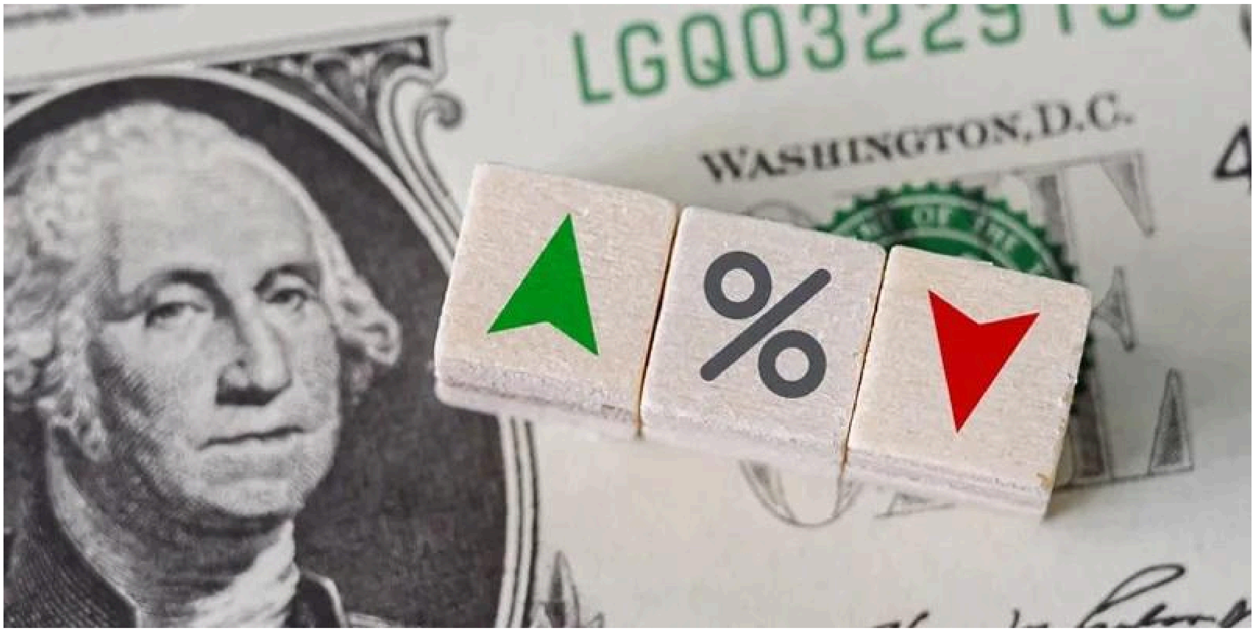

Investor perspective on the state of hotel financing

After HREC offered takeaways from annual mortgage bankers conference, Hotel Investment Today asked industry investors for their opinions on the current lending environment.

NATIONAL REPORT – There is optimism about hotel debt originations in 2024, stated HREC Capital Markets after speaking with dozens of capital sources at the annual Mortgage Bankers Association Conference.

HREC shared its takeaways from the event and Hotel Investment Today reached out to investors to get their current opinions about the state of hotel financing. Here are the findings.

Debt originations

The first question we asked investors is whether or not hotel debt originations will increase in 2024.

Greg Friedman, CEO, Peachtree Group, Atlanta. "We are already seeing a hint of what will come in our commercial real estate credit pipeline, where activity is ramping up. Over the past three months, we have deployed close to $700 million in credit investments, with new deals to review weekly.

"With a record amount of maturing loans, potentially approaching $1 billion this year alone, it is inevitable that originations will see a sizeable uptick. Now, who will be the recipient of those originations is open to debate, but banks are in a multi-year-long process of unwinding their positions in commercial real estate. The securitization market is improving, but private credit lenders like Peachtree Group will fill the void."

Christopher Ropko, CEO, McNeill Investment Group, Germantown, Tennessee. "I do not believe tradition bank originations will materially increase from 2023, particularly in light of recent regional/community bank instability. Private/non-traditional originations will increase as a function of natural 'end of lifecycle' transaction activity expected for 2024."

Glyn Aeppel, Glencove Capital, New York City. "Debt originations have been at an all-time low given interest rates quick rise and bank patience. But between stress and rates slowly reducing, there will be transactions in 2024 and they will get financed with debt. We are starting to see a number of sales in New York City with more to follow."

