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SPECIAL REPORT: THE DISTRESSED HOTEL SUMMIT

Viable strategies for troubled assets

Special servicers, lenders work it out

By Stephanie Ricca
EDITOR IN CHIEF

WASHINGTON, D.C.—While many industry segments are shrinking in the face of operational belt-tightening, layoffs and other recession-related efficiencies, lenders and special servicers are experiencing a wave of new business as they deal with the intricacies of loan workouts. Several shared their perspectives at the Distressed Hotel Summit here in October.

Jeff Carter, VP of CW Capital Asset Management put the changing lending environment into context: “In June of 2007, we had three hotels in special services. The loan balance on those three was \$26 million,” he said. “By January of 2008, we had eight properties [in special services] with a loan balance of \$44 million. By January of 2009, we had jumped to 37 properties and a loan balance of \$372 million. Now where we stand nine months later, it’s 106 properties and \$1.4 billion of hotel loans in special services. It gives you a sense of the meteoric rise of distressed assets.”

Carter handles special servicing for a portfolio of commercial real estate loans, and his recent focus is on
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Jeff Carter said special servicers can help a borrower know the inside scoop.



ALL PHOTOS: SHAWN HOEFLER

Panelists debate what will drive transactions

By Paul J. Heney
EDITORIAL DIRECTOR

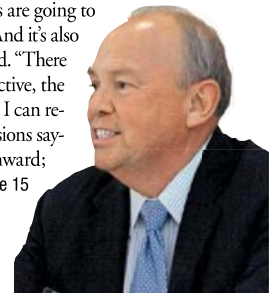
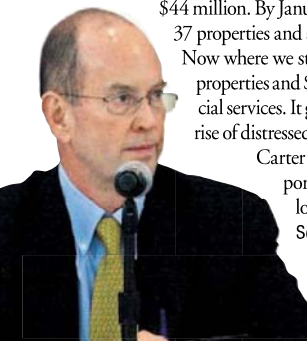
WASHINGTON, D.C.—Ask longtime hoteliers about the on-again, off-again nature of the industry, and they’ll likely start by telling you how many cycles they’ve been through in their career. But each cycle is different, and panelists at the recent Distressed Hotel Summit mostly agreed this cycle is unique—as are the challenges in getting out of it.

Lee Pillsbury, chairman and CEO of Thayer Lodging Group, told the audience that trying to figure out when the turnaround will happen was a futile exercise. He pointed out that no economist foresaw 9/11, the recovery after 9/11, the rapid increase in revenue per available room in 2005-2007 nor the current downturn.

“It is inevitable that the forecasters are going to see a continuation of the current [trends], that their views are going to tighten around the current slope of that line. And it’s also inevitable that that won’t happen,” Pillsbury said. “There will be a turn in the market. From my perspective, the recovery is going to be extraordinarily steep. ... I can recall economists at the bottom of [other] recessions saying that ‘things are going to continue downward;’
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Lee Pillsbury said when the market turns, people will be surprised at just how dramatic the recovery will be.

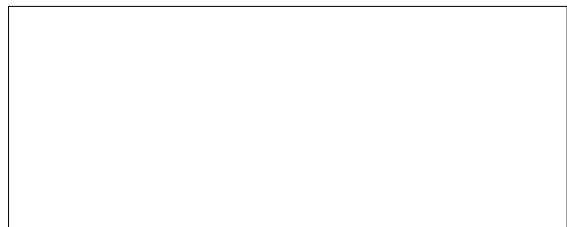
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▶ Gradual start to transaction activity
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INFO CONCIERGE

H&MM Web Poll: What effect do you think the Travel Promotion Act will have if passed?

-  It will increase international travel to the U.S. **12%**
-  It will benefit big cities only **13%**
-  The \$10 fee will annoy travelers **24%**
-  The less the government is involved in the industry, the better **49%**



"It takes time for capitalism to find its way to the hole of need." BOB WEBSTER, HODGES WARD ELLIOTT

DISTRESSED HOTELS

Debate

Continued from page 1

[we] are going to bounce along the bottom; there's not going to be a recovery."

