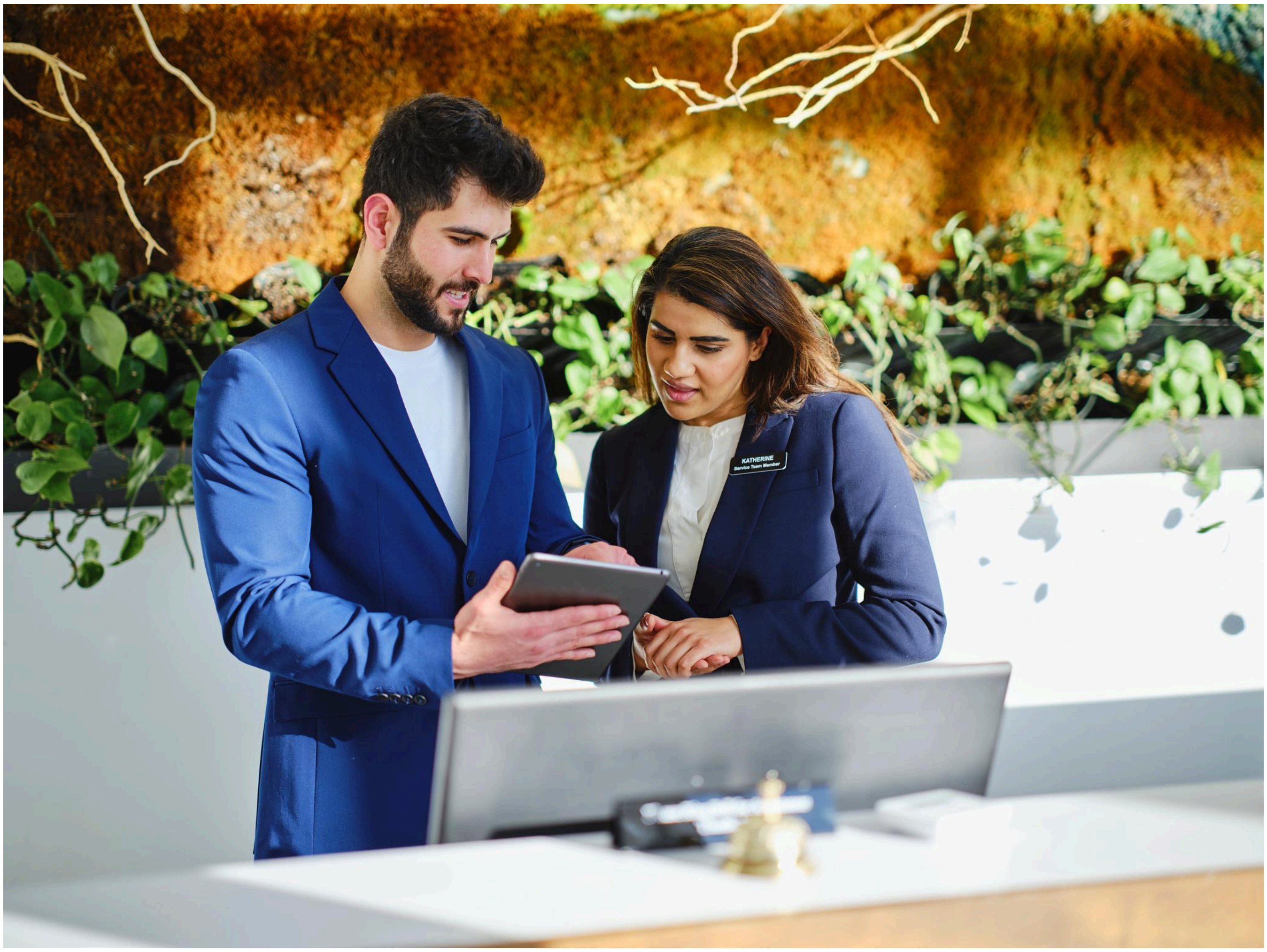
Poor Management Drives Hotel Distress, Finance Executives Say

In Era of Expensive Debt, Experts Stress Hotels Are More Than Just Real Estate



Hotel operations can make or break a hotel's financial outcomes. Speakers at the Meet the Money conference said poor hotel management is a leading driver of hotel financial distress. (Getty Images)

By Sean McCracken
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LOS ANGELES — After many predictions of waves of post-pandemic hotel distress, experts believe the limited distress arising in the market now is still primarily driven by operational missteps.

