Hotel Deals and Lending Zapped by Coronavirus at the Finish Line

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Heading into 2020, the hotel sector was expected to slow down, but deals were still getting financed. Then came coronavirus.

U.S. hotel investment sales were already down 21 percent in 2019 and on track to decline an additional 6 percent in 2020 due to election year uncertainty, according to a February JLL report. Coronavirus uncertainty pushed the industry's investment nose down even further. Banks have shored up lending to the hotel sector over the decimated travel demand, and investors tell Skift that will include previously confirmed deals.

"Generally speaking, there is not a marketable number of buyers or willing sellers, and that creates a difficulty on the valuation side," LW Hospitality Advisors Chief Operating Officer Evan Weiss said. "There's always going to be value in an asset, but the question is how is all of this going to shake out?"

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The hotel sector has been one of the most active for travel industry mergers and acquisitions in recent years. That spawned years of unprecedented growth, with Marriott announcing in 2019 plans to expand by 1,700 hotels over three years. The only thing that seemed to impair hotel expansions was a construction worker shortage. But coronavirus threw a wrench in all levels of hotel deals, ranging from construction and acquisition financing to refinancing of existing properties.

LWHA specializes in hotel valuations and advisory services, and Weiss said the firm had two deals on the one-yard line that got pulled due to coronavirus uncertainty upending the hotel market. One was an acquisition deal for a full-service hotel in the Northeast. Financing was structured to include mezzanine debt, which is a second mortgage, and a balance sheet lender, or a lender that keeps a loan on the books rather than selling off to another financial institution. He would not identify those deals to Skift.

“The mezzanine debt was still willing to go 2.5 weeks ago, but the balance sheet mega-lender basically said they were pulling back,” Weiss said. “There’s so little certainty and, at that point, a lack of transparency of what the government was going to do.”

The global health crisis continues to pummel the travel industry. Hotel giants like Marriott and Hilton furloughed thousands of employees, and some airlines have temporarily halted commercial operations over business and leisure passenger traffic cratering in recent weeks.

Another LWHA deal for a New York City hotel was expected to include a debt fund lending to a private equity firm that wanted to refinance. The debt fund was still willing to push ahead during the initial weeks of coronavirus outbreak in the U.S.

“They told us, ‘If we had not already quoted you, we would not do this deal. But because you’re a Class-A borrower, we’ll go forward,’” Weiss said.

But even that deal got pulled last week.

Commercial lending is based around the premise of loan-to-value (LTV), or how much of the property’s overall value would be covered by the mortgage. Since the 2008 financial crisis, lenders have operated conservatively between a 65 percent and 80 percent LTV to avoid the kind of over-leveraged real estate seen in the lead up to the last downturn. But with hotels sitting empty and nobody knowing how long it will last, even a sub-65 percent LTV could swiftly turn into something much higher.

“The underwriting from April 1 going forward is tough because you just don’t know what these losses are going to be,” Weiss added.

Waiting for the Dust to Settle

If there is reason to be optimistic during a catastrophic time for the travel industry, it is that most lenders and hoteliers expect a recovery to arrive quicker than previous downturns. Unlike the most recent one in 2008, banks are in a position to snap back to normalcy since this is a health crisis — not a financial one.

“Our take is basically anything that was set to close in the next 30 days is on pause or getting extended until there is clarity on travel and the economic recovery. We don’t have a timetable on when or if those transactions will move forward but hope it will be in within the next 45 to 60 days,” said Brent LeBlanc, an executive vice president at Atlanta-based Stonehill, a hospitality lender specializing in select-service and compact full-service hotels. “We feel there’s going to be opportunity to close, but we have to let the fog clear to see the playing field.”

But even LeBlanc admits it is better to be in the construction phase of a project months or even years from opening rather than a seller of an existing product. Given uncertainty in the market over how long coronavirus fears will keep travelers at home, it is hard to pinpoint a value to any property. Whenever the industry does recover, sellers who were close to a deal before coronavirus spread will likely have to get a new valuation for their project before moving forward, LeBlanc said.

“As real estate guys, we don’t put this in underwriting,” he added. “How do you put two months of zero revenue in underwriting? I think there’s going to be a stigma in hotels for a long time, as you can never predict something like this.”

The commercial mortgage-backed securities (CMBS) market, which is where a majority of commercial loans are sold, is essentially on pause due to market uncertainty. Local and regional banks are expected to return to hotel lending first, and LeBlanc said the CMBS market would likely reopen to the hotel sector further down the line.

“If it’s a good project with solid demand generators, in the right market, and with the right branding, I don’t see an instance where a hotel project is not getting done,” LeBlanc said.

Arcturus Group Senior Vice President Carolyn Pianin, whose firm works with hotels on underwriting and market assessments, is advising clients in the meantime to focus on cost containment, physical assessments, and navigating through operation agreements.

“Figure out where you can go, if possible, to get funds to survive the next couple months and then make a plan on what you want to look like when you come out of this,” Pianin said. “Most importantly, if you are franchisor, talk to your flag, negotiate with them, be open with your lender, and put together a plan.”

But When?

The industry recovery back to pre-coronavirus lending levels is still a guessing game.

“You can look at a well-located shopping center that had good sales prior to coronavirus and assume that, when it does open, that the strength of that center will come back. It may not be full speed ahead. June 2020 may not look like June 2019, but people are going to go back to their shopping habits,” Pianin said. “Hotels are a different story. There’s nobody I know who is ready to get on an airplane.”

But Washington delivered a potential band aid to the sector early Thursday morning.

The U.S. Senate passed a $2 trillion stimulus bill for the overall U.S. economy, including provisions for workers and businesses. The bill is expected to pass the House and be signed into law in a matter of days.

“The loan side may return faster now that there’s a bit of clarity on stimulus package. There is certainly some level of relief for workers and loan workouts,” Weiss said. “All of that is going to help the lending market return. However, that said, the true effects of the $2 trillion stimulus both on the distressed workers and on the lenders and borrowers are not yet fully known. As they say, the devil is in the details.”