

# Distress Checks In

By Maria Wood

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## Hotel Blake

changing a bit. We've spent a lot of time in the past four months staying very close to lenders and special servicers and people that we have relationships with to monitor that. We are hearing that the trickle is starting, and there is a lot to come."

Indeed, out of all the property classes, hotels are poised to endure the most pronounced distress in 2009. "I think you'll see an explosion in hotel defaults," says Bill Hoffman, president and founder of Trigild Inc. of San Diego, which specializes in handling non-performing commercial loans. "It will start to accelerate quickly over the next couple of months."

According to Real Capital Analytics' most recent statistics, 166 hotel properties with an aggregate worth of \$9 billion are in the troubled asset category, with 44 valued at \$800 million in lender/REO status.

Yet John DePaul, president and CEO of National Hospitality Holdings LLC in Philadelphia, says that owners and even lenders appear unwilling to acknowledge the dwindling worth of their lodging holdings due to deteriorating fundamentals. "We are fundamentally resetting the value of hotels right now," he says. "No one is willing to either face the fact that their assets have no equity in them or that the debt is higher than the value of the asset. I don't think a lender, servicing company or equity player has any interest in wanting to face that elephant in the room at this point."

When a hotel falls into financial difficulties, a management company can play a number of roles. It may come in as a court-appointed receiver, in which its main duty is to protect the value of the asset as a neutral party, or act as a mediator between the owner and the lender for a loan workout. Or a company may simply be brought in as the new operator for a troubled hotel or to give an opinion of value.

Since the end of 2008 and the beginning of 2009, NHH has completed six troubled asset advisory assignments, with three more in the pipeline, according to DePaul. He declines to give specifics of those assignments, saying only that his company is typically called in by the equity partner that owns the hotel, the lender or a servicing entity. "For example, we may be called in prior to an owner of debt being put on notice of default," he says. "We could help work out the relationship between the borrowing entity and the lender." In one high-profile deal, Hostmark was tapped in July of last year to take over the management of the 162-room Hotel Blake in Chicago. The property was originally envisioned as a condo hotel, but ended up in bankruptcy. "We've been in the process of evaluating the ongoing strategies for that hotel and have been recommending to the controlling interest what some of its options are going forward," Cataldo says. "I'm not at liberty today to reveal those, but you will see changes going forward in the positioning of the hotel." He would not reveal the name of the controlling interest, referring to it only as the mezzanine lender.

SCHAUMBURG, IL-In 2008, locally based Hostmark Hospitality Group oversaw seven lodging properties that were involved in a foreclosure, receivership or bankruptcy. The company's executive vice president of development, Jerome F. Cataldo, says that while such assignments had previously been slow to materialize, he expects the pace to pick up as 2009 progresses.

"Lenders are still reluctant to go down that path," he says. "For the initial properties that we've seen in distress, the lenders have been willing to work out some extensions before they make a monumental decision. We are starting to see now, however, the first signs of that

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Whether brought in as a court-appointed receiver or simply as a new management entity for a troubled asset, Hostmark follows the same guidelines. "Every situation is a bit different, but our first goal is to secure the assets of the property, whether physical or intangible," Cataldo says. "Simultaneously, we work to calm what typically is a very stressful situation for the employees. In most instances, we can make that a very smooth transition because the majority of the employees in these assets are not affected by the transition and do not lose their job or benefits.

"Then we immediately try to get a handle around the sales and marketing aspects of the particular property, securing the reservation, group and sales files and all the data that we can in terms of trying to protect and promote going forward the business for that property," Cataldo continues. "While we are doing this, we are obviously developing a strategy for the property. Depending upon the assignment, it could be short term or a bit longer term in nature. And the strategy involved could be different depending on the circumstances and hotel."

Although the number-one tactic is to dispose of the property quickly, Cataldo says sometimes it's better to wait. "It could be a situation where holding the asset for a year or two makes more sense than immediately putting it up for fire sale," he says. For now, however, potential buyers are keeping their powder dry. "What we've seen primarily to date on a larger scale has been activity to buy the debt as an initial strategy," Cataldo says. "There is still a strong belief, too, that values are going to continue to decline. So there are a lot of people on the sidelines, thinking it may be too early to try to take advantage of the opportunity."

Until the capital markets thaw, DePaul doesn't envision many hotels changing hands. "We are seeing larger types of transactions starting to happen, but until the capital markets respond and there is some liquidity for refinancing, we are going to see a lot of discussion and very little activity," he says.

At the same time, banks would rather work with a borrower than take over the hotel outright. "Most lenders do not want to be owners," Cataldo says. "They don't make good owners, quite honestly. They would admit that themselves."

Likewise, the legal system prefers a workout scenario. "We have definitely found that most courts today have been very sympathetic to the borrower, and not the lender, because of the unprecedented decline in demand," DePaul states. "The courts are very interested in not exchanging the property back to the lending agent."

Both DePaul and Cataldo anticipate more workout and/or receivership assignments this year and beyond. "Receiverships present themselves very quickly and we have to move very quickly," Cataldo says. "There are probably four or five assets that are in our watch mode that could definitely go that route. Again, there is still a lot of uncertainty as to what the best courses of action are. Unfortunately, the pain for the borrowers as 2009 progresses is going to get worse and that will dictate a lot of what happens in these various projects. Will there be a lot of deeds in lieu of foreclosure or receiverships? It hasn't yet manifested itself into a clear-cut path of what's happening."

NHH has three business lines: direct investment, asset management and advisory services. "Our involvement in the advisory world will keep me and my team very busy through the end of 2010," DePaul says.

*Additional reporting by Sule Aygoren-Carranza.*

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