Greg Mount, CEO and founder, Victory Hotel Partners, Denver. "Lenders have begun to over-allocate new originations to hotels to make up for the declines in loan volumes elsewhere. This should continue into 2024 unless rates move meaningfully lower or cap rates on other asset classes move significantly higher."

Mike Wilbert Sr. managing director, head of Acquisitions, Mission Hill Hospitality, Denver. "Debt originations will increase due to the amount of capital on the sidelines (capital raised but not yet deployed) and debt maturities coming due."

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>
> Greg Mount

Potential for rate cuts

HREC said while fixed-rates have rapidly improved (10-year treasuries down 80 basis points from October 2023 highs, CMBS spreads down 75 basis points from November highs), the prospect for further interest rate declines are muted.

In fact, floating rates, which are directly tied to the Fed Funds rate, remain stubbornly high in spite of declining spreads, HREC commented, adding that conference participants were less optimistic about significant Fed cuts in 2024 than in December.

What do hotel investors think?

Christopher Ropko. "I am in the camp that any rate cuts will be purely tied to the lead-in to the the election I do think we will see cuts mid-year as the financial system is nowhere near as healthy as is being reported in the mainstream media; in fact, it is teetering, in my opinion."

Greg Mount. "As we all saw a couple of days ago Powell, said that he thought the central bank would begin to lower borrowing costs in 2024 but that policymakers still needed to gain confidence that inflation needed to be conquered before making a move."

Greg Friedman. "I anticipate that the Federal Reserve will uphold the existing rates during this month's meeting. Future decisions will likely hinge heavily on data, particularly regarding the timing and necessity of rate cuts. The Fed will unlikely reach its target of 2% inflation this year but still expect a rate cut in the latter half of the year."

Mike Wilbert Sr. "I'm optimistic for lower interest rates in second half of the year driven by Fed cuts."

Glyn Aeppel. "[Fed Chairman] Powell has indicated inflation is about to stabilize at 2% and they intend to slowly reduce interest rates. It will be very slow and steady."

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Christopher Ropko

Refis in 2024

HREC said it foresee this being a strong year for refinancing given more a more stabilized capital markets environment, a wall of maturities, and banks' reduced appetite to "extend and pretend."

What do hotel investors think?

Glyn Aeppel. "I'm not sure strong is the right word. There will be refi opportunities for those assets that have strong operations and cash flow but tough for those under stress which may force sales of assets."

Christopher Ropko. "Rates will stabilize, but cost of capital will remain high on a secular basis (i.e. last 15-year comparison). Non-traditional lenders will rule the day by providing liquidity."

Greg Friedman. "Rate stability will certainly drive refinances. But with real estate values adjusted down due to increased interest rates and expanding cap rates, many prospective borrowers will need new equity infusions, referred to as 'cash in refi,' to even think about refinancing their properties. We see roughly 20% or more borrowers require additional equity for refinancing."

Greg Mount. "In 2023 we saw $541 billion in debt come due, the highest ever. From what we've heard, in 2028 more than $2.2 trillion in debt is maturing and much will have to be refinanced at a higher rate. So, to answer your question refis in 2024 will likely not be as strong as 2023, and from what we have seen lenders seem to be working with borrowers, albeit at higher rates."

Any relief for construction lending?

HREC stated that construction lending remains very difficult given high rates and construction costs, and the pullback from banks. It added that PACE lending is gaining acceptance and helps to reduce the cost to build.

The investor's perspective?

Christopher Ropko. "It's nearly impossible to make new development pencil with the cost of capital where it's at coupled with the fact that liquidity has virtually dried up for construction debt. Expect a muted supply line."

Greg Friedman. "Tighter lending standards from banks are making it harder for U.S. hotel developers to secure funding, slowing the construction of new hotels. The upheaval with banks, particularly regional banks, has limited access to loans, and higher construction costs have delayed projects across the country."

Glyn Aeppel. "It's gently coming back but expensive. There are lenders active like Peachtree but highly selective - need strong sponsors and relationships - or low debt ratio at high interest rates."

Mike Wilbert Sr. "Debt financing for new construction is available for strong sponsors."

Greg Mount. "It's available but expensive."

The upheaval with banks, particularly regional banks, has limited access to loans, and higher construction costs have delayed projects across the country.

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