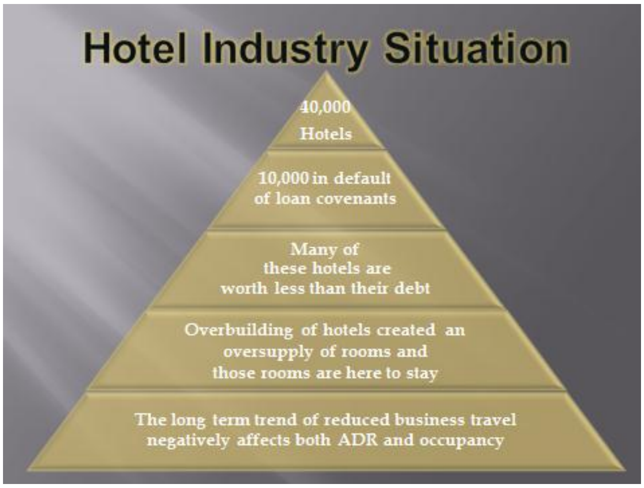
Any self-made business owner would winch at such advice, and the financial strategy is even more vexing for Asian-American hotel owners as many of them pride themselves on working hard to pay back their lenders. Culturally, bankruptcy and foreclosure are to be avoided at all cost. So they keep on keeping on, paying the mortgage that is now more than what the hotel is worth – often to the detriment of their business, their employees and their families, says Darrow and his contemporaries. 'The bank will collect on that debt eventually,' said Darrow, the key is who will be at the wheel navigating the road to recovery. It must be the hotel owner, he contends.

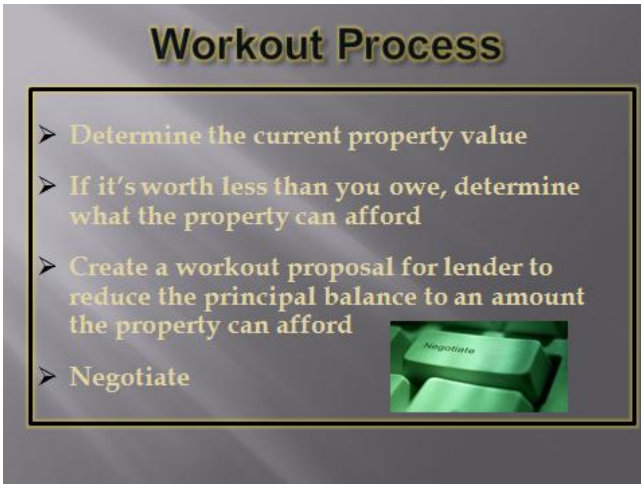
Darrow launched PHD Financial at the beginning of this year after working as managing director at Delta Capital Group, a financial services companyin Connecticut, for about 20 years. He became entrenched in the hospitality business in 1983 when he bought his first hotel, the Beach Plum Inn and Restaurant in Martha's Vineyard, MA. He went on to earn an executive chef and hospitality management degree in 1988 from the Cordon Bleu Cookery School in London. He then purchased the Intimate Inn of Saint John in the US Virgin Islands. He sold both properties 10 years later.

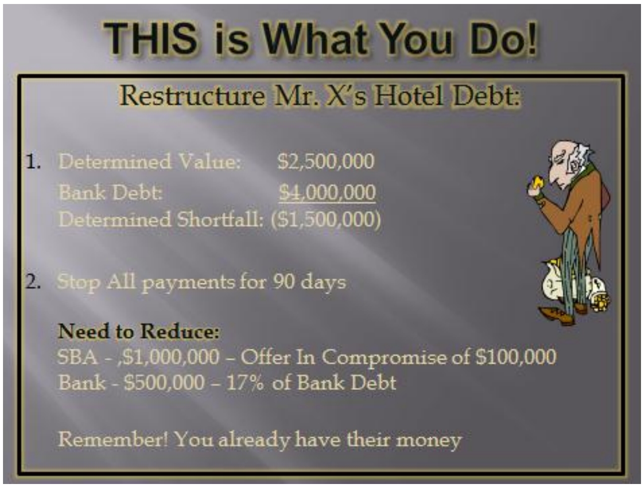
Growing demand

Workout specialists like Darrow are in great demand as the US real-estate lending crisis of 2008 continues to dog the commercial-financing industry. Even banks have specialists in debt restructuring. Very little credit is available to hotel owners, and Darrow has been selling his services to Asian-American hotel owners as most own limited-service mid-sector hotels – commercial real estate that banks are not keen on financing these days. The Federal Deposit Insurance Commission or FDIC still has nearly 400 banks on its at-risk list. Banks with portfolios heavy in CMBS loans are clay pigeons in today's regulatory environment.

