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10 tips for dealing with distressed hotel debt

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Most hotel owners are uncertain how to do deal with a hotel loan in distress. This is understandable—their skill is in buying, building and operating hotels. The problem is that they think because they are good at hotel development and management, they will also be good at working out their loan's problems with their lender. As a result, they often don't consult with anyone with real expertise in negotiating troubled loans with lenders. Here are 10 pointers to consider before picking up the phone to call your lender:

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1. Find out all you can about your lender. No one ever obtains a loan thinking about what might happen in the event of a default. Borrowers can learn the hard way that the identity of the lender may make all the difference in working out a defaulted loan. If the lender is a bank, its status—financially sound, troubled, or so bad it has been taken over by the Federal Deposit Insurance Corporation—may determine its approach to your loan. If the lender is a commercial mortgage-backed securities special servicer, the approach may be entirely different than that of a bank.

2. Don't assume the lender doesn't understand your industry. Many players in the hotel industry seem to believe that most CMBS special servicer workout officers are inexperienced and lack any hotel knowledge or expertise. In fact, many CMBS special servicers have degrees from hotel schools or have worked through hotel loans in previous down cycles. Banks, although generally lacking substantial knowledge of hotels, are more likely to have access to that expertise, with hotel brokers, consultants and others beating on their doors for assignments.

3. Prepare thoroughly before making your proposal. You wouldn't seek a new loan from a lender without presenting detailed financial statements and projections, including market analyses, Smith Travel Research (www.str.com) reports and a list of needed capital expenditures. Approach a workout the same way. You need to educate the lender about what is happening with the hotel and its market. Simply telling your lender that these are challenging times will not be enough to make your case.

4. Be prepared to "share the pain." If you are in monetary default and need relief on your debt service, many lenders will want you to come up with new money if you want to retain your ownership. If you are unable or unwilling to do that, most lenders will seek to take the keys and obtain the entire hotel's upside potential for themselves.

5. One size does not fit all. It is wise to ask other hotel owners what lenders are doing in terms of working out their loans. However, just because one borrower obtained certain concessions from a particular lender does not mean you will get the same concessions. Each workout is judged on its own merits based on factors such as the hotel's value compared to its debt, how much cash the hotel needs, deficiencies in the lender's loan documents and the existence of any personal guarantees.

6. Beware the springing guaranty. A common feature of most CMBS loans is that there is a guaranty that springs into effect only upon certain defined events. A well-known triggering event is the borrower's bankruptcy. However, there are often a number of other possible triggers, including failing to pay real-estate taxes, allowing mechanics' liens to be filed against the hotel, and, in some instances, even abandoning the hotel back to the lender. You need to know what that guaranty says before you talk to your lender.

7. Don't make a lowball first proposal. There is a school of thought that the first offer should be sufficiently low so that you can negotiate to an acceptable middle point. That may make sense in some negotiations, but you run the risk of this strategy backfiring. Make your first offer meaningful enough that the lender sees a point to continuing settlement negotiations.

8. Get ready for foreclosure. Many lenders will negotiate with a borrower, but at the same time pursue foreclosure of the hotel. This does not necessarily mean that a workout cannot happen. It does mean that the lender wants to keep the pressure on the borrower to come up with an acceptable proposal. It also positions the lender closer to getting the property back if no consensual resolution occurs.

9. Do damage control. The filing of a foreclosure complaint against a hotel often makes the press. If it does, competitors will mention it every chance they get when pitching group business. Such news will make event planners nervous about whether the hotel will be open when their events roll around. Arm your sales staff with the information to address client concerns and reassure the public that foreclosure does not mean the hotel is closing.

10. Know what you are fighting for. There have been a few high-profile hotels where the borrower has simply returned the keys to the lender and walked away. Whether or not this makes sense for you depends on many factors, such as whether or not you get cash flow from the hotel through a management fee, whether or not ownership allows you to avoid recapture of taxes, the amount of money your hotel needs and the extent to which you believe your hotel will recover when conditions improve. If you decide to just turn over the keys, it takes planning and forethought. You need to be aware of any potential liability to employees if they are terminated, to your franchisor when your license agreement is terminated, to any equipment lessors that may have personal guarantees and to taxing authorities for unpaid sales and withholding taxes. No matter what you do, it will take careful consideration and cost money to get it done right.

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