During the "Winning in the Distress Game" session at the 2024 Meet the Money conference, Kevin Gallagher, senior director at Trimont, said people need to remember hotels are operating businesses, and people can make or break financial outcomes.

"Yes, there are economic [headwinds] and yes, there are issues with capital stack structures, but a great hotel is run by a great general manager and a great director of sales," he said. "When you look at a distressed hotel, it almost always boils down to the competence of the people on the property."

Gallagher said that remains true even for hotels with the backing of strong third-party management.

"A great general manager could overcome a mediocre management company," he said. "A terrible general manager cannot be lifted up by a great management company."

Building out a strong team is the first step for success in any hotel operation, said Jack Westergom, founder and managing director of Manhattan Hospitality Advisors.

Westergom focuses on operational issues first and foremost when he takes over as a receiver for hotels with severe financial issues. Turning operations around can help drive demand even to older, underinvested hotels, he said.

"You have to come up with creative solutions to find your market and tell them why — even though you're distressed — you are the choice for them," he said.

Part of that comes back to more aggressive sales and marketing tactics. Westergom said there is a difference between hotel salespeople today versus even just decade ago.

"There is a generation of order-takers not order-makers now," he said.

While panelists said operations can be the key issue driving hotel distress, some noted it's not the only issue.

Noble Investment Group's Emily Feeney (left) and Trimont's Kevin Gallagher speak at the 2024 Meet the Money conference. (Sean McCracken)

Jon Kapit, managing director of investments at Access Point Financial, said the few hotels where his company is seeing distress are either from operational issues or "capital markets issues."

"So I wouldn't call it a distressed property, but it's a stressed capital markets issue, where the hotel is covering debt service but the loan's maturing," Kapit said. "And due to current dynamics, they can't get us out. So the question is, what do you do? Do you extend? ... We're not a loan-to-own shop. We don't want to take things back."

Panelists acknowledged most lenders are in that position today, only taking back keys when they have no other options or circumstances force that move. But there are some groups that buy hotel debt with the hope of a default and taking over the property, said moderator Frank Anderson of Anderson Hospitality Consultants.

Gallagher said the best way to avoid issues with that type of lender is to "hold on and pray" and to "not default."

"If you trigger an event of default, they're going to come after it," Gallagher said.

David Scheiber, Cathay Bank's senior vice president and special asset department manager, said legal issues are also a key indicator of potential distress.

"I think a good distress trigger that's not been mentioned is when the number of subpoenas exceeds the number of deposits," he said.

Distressed Investment Opportunities

Investors waiting on a tidal wave of hotel distress have been so far disappointed. Emily Feeney, Noble Investment Group's senior director of capital markets and investments, said there is opportunity if investors scratch past the surface.

"It's finding that needle-in-a-haystack deal that everybody's always talking about, which for us means finding distress in the capital stack rather than the market," she said.

Feeney said even in markets with overall strong performance, there are hotels that have "a gap that has some friction looking to exit" somewhere in their capital stack that is ripe for an outside investor.

"So it's finding an owner that has looming debt maturities or renovations that are coming up and require significant capital," she said. "So you can step in and be able to take over and take on the deal."

Noble itself was able to avoid significant distress throughout the COVID-19 pandemic in part because of its debt strategies, including purchasing interest rate caps when rates were still low, she said.

"We saw the writing on the wall," Feeney said. "We saw where interest rates were and what was eventually going to happen. It proved to be very, very beneficial."

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