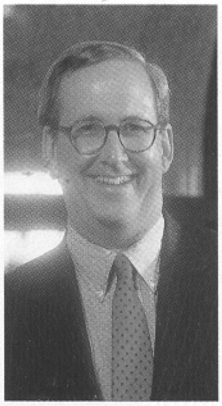
Hotel Investment Strategies

Identifying Distressed Hotel Acquisitions

With the downturn in the global economy coupled with the decline in travel following the events of September 11, hotel buyers have been aggressively seeking acquisitions hoping to pick up distressed hotels at bargain prices. Unlike the massive recession of the early 1990s, I believe most hotels around the world are in sound financial condition and will not become distressed nor will they sell at bargain prices. If this observation is correct, then how should all these hotel buyers go about identifying the few distressed hotel acquisitions?

A distressed hotel is simply a business that does not generate sufficient revenue to cover its expenses (operating, reserves and debt service). When faced with a potential or actual cash shortfall, hotel owners often implement various cost-cutting measures. This strategy soon becomes apparent, producing observable signals that studious buyers will notice and swoop in for the bargain acquisition. Here is what you should look for.



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First, focus your attention in the markets that were hardest hit by the recessionary decline in travel and overbuilding. Last month's column pinpoints the cities where hotel values have rapidly fallen. These include Boston, New York, San Francisco, Dublin, Copenhagen, Manila and Singapore. If you have a choice, it is generally better to select a market suffering from a temporary drop in travel demand rather than an increase in new supply. Demand will usually recover faster than the dilution caused by overbuilding.

Second, look at the hotel itself to see if there are any visible signs that the property is suffering the effects of a massive cost-cutting strategy. Is there any apparent deferred maintenance? Does the parking lot need repaving? Are soft goods worn and outdated? Is the pool area tired and dingy? Does the fitness room have obsolete equipment? Is the property rundown and out-of-date?

Another sign to look for: has the franchise been downgraded? Owners sometimes cut costs by changing affiliations to franchises with lower physical and operating standards. While this short-sighted approach enables a hotel to spend less in maintenance and replacements, it usually suffers from lower reservation volume and a decline in room rate.

You should also find out if a property has operational problems. Discussions with local operators will reveal the typical operating problems such as high employee turnover (particularly on the management level), dissatisfied suppliers and purveyors requiring payment to be made at the time of delivery, cutbacks on local sales and marketing efforts, as well as a general loss in competitiveness. Also, check the assessor's office for delinquent property tax obligations.

Lastly, book a room, check in and get a feel for the property. A distressed hotel will often feel defeated. The staff is likely to be untrained, inefficient and unfriendly. Long check-in lines, slow roomservice, limited restaurant hours and an apparent absence of supervisory management is a sure sign service levels are suffering. A brief talk with staff members will often elicit revealing comments about management, ownership and the property's overall financial well being.

Some more obvious signs of a distressed hotel are a notice of foreclosure, filing of bankruptcy and a default listing for a CMBS pool. These signals of distress are generally well publicized through the local press and can have a devastating impact on a hotel's future operating performance.

Identifying and pursuing distressed hotel acquisition targets before they become publicized bankruptcies or foreclosures enables a hotel buyer to work out an exit strategy for the beleaguered owner that proves to be a win-win for both parties. This can include an outright sale, purchasing the debt at a discount, creating a joint venture with an infusion of capital or a host of other options. Since hotel owners do not hoist a distress flag and ask for help, it requires an observant buyer to see the signals, meet with the owner and work out a solution. ◆

By Stephen Rushmore, *MAI, CHA, CRE, president and founder of HVS International, a global hotel consulting firm with offices in New York, Miami, Denver, San Francisco, Vancouver, Mexico City, London, New Delhi, Singapore, São Paulo and Toronto. Mr. Rushmore can be contacted at 1.516.248.8828 Ext. 204.*