Pillsbury said he sees a recovery that is going to be as steep or steeper than the decline was.

"Certainly by the end of 2010, we're going to see a very significant upturn in demand in this business. I am very optimistic," he said.

Michael Medzigan, chairman and managing partner of Watermark Capital Partners LLC, said there has been an unbelievable lack of clarity as to the depths of this downturn, but he thinks we're in some sort of bottom now.

"We might be bumping along a bit, but it doesn't feel like we're going down another 5 or 10 percent," he said.

Medzigan explained that a key question to ask is when do sellers give up?

"Most sellers today have hope certificates, they don't have equity left in their assets," he said. "The

lender or somebody else is going to have to force it. I've been hearing... within the last two weeks that the regulators are waking up to this issue. I'm not sure they were asleep as much as they weren't willing to make institutions take write-downs now. I don't think the regulators can just turn their backs and say 'let's let these guys hold this stuff until it gets better.' ... I think that's where the pressure has to come from to get things moving. My sense is it'll happen. Is it three months or six months? I think it's starting."

Bob Webster, senior managing partner, Hodges Ward Elliott, said this year has been a fascinating one for transactions.

"We had 112 hotels traded year-to-date," Webster said. "A total of \$2.5 billion of capital has traded hands. That includes lodging, where one deal represented \$775 million. If you take that down to just hotels, and hotels of \$10 million or more, we've actually had about \$1.5 billion in trades and 49 hotels. That's your pool, \$1.5 billion."

Webster explained that several types of buyers have become involved in transactions: foreign buyers, the direct participation program market, hotel companies, insurance companies and cross-over investors—those who haven't owned hotels but have owned other types of real estate.

"It will be interesting to see ... who really takes the ball and runs with it," Webster said.

Who is distressed?

An interesting subtext to the discussion was some panelists felt the very definition of a distressed hotel asset was making things difficult for buyers and sellers.

"I think we still have a situation where we have a lot of hope that our assets aren't distressed," said Jonathan Benowitz, managing director of RockBridge Capital.

"Realizing your losses is difficult," Webster said. "We're still trying to figure this out; this has been a catastrophic event to our industry, and it's difficult to figure out where we are in the mess."

Medzigan told the audience to be practical.

"If I've got an asset where my debt is coming due in three years ... to me, that's distressed," he said. "I'd like to think today about what to do about it as opposed to three years from now."

Forcing the issue

Medzigan said private equity funds have been bruised pretty badly in this cycle, and as a result, there isn't a lot of capital available.

"But they're not gone, there's certainly going to be private equity funds going forward," he said. "A couple of months ago, some of the real estate investment trusts were taken for dead, and suddenly, they're looking pretty good. I think the REITs could be active buyers in this next cycle."

Pillsbury was concerned about a lack of external factors.

"I recall in some of the earlier cycles ... things forced sales ... this time around, there don't seem to be any external factors forcing sales," Pillsbury said.

Medzigan said there might be

a need for a resolution trust corporation, like the one that liquidated the old savings and loan assets in the early 1990s.

"Last time, it took time to get there, but it was very organized," Medzigan said. "Once people figured out the system, it just worked. ... Right now, there's just no organization like that. Do we need an RTC? Probably wouldn't hurt."

Webster relayed the story of REITs in the 1970s real estate boom and bust, when they were the primary source of debt and equity capital. When the whole model collapsed, the REIT market virtually disappeared, until Barry Sternlicht brought them back with great success in the mid-1990s.

"This boom was fueled by CMBS and was incredibly optimistic," Webster said. "We're going to have to go through a time where we find intermediaries to replace the large shoes of CMBS. ... It takes time for capitalism to find its way to the hole of need. And it will, but it's just going to take time."

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