Hotel News Resource

Banks and Hotels, We stand together - By Jerry Cedicci & Robin Trehan

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Hotel lending has undergone cyclic changes as the economy rises and falls. Booms follow busts as the occupancy rates of hotels rises and falls. Many financial institutions, including commercial banks, have become conservative in their lending practices to the hospitality industry in the wake of the economic crisis of the 1980s to the early 1990s.

Tighter lending practices has served to stabilize the hospitality industry in terms of the number of newcomers into the market. This translates to fewer hotels competing for a recently growing number of clients, reducing the exposure of those banking institutions that have enabled the establishment or repositioning of new or existing hotels.

At the same time, the number of lenders available for ideal projects has affected the current hotel lending market as more aggressive lenders compete for loans to solid properties, encouraging the return to hotel investment on projects with yields on equity of about 7.5 to 11 percent. Expectations on debt-to-equity rate are low, about 14%, but since there has been little need for high leverage in the transactions, such conservatively structured contracts leave lenders with relatively low exposure.

Because hotels have ongoing operations, investors have a clear idea of how a hotel owner raises capital and whether the strategy is workable in terms of a business as well as purely investment in property. Hotel management takes center stage in such cases as the profitability of a hotel depends largely on the skill of its management.

First mortgage lenders are exposed to less risk as they dictate well-informed terms for the loan. In other words, banks and other lending institutions are in a better position extending loans for the acquisition or improvement of hotels rather than other types of real estate because the investment is based on current performance and future, predictable trends.

One of the more aggressive financial groups that favor the hospitality industry is the private equity group. Private equity is any kind of ownership equity of non-public securities, meaning they are not listed in the stock market, and is typically locked in long-term investments such as hotels. Because the initial investments are liable to be substantial, private equity groups are often institutions that have an eye for the potential returns (about 30%) over the long term. In the case of hotels, investments by private equity groups will depend largely on the stability of the hotel over the long-term as well as the potential for a merger, consolidation or an initial public offering, at which time the investments will pay off dividends. A well-established hotel is unlikely to belly-up and more likely to be absorbed by conglomerates, which is good for investors.

Currently, the trends in the hotel industry favor the improvement in the hotel lending market. Proven management success and well-positioned hotels have better chances at getting favorable lending terms, at the same time decreasing the risk for lenders. There is also an increasing demand for first mortgage financing, which is bound to maintain conservative standards in underwriting in the near future. Lower loan-to-value ratios as a result of conservative lending practices coupled with higher yields are projected to encourage banks and other financial institutions to delve into the hotel lending market.

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