

With the good times continuing to roll, *Hotel Business* spoke with a variety of lenders to ascertain where we're heading. We caught up with David J. Antonelli, founder of Patriot Funding; Michael Cahill, CEO/founder of HREC; Taylor W. Grace, managing partner, MidCap Funding; Michael Sonnabend, managing member of PMZ Realty Capital LLC; and Jon Wright, chairman/CEO of Access Point Financial.

—Gregg Wallis

What types of projects will lenders fund most in 2019?

Antonelli: There is a lot of ground-up construction nationally, along with multifamily, hospitality and retail, not to mention the mass of CMBS loans coming to maturity. However, look to see a large amount of bridge lending to be completed, making for a solid 2020 when they all convert to permanent financing.

Cahill: Bread-and-butter acquisition financing will continue to be strong, with interest rates still attractive compared to long term industry averages. Refinancing will continue to be desirable for existing owners with maturing loans that don't want to sell, even though volume may decrease since many investors have already refinanced.

Grace: Though hotel lending experienced a slight slowdown in 2018, we believe it will hold steady during 2019. Permanent market financing will remain readily available, though with rates creeping steadily higher, across all flagged hotel types. Independent hotels, however, unless located in a primary market, will continue to see a general lack of interest in the capital markets. For construction projects, as with 2018, we believe lenders will continue to focus on good locations with experienced operators. Importantly, for ground-up hotel construction, we also believe loan-to-cost ratios will continue to see downward pressure. The days of 75% loan-to-cost, outside of SBA programs, are in the rearview mirror. Expect to see the current loan-to-cost environment of 65-70% continue to compress toward 60-65%.

Sonnabend: Lenders will continue to aggressively fund projects for seasoned owners with strong track

records. There will continue to be significant capital available for newly built hotels to repay less attractive construction financing and allow them to stabilize their cash flow prior to obtaining long-term refinancing or selling the asset. Somewhat surprisingly, I believe there will be some new lenders looking to fund construction of deals in the \$40 million to \$100 million range. The senior debt will be lower leveraged, and there will be additional layers of the capital stack to bring the leverage back to 70-75% LTC.

Wright: In our view, the inflow of capital for hotel lending has been healthy for five to six years now, yet slowing as banks reach exposure limits, with clients in their footprint and overall concentration of hotel assets on their balance sheet. In most instances, lenders prefer to underwrite hotel risk when the developer is insulated with brand affiliation (especially going into Q4 and currently year-end), stabilized debt service for 12-24 months minimum to include a recently executed license agreement.

The rationale developers employ to align with certain brands is not at all dissimilar than the bank underwriting of risk assessment (not to mention voting members of a typical credit committee). Although independent/boutique assets certainly offer great value over branded hotels in specific markets, bank lenders are slower to react to such requests (as a rule of thumb), specifically if the asset is not positioned in the backyard of the lender. Therefore, strong brand affiliation, along with substantial equity (based on loan to cost), is paramount for any loan request. Credit quality of the "entire" partnership (i.e. background check) is also of the utmost importance. Independent/boutique assets are also considered strong candidates for low leverage debt.

New-construction remains a challenge due to the economic and political unknowns from start to finish (typically 30 months) and extended timing required for capital deployment (most institutions are strategically motivated to fund commits ASAP). Middle Market loans (\$1 million to \$50 million) are currently in most lenders' sweet spot. This includes community banks (\$100,000 to \$5 million),

regional banks (\$1 million to \$25 million), private lenders (\$5 million to \$100 million) along with institutional capital (\$50 million and up).

Which markets will receive special attention in the upcoming year?

Antonelli: That's a tough one actually; the Fix and Flip industry has taken off. Hospitality is hot and many investors are jumping from duplexes and six units over to the 50-plus multifamily, so the focus is broad.

Cahill: I believe secondary and tertiary markets will be strong, due to lack of opportunities for lenders to place debt in gateway cities. Local lenders will continue to dominate lending in tertiary markets.

Grace: As always, primary markets will receive the most attention. However, secondary markets will continue to receive interest if significant demand drivers are present. Tertiary markets will be hit-or-miss during 2019. For projects in these markets, local/regional lenders will be the best option. Lastly, expect to see continued difficulty in finding lenders willing to go into oil and gas markets during 2019. This is a consistent theme over the past few years, but has become more pronounced of late.

