

## 10 Questions About Buying Distressed Hotels

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The market for distressed hotels owned by borrowers facing lender action, or by lenders who have recovered real estate through foreclosure or a deed in lieu of foreclosure, or through buying discounted hotel loans and first priority security positions that will produce a "loan to own" scenario, will likely become more active as recovery nears. We've asked the seasoned valuation experts at HREC for advice on what to look for and what to expect in these situations.

*1. Will the distressed market present attractive investment opportunities for investors, and if so, when?*

Definitely. However, 2010 is likely to present more of a trickle of deals than a tsunami. We are already seeing the flow begin, primarily consisting of acquisition opportunities under \$10 million. While the flow of opportunities may be slower than many anticipated, the duration of distressed deals coming on market will be longer, extending well into 2013.

*2. What investment style is best suited for this market?*

The first wave is best suited for the "gun slingers," as much of the upside will be difficult to pencil out, causing the institutional buyers to stall due to "analysis paralysis." All cash/equity buyers will be "King" in the first waves.

*3. What evaluation criteria should be applied to distressed hotel situations, when cash flow is negative and capital expenditures are likely well behind schedule?*

These deals will be superficially sold on a "price per pound" basis at a significant discount to replacement cost. However, the buyers will each have a unique plan relative to the property under consideration for substantially increasing cash flow and hitting targeted investor yields.

*4. What is the best way to address brand affiliation and brand encumbrance?*

Branding will continue to have a major impact on sales prices. Many of the early hotel waves will contain assets losing their flags and beginning their inevitable descent down the hotel food chain. The "diamonds in the rough," where upbranding is possible and feasible, will be the deals highly sought after, and the ones that sell for a premium due to competitive bidding pressures.

*5. How should current management be evaluated?*

Very carefully; buyers need to decide whether existing management is part of the problem and if their replacement is an integral part of the solution. This issue is somewhat moot since most of the early wave buyers will be owner/operators or operators married to a specific investor. Under these scenarios, existing management is out regardless.

6. *If you could pose one question to the current general manager (GM) and one question to the current director of sales (DOS), what would the questions be?*

GM: If you were given x dollars in capital expenses to spend next year, what would be the top three areas or items that you would spend it on to increase cash flow in the next 12 to 24 months?

DOS: What is the greatest curable problem that you face when attempting to sell the hotel to consumers and planners?

7. *What should be the new owner's priorities immediately after taking over the property?*

Stabilize cash flow and staffing (retain the good performers and exit the poor performers as soon as conditions permit).

8. *What markets or areas are most likely to return quickly to stable and profitable Revenue Per Available Room?*

For the next 18 months, we believe the "deal" will be more important than the market area.

9. *What non-traditional approaches offer enhanced prospects for success in the new reality of hotel ownership?*

The buyer's ability to buy and close all cash/equity now and to place debt financing on the property at a later date.

10. *What role will macroeconomic factors play in the execution of a distressed hotel acquisition strategy?*

The major macroeconomic factor will be the availability and cost of debt financing. Recourse versus non-recourse? Maximum proceeds? Duration (term)? These factors will dictate both pricing and buyer deal volume capacity. The second factor is simply the economy, especially job growth. As the economy goes, so goes the hotel business.

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