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When your bank won't lend: four hotel refinancing tips



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A bank you've done business with before is like gold today. Financing has always been a relationship business. That's even truer in the midst of the current financial turmoil. Lenders are more conservative and less inclined to work with someone with whom they don't have experience.

Yet many banks you have existing relationships with might be unwilling or unable to lend today. They might suddenly be "full" on hotel loans, or exposure risk might limit their ability to lend further to existing borrowers. Maybe your go-to bank is either in trouble or waiting on the sidelines to see how the economy shakes out. Thankfully there are other banks still lending on hotels.

Getting to the top of the stack

It's key to understand that all banks still actively lending are swamped with loan requests. Every loan originator has 40 deals on his or her desk he or she hasn't had a chance to return calls on. They can "cherry pick" from the best and easiest deals, and, unfortunately, many banks don't entirely understand hotels.

In this unique credit market, the only way to get to the top of the stack is to trade on someone else's bank relationship or come to the table with very compelling and organized data. It's best if you can do both.

Resetting expectations

Most of us need to hear something several different times from multiple sources before we genuinely accept a new reality—this is the essence of Winston Churchill's timeless passage, "I am always ready to learn, although I do not always like being taught."

The following lists several of these new realities. If you borrowed on a hotel before 2003, you'll recognize familiar requirements that lost relevance during the 2003-2006 "go-go" lending days, a period of easy money that significantly contributed to the recent economic maelstrom.

The rules of the road haven't changed per se—they've just returned to normal. Some will find this frustrating or intolerable. For others, it will be unmanageable, especially if 65 percent leverage would require additional equity. But given that this new reality is likely to be with us for the foreseeable future, it's best to adapt to the new environment.

Financeable deals

Conventional (vs. SBA) refinance deals that can get done today must fit "in the box":

- maximum 65 percent loan-to-value;
- pricing: 5.75 percent to 6.75 percent (variable) or 6.25 percent to 7.25 percent (fixed);
- three- to five-year loan term;
- 20- to 25-year amortization;
- +1.40X debt service coverage;
- hotels operating over 100 percent of the Smith Travel competitive set revenue per available room index are underwritten to market average average daily rate and occupancy (in addition to being stress-tested in other ways);
- full personal guarantees/recourse;
- financially strong sponsors with ample liquidity (e.g. liquidity of 20 percent of the

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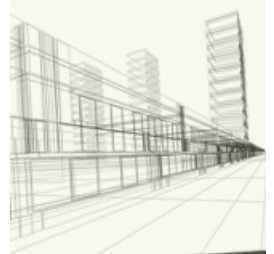
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- refinanced loan amount);
- limited (if any) equity cash-out;
- franchise term beyond the loan term; and
- ability to bring meaningful additional business to the bank (e.g. deposits, merchant card servicing, other loans).

While there might be exceptions on particularly strong deals, the vast majority of deals that actually get done today will fit in this box.

Next steps

During the “go-go” lending days, many got used to leveraging up to 75 percent, cashing out the majority of trapped equity, and otherwise putting the loan out to auction for the best possible rate, terms and conditions. Thankfully, interest rates remain historically low, but otherwise, things have changed. And it’s not all bad. The best borrowers and hotels will obtain competitive financing, hotel room supply will remain in check, and the next cycle peak will be longer and healthier as a result.

Credit markets likely won’t be fully healthy and functioning normally until roughly mid-2011, so hoteliers should manage refinancing plans accordingly. This “credit crisis” will define a generation and will take some time to heal.

A three- to five-year refinance program bridges your hotel into a time when we’ll likely see the return of 75 percent loan-to-value, fixed-rate, 10-year term, non-recourse loans. That will be the time to recapture/cash-out some equity and put your hotel loan to bed for the long term. In the interim, stay in “the box” and you’ll do just fine.

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