Hotels Face Challenges As Wave Of CMBS Maturities Nears

By **Andrew McIntyre**

Law360, Minneapolis (March 1, 2016, 4:20 PM ET) -- Many of the commercial mortgage-backed securities loans made before the 2008 market meltdown are coming due this year and next, and lawyers say hotel borrowers in particular may have difficulty refinancing because of tighter underwriting standards and limited available capital for new hotel loans.

Hotels, which by definition don't offer stabilized and predictable income streams, draw unique scrutiny from underwriters of CMBS loans when they are determining what interest rate to charge and how much leverage to offer.

New regulations on CMBS loans that go into effect at the end of this year will likely make it even harder and more costly for such borrowers to take out fresh debt, attorneys say. And access to capital can also pose a problem, as traditional balance-sheet lenders often only allocate a small percentage of their loans for hotels, given the complexity and uncertainty of the asset.

Add to that a few choppy months on Wall Street, and the outlook for hotel owners looking to refinance further darkens.

"We have definitely heard from CMBS servicers that there is a large wall of upcoming maturities in the hotel space," said David A. Sudeck of Jeffer Mangels Butler & Mitchell LLP.

"When someone senses a potential market downturn, the first to react is the hotel industry because the rent is on a nightly basis," he added. "It's very easy for demand to change on very short-term or no notice."

CMBS loans, or conduit loans, are loans secured by commercial property and then bundled and sold to investors. CMBS debt typically comes with longer loan periods, lower interest rates and higher loan-to-value ratios than what accompanies more traditional loans.

The loans coming due this year and next are for the most part 10-year loans, inked in 2006 and 2007. CMBS issuance peaked at more than $200 billion in 2007, fell to roughly $10 billion in 2008, and dipped well under $10 billion in 2009.

"As we sit today, it's difficult for lenders in the CMBS market to price new originations, just really because the market is kind of choppy. The equity market is kind of choppy," said David N. Sonnenblick, a principal at real estate investment banking firm Sonnenblick-Eichner Co. "The question is where they're going to price. ... There's a tremendous amount coming due this year and next year, and into 2018."

On the one hand, refinancing 10-year loans now can be an advantage for hotels. Those loans a decade ago might have been at 5 percent or maybe even as high as 6 percent, and the 4 percent to 5 percent range now looks attractive.

Sonnenblick says he's seeing hotel financing deals now with anywhere from a 65 percent loan-to-value ratio to as high as 70 percent or even 75 percent, and the CMBS sector tends to operate at the upper end of that leverage spectrum.

But all of this assumes the borrower can find a lender, which is no given.

When borrowers can't refinance their CMBS debt from a traditional balance sheet lender, they look mainly to either do another CMBS loan or to do a loan with a fund set up by a hedge fund, according to Jeffrey S. Page of Reed Smith LLP.

But funds of hedge funds, like traditional lenders, only have a limited exposure to the hotel sector, and CMBS lenders have an additional concern: New risk retention rules as a result of Dodd-Frank take effect Dec. 24 this year.

Those rules say parties issuing pools of CMBS debt have to keep 5 percent of those pools on their books for five years. Currently, such pools are entirely liquid and can be traded at will.

"It's a very significant issue," Page said. "It isn't resolved yet. It will at a minimum increase borrowing costs for CMBS borrowers and very likely in the short term reduce the availability of CMBS loans."

"There will be a big push to try and close deals," he said. "Unfortunately, there's already a fair amount of disruption in the CMBS market impacting availability. … Everyone from someone who owns one hotel in the middle of Pennsylvania to large hotel operators, they all have CMBS debt."

Indeed, the combination of those looming changes to CMBS regulations on top of some economic uncertainty is causing underwriters to struggle to figure out just how they should be underwriting such loans.

And that's creating a big question mark for borrowers.

"No one really knows right now how the CMBS market is going to shake out," Sonnenblick said. "The CMBS market is trying to digest … how they're going to price all this paper as they continue to originate loans."

Hotel borrowers looking to refinance debt may have to put in more capital, either because their property isn't sufficiently valuable or because the lender is offering less leverage. Or they may have to supplement a new loan with a second bridge or mezzanine loan.

Even hotel owners in New York, where asset values have climbed over the past five years, may find difficulty getting refinances, said Wayne S. Cook Jr. of Windels Marx Lane & Mittendorf LLP.

He said with hotel room rates and revenue per available room "taking a dip" in New York, some hotels in the city may encounter difficulties finding refinancing.

Indeed, while various other asset classes also run up against CMBS loans coming due this year and next, the process of refinancing for hotels presents various additional challenges, lawyers say.

"Hotels are much more of a hands-on operating basis than traditional commercial real estate. It requires a more specific understanding of the industry by the underwriter," said Thomas F. Hanley III of Loeb & Loeb LLP.

"Hotels for CMBS are a completely different animal."

--Editing by Jeremy Barker and Patricia K. Cole.