The Asian American Hotel Owners Association in Atlanta and other lodging groups such as the American Hotel & Lodging Association in Washington, D.C., have argued before the FDIC and Congress that hotels should not be classified as commercial real estate as they are different from other retail investments because they do not sell a consumable product. Nitin Shah, a former AAHOA chairman, a hotelier and founder of Embassy National Bank in Atlanta, has said the ho-







Paul Darrow of PHD Financial, a debt-restructuring specialist who caters to the US hotel industry, speaks to a member of AAHOA during a regional business meeting in Chicago last month. Darrow is a frequent presenter at events sponsored by AAHOA, whose 11,000 members own nearly half of the hotels in the US.

tel industry sells rooms, not doughnuts.

Darrow stresses that times have changed and what used to work with past business strategies is no longer viable in the hotel industry.

Deciding to pursue a workout on a hotel debt – even if it involves filing for bankruptcy protection – does not mean failure. In fact, it's a business strategy that can breathe new life into an existing business by getting it out from under crushing debt, generating new cashflow and giving it a clear path toward growth. It's all about staying in business by creating a new business model that is right for today's market. Debt restructuring is not an act of giving up; it's righting the ship capsized by a storm that was beyond the control of the hotel owner. In the great scheme of things, the US commercial lending market realizes this. But it's up to the debtor to take pro-active steps.

'Debt restructuring is not an act of giving up; it's righting the ship capsized by a storm ...

Big economic problem

Since the great build-out of economy and midscale hotel rooms that took off in 2005 and ended in 2007, hotel debt maturities are coming home to roost. Through no fault of their own, many hotel owners are underwater, owing more than their property is worth.

Since 2008, $375bn of commercial real estate has been categorized as distressed, according to Real Capital Analytics. About $169bn has yet to be resolved in the US. While the US commercial-lending market is seeing some signs of recovery because of successful debt restructuring, the hotel sector continues to lag, according to recent index results by Fitch Ratings.

Last month, Fitch Ratings reported that CMBS delinquencies, increasing for much of this year, took a step back in July with a 15-basis-point drop. In contrast, hotel CMBS delinquencies, falling for the past several months, saw a 24-bp increase. The hotel sector fared worse because of 11 new loans totaling $280m becoming newly delinquent, said Fitch Ratings. At 11.46 percent, the delinquency rate of hotel debt is the highest of all major property types, and it is the only sector that saw an increase in delinquency rates in July, up from 11.22 percent in June.

Darrow says $2 trillion ('That's with a T,' he stresses) in commercial real estate debt is coming due in the next several years, and few hotel owners will escape the loan call. 'Everything in the CMBS market has changed since 2008 because most real estate is worth less today,' especially for the ubiquitous limited-service or select-service hotels. The old lending environment is gone. 'Underwriting has changed, what you need to get financing – guarantees, cash flow, equity – has all changed.'

Hoteliers seeking to refinance their debt are finding out they have little to no equity in their property and prospective lenders want 30 to 40 percent cash value before

An example of determining whether a hotel property is under water.

In 2008, Mr. Hotelier bought a hotel with $2m in annual revenue. His EBITDA (earnings before income, taxes, depreciation and amortization) was $500,000. The value of the transaction is 10 times the EBITDA or $5m.

Mr. Hotelier puts down $1m in cash, gets a first mortgage for $3m from a conventional lender and a second mortgage of $1m through the US Small Business Administration or SBA.

Jump to 2011. The hotel is earning just $1m in annual revenue. EBITDA is $250,000, meaning the business is now valued at $2.5m.

The remaining bank debt is $4m. So the negative equity totals $1.5m.

After stopping all payments for 90 days, Mr. Hotelier needs to reduce the $1m SBA loan to $1,000 by offering a compromise to the guaranteed lender. He also offers to pay 17 percent or $500,000 on the first mortgage.

The loan officer will offer different payback strategies and most likely reject your compromises – at first. The SBA loan will get transferred to a workout center where Mr. Hotelier can offer in compromise of 10 to 35 percent in cash or bring in a third party to buy the note. PHD Financial and other workout companies can provide the third-party buyer for both the SBA note and the primary mortgage.

A summary of what Mr. Hotelier's restructuring could look like.

Present market value is officially $2.5m. Purchase amount of the combined mortgage notes is $2.2m. Mr. Hotelier (who has been accumulating cash during the stop-payment period) has $220,000 to invest in the loan. Payoff to the primary note holder is $1.98m. The refinance at the new loan-to-value is 70 percent or $1.75m. Mr. Hotelier has to put up an additional $230,000 in capital.

The worked-out loan is now $150,444 a month for 20 years with an interest rate of 6 percent. Previously, the distressed debt demanded $343,884 a month at the same interest rate and term length.

Under this illustration Mr. Hotelier reduced his mortgage balance by $1.8m and reversed his current loss of $93,884 to a profit of $99,556.

they even consider inking a deal.

