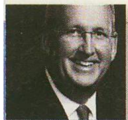

RUSHMORE

LENDERS' DILEMMA: WORK OUT OR FORECLOSE

With the downturn in the economy, an increasing number of hotels will soon experience financial difficulties, if they haven't already. Those with large amounts of debt will have trouble paying monthly debt service when net income starts to drop, and those with mortgages coming due this year or next will have challenges getting replacement financing. In both cases, owners will probably have to negotiate some type of relief plan with their lenders to avoid foreclosure and losing their properties. Before approaching your lender to ask for assistance, it is helpful to understand what the lender looks at before deciding how to proceed with a problem hotel loan.

Many lenders are monitoring hotel loans that aren't current on their debt service payments or are close to the end of their terms. When faced with these distressed situations, lenders must make some important decisions regarding a plan of action that will best protect their long-term financial interest. Each distressed hotel loan is different and requires a specific, custom-tailored strategy:

1. Identify the problem. Distressed hotels typically evolve from one or more of the following conditions:

• Problem location. Poor access, poor visibility and other factors hamper a hotel's ability to attract customers and generate occupancy. Unless a hotel can overcome a suboptimal location with a strong identity (franchise) or management, location problems are difficult to overcome.

• Physical factors. A deteriorating hotel in need of upgrading and replacement of ff&e won't be able to optimize occupancy and average room rate. If the hotel suffers from functional problems relative to inefficient layout and utility, operating expenses may be inordinately high.

• External conditions. An abundance of nearby lodging supply and/or decline in transient demand in the market are external factors that can impact a hotel's ability to achieve satisfactory occupancy and rate. Over time, a hotel may also suffer from a declining or noncompetitive neighborhood.

• Identity (franchise). Optimal product identification is a critical component for a successful hotel. If a hotel's franchise affiliation doesn't fit the market or enhance the property, earnings are likely to suffer.

• Management. A number of hotel management companies are incapable of operating a property in an effective manner. These difficulties usually stem from an inability to generate revenue while at the same time controlling expenses.

• Ownership. Hotel owners often create or exaggerate hotel problems. Those who are incompetent are likely to make too many mistakes; those who are undercapitalized are unable to correct the mistakes; those who are dishonest don't really care about their mistakes.

2. Determine whether the problem is curable. Some of these conditions are curable while others are not. For example, a lender can do little to improve the operating results of a hotel suffering from a large decline in local market demand. On the other hand, if a hotel is losing business because the property needs a complete renovation, the lender might want to assume ownership, make such an investment and attempt to enhance earnings.

3. Develop a plan of action. Once the problem(s) are identified and it's determined whether the problem is curable or not, the lender must evaluate the advantages and disadvantages of either restructuring the loan with the borrower or acting to gain possession of the property.

If one or more of the incurable factors are causing the hotel's financial problems and if the borrower is honest, the lender should consider restructuring the loan to provide some type of short-term debt-service relief. This would give the borrower time to recover and alleviate it from defending a foreclosure or bankruptcy.

Curable problems, particularly those related to ownership, often signal the need for a more forceful approach. If a property's owners are incapable of recognizing and curing the conditions that negatively affect a hotel's earnings, the lender should consider the various measures available to gain possession of the hotel. Before proceeding with this course of action, however, the ramifications must be considered.

A hotel is a retail business that depends on continuous patronage to survive. Any publicity that even hints of a financial difficulty may have an adverse effect on attracting future business. A foreclosure or bankruptcy can devastate a hotel's occupancy rate and seriously erode a lender's security. Here are a few situations in which negative publicity can be particularly harmful to a lodging facility:

• The hotel has a significant group orientation that depends on meeting and conference business. Meeting planners are usually aware of situations that could jeopardize their success and will steer clear of hotels having financial difficulties.

• Hotels dependent on business from travel agents will quickly feel a decline in referrals from agents who may be wary of their ability to collect commissions.

• In addition, negative publicity could place the hotel on C.O.D. delivery basis with most purveyors, cause employees to seek more secure employment and generally create an operational nightmare.

4. Implement the plan. When a lender takes back a hotel, it assumes an ownership position that requires significantly more supervision than was previously required. Lenders that aren't equipped to handle this burden in-house can use asset management services to take over some of the ownership responsibilities.

Lenders looking at a loan with a curable problem but an uncooperative borrower are generally forced into using foreclosure to gain possession of the property. Depending on the state in which the property is located, a foreclosure can take from as little as a month to as long as several years. Faced with an imminent foreclosure, a militant hotel owner may put the hotel into bankruptcy, which could extend the timetable another one to four years.

In addition to these primary issues pertaining to the handling of distressed hotel loans, there are other considerations worth mentioning:

• If the problem is largely due to incompetent management, don't hesitate to terminate the management contract.

• Lenders need to keep a low profile. Publicity usually doesn't enhance distressed hotel situations.

• Since history has shown that most hotels will turn around over time, lenders should stay with a hotel and attempt to improve its operating results rather than dumping it on the market at a significant discount.

Now that you understand how hotel lenders will evaluate your request for relief, you should be better prepared to present your case in a way that will show how your lender would be better off working with you rather than against you by resorting to foreclosure.

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