How Barack Obama will affect the US hotel industry

Economic woes in 2009: Managing in a downturn

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The GM of the «Best Hotel in the World» tells us where luxury is heading

Thoughts on 2009 from the CEOs of Scandic and Mövenpick
This may be the phrase of the year, summarizing in nine little words the increasing difficulty hotel industry borrowers will face in 2009 as they try to secure financing for their projects. The good news? Tough conditions in the capital markets won’t last forever, writes W. MICHAEL MURPHY of Atlanta-based FIRST FIDELITY MORTGAGE COMPANY. The bad? We won’t see real relief during 2009.

I am writing this in the midst of the Congressional debate over the « bailout » of Wall Street. I put the word in quotes because in this political season, populism seems irresistible to politicians and thus we are urged to believe that the taxpayer is paying to rescue fat-cat bankers and that the implications of the current credit paralysis will have no impact on Main Street. You will forgive me then for what I hope won’t be overly pessimistic predictions about our industry’s fate in 2009.

Hardening attitudes
I believe that 2009 will see a hardening of lender attitudes toward the hospitality industry. The continued weakening of business fundamentals, the resultant leveling or decline of RevPar growth, and a surplus of opportunity for senior secured lenders will contribute toward a very conservative attitude toward real estate in general and hospitality in particular.

But along with that discipline will come results – eventually. The fall of 2008 won’t be forgotten quickly, and the trend of credit officers regaining command in lending shops will continue. Senior secured lenders will lend at 2008 volume levels, or slightly above, but with wider spreads of from 300 to 400 basis points over the applicable index and lower loan-to-value metrics, coupled with coverage requirements that will be 1:3 and up.

Economic impact on hospitality
In 2006 and 2007 it was generally agreed, at least by CMBS lenders, that hospitality had joined the other major « food groups » of real estate (office, residential, industrial and retail) as an institutional-quality asset class, and that the level of sophistication of the investor community was such that the operational nature of hotels could be ignored or dealt with by diffusing risk through diversification in mortgage pools. During those exuberant lending years, only the insurance industry held to stricter underwriting standards and maintained their historical perspective of hotels as operating businesses.

In 2009, expect all lenders to adopt a view of hospitality as an outlier in real estate and to carefully scrutinize both forecasts of future performance and historical operations. Underwritings will rely principally on past performance, and extraordinary years will be discounted to the norm.

Given the extraordinary amounts of subordinate capital that has been organized for investment in hotels, one could then expect to fill any required equity gaps with either preferred equity, mezzanine or equity from institutional partners.

And one would be wrong. Almost all of the money on the sidelines now is allocated for investment in « distressed » real estate or real estate debt and the return expectations for this capital will be in the mid-teens on an unlevered basis. Subordinate capital will be available, but it will be pricey and available mainly – perhaps only – to the highest quality projects and sponsors.

Development deals can get done, but only those that have plans advanced to the construction drawing stage, with costs very clearly defined, land under control and sponsor equity of 25% of project cost in hand. 2009 will be a great year to advance the best projects – which will be the only ones that make it through the very fine lender sieves of the new era.

Underwriting toughness; better times
Out of the gloom will come improvements. 2009 will be characterized by tough underwriting standards, an insistence on quality sponsorship willing to put its own equity at risk, and pricing and sizing that will respectively be short and wide of 2006-2008 target levels. Development deals will again be the hardest category of hospitality to finance. Both debt and subordinate capital will be looking for deals in distress, so sponsors who have access to, and control of, such transactions will be rewarded.

Finding senior and subordinate capital in 2009 will require patience as well as access to the decision makers at capital providers who are active in the market. Though the underwriting standards will be familiar to industry hands, the production personnel at active lenders may not be. Allow more bandwidth to the process of financing in 2009.

Finally, I boldly predict that 2009 will give way to 2010... at which time things will begin to look brighter. Productivity, creativity and competence never go out of style.
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