Darrow blames the huge supply of limited-service hotel rooms on the market for dragging down occupancy and rates and squeezing profit margins. 'What's worse, other hotels that surround your property have restructured. So you cannot fiscally compete because you are paying a higher mortgage than your competitors. You cannot sell your hotel to pay back the bank because your property is worth less than what you owe.'

The hoteliers listening to Darrow are hardly alone. With 40,000 hotels mortgaged in the US, 10,000 of them are in default of loan covenants, claims Darrow.

What to do?

Brad Mead, president of Delta Capital Group in Simsbury, CT, a former colleague of Darrow's and another hotel loan workout specialist who has conducted seminars for AAHOA members, says the first and worse reaction for hotel owners is to fire employees, cut back on amenities and services and try to run the business themselves. It becomes a futile 24/7 attempt at survival, says Mead, who likes to tell AAHOA members not to turn their hotel into a 'Patel prison.'

'Paying the bank first is a going-out-of-business proposition,' he says.

Darrow and Mead both paint the banking industry as a cold-hearted Ebenezer Scrooge. 'The banker is not your friend,' advises Darrow, which is another hard reality to swallow for Asian-American hoteliers as so much of their business success is based on trust and good relationships. Several commercial banking groups and associations contacted for this article did not respond or declined to comment. However, lenders that have exhibited or spoken at recent AAHOA trade shows and events have agreed the refinancing market is stingy right now, and in most cases only the best-looking portfolios in strong gateway markets can attract new financing, but it is still hard to come by.

Darrow likes to tell his audience that hope is not a viable strategy in saving their hotels. 'And doing nothing is not an answer because market conditions have changed beyond your control. The old method of determining your business value does not exist anymore.' Revenue and income projections are no longer useful because lenders do not know what tomorrow will bring.

There are steps that can be taken to regain control and save the business, although it will be a labor-intensive process that takes a long time to settle and many times an emotional one. To avoid the headache and heartache of being battered by lenders who want their money now, Darrow, Mead and other workout specialists advise hoteliers to hire them to do the dirty work. Meantime, the hoteliers can focus on running their business.

Darrow repeats this mantra at every presentation: Do not wait until the eve of foreclosure to seek help. The workout process requires planning. If a hotel owner even suspects he will not be able to deal with the pending loan call, he needs to seek help now. ■

NEWS

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been with the company a lot longer, 15 years, and has taken advantage of opportunities to lead and learn as a top executive with the $7bn company. Before she got the phone call, Rautio had served for eight years as executive vice president and chief financial and administration officer at Carlson, in charge of the company's financial and technology operation and included in all of the company's decision-making. 'Today's chief financial officers are very much business partners,' she said. 'You have to be integrally involved with strategy and make sure it's a partnership that moves forward.'

With solid experience in her background, Rautio said she knows she still has a lot to learn about all the facets that make up Carlson, and is prepared to lead the company in the face of difficult economic headwinds in the US and Europe.

Carlson announced Ambition 2015 in 2010. It's a global growth strategy aimed at expanding its portfolio by at least 50 percent by 2015 to more than 1,500 hotels. Currently, it has 1,319 hotels in 80 countries, making it the ninth largest hotel company in the world. Ambition 2015 was launched to take advantage of the momentum begun Carlson and Rezidor Hotel Group more closely aligned themselves in January. At the time, Joly said the company's pipeline is 26 percent greater than the industry average. ■

Hoteliers to push for SBA refinancing renewal

A GOVERNMENT small-business lending program is about to expire at the end of this month, spurning US hotel owners to rally at Capitol Hill next week to convince Congress renew the re-financing opportunity for at least another year.

The failure to renew the refinancing provision of the US Small Business Administration's 504 loan program would have a 'devastating effect for any business seeking a loan higher than $5m,' said Nitin Shah, a hotelier and founder of Embassy National Bank in Atlanta, which is tagged a preferred SBA lender by the federal government.

'This provision is important because there is no other form of financing available' to hotel owners in need of capital to improve their properties and increase business, he said. 'The whole original idea of 504 was to create jobs. If the government does not allow 504 refinancing, there will be loan defaults, properties closed and jobs lost.'

Alkesh Patel, chairman of AAHOA, said members plan to visit Washington, D.C., September 12 and push for the reinstatement of the 504 refinancing. 'This is about jobs for America,' said Patel.

The refinance provision of the SBA 504 loan program allows small business owners to refinance commercial mortgages with longer-term, below-market, fixed interest rates afforded by the SBA 504 program. Before Congress OK'd the provision last September SBA-guaranteed loans could not be used for re-financing, only for first mortgages.

SBA 504 refinances accounted for 14.7 percent of all SBA 504 loans made in the first quarter of 2012, and 20.6 percent of total SBA 504 dollars during that time period, according to reports.

The program is funded by fees. 'It does not cost the taxpayer a dime,' said Shah. 'Unfortunately, a lot of people in Congress don't know that; they think it's a handout.' ■