Sonnabend: Special attention can be either positive or negative. On the positive side, lenders will continue to focus on areas with multiple demand drivers and barriers to entry. An excellent example of this is college towns. We have completed all types of financing in towns that have a significant educational component to the demand, and they have fared well in all parts of the market cycle. On the more challenging side, lenders are going to look more closely at transactions in smaller markets that have fewer barriers to entry and more focused demand drivers.

Wright: For 2019, we forecast heavy emphasis on portfolio/risk monitoring, along with "tempered" exuberance specific to new business development. By the way of example, APF currently enjoys a roster of roughly 500 unique/repeat clients (whose historic behavior is stellar). Therefore, new clients will be subject to a more thorough diligence process. APF would typically view a new application (potential new client) as perhaps, someone who is



David J. Antonelli
Patriot Funding



Michael Cahill
HREC



Taylor W. Grace
MidCap Funding

approaching as a "Lender of Last Resort." And, unfortunately, most institutions have a similar view (typically SBA candidates are the exception to this thinking). By this time in the cycle, qualified borrowers/developers have found sources of reliable capital and, in that case, we take a view and confirm if such application has simply exceeded lending limits with typical debt providers. In that case, a well-qualified candidate could utilize a private institution, such as APF, to

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act as a bridge lender (for “midterm” needs) so long as client global cash-flow results are verifiable and track at least a 1.25 debt service coverage ratio or greater.

How long do you foresee the lending environment staying favorable for borrowers?

Antonelli: If the presidency stays as it is for another six years, we believe rates will continue to climb. Commercial property will always move along—there is always an opportunity to grab foreclosures, deed sales, non-performing notes, so rates will clearly impact those transactions moving forward. We expect it to be good for a number of years to come as we watch our origination’s climb weekly.

Cahill: All looks rosy for the future pending the results of the 2020 presidential election.

Grace: While the hotel lending environment is still favorable on a historical basis, it has already pulled back somewhat compared to the last few years. We expect a stable lending environment in 2019, on par with 2018. However, there appear to be dangers flashing for 2020 and beyond. Look for lenders to become more cautious going into the end of 2019, which will manifest itself mostly in terms of lower leverage and higher cash flow hurdles.

Sonnabend: Barring any black swan events, the lending environment should stay relatively favorable for the next 18–24 months. Although capital will be available on generally favorable terms, interest rates will likely tick upwards, and underwriting standards will tighten up during this time. I would encourage any owner looking at a deal to be realistic on the pending market conditions today and the trajectory of interest rates.

Wright: How long are markets stable? From 1988 (my first year of a 30-year lifespan in hospitality financing), we have weathered five economic downturns, and simple math is approximately every five to six years, the market is flushed via over-supply of inventory, and a collision of economic or political unrest (or both) occurs.

When U.S. or global economies dip (or crash)—and one is typically

a byproduct of the other—the most prudent behavior is to step back and assess portfolio performance.

These aforementioned/unknown cycles create a scenario to “thin the herd” or shake out “part time” or “speculative” lenders. Long-term viability of well-known lenders is a byproduct of overall enterprise disciplines (or lack thereof) over the long haul. And, although not a prophetic outlook, the simple template is for developers/owners to pay close attention to leveraging assets via close longer-term relationships, rather than chasing a reverse auction process to garner another 25bps of margin savings.

What is getting a lot of play: fixed rate, floating rate, mezz, other types of debt? And for what?

Antonelli: Small balance commercial is generally looking at five-year fixed rates. What we are seeing is the need and the want for a longer amortization period, stretching it out for the lower payment. In addition, it helps the DTI. We do not see many at all seeking the floating rate, especially in an economy of rising rates, and all bridge loans are interest only.

Cahill: Over the last six months, fixed-verse floating has been the big question. More conservative investors have made the move to lock in debt at fixed rates, especially if they anticipate a long-term hold. Other investors, many of them highly sophisticated, have opted for variable if they have a shorter-term hold perspective for their lodging investments. Bridge loans still have their place, for hotel purchasers with major value add scenarios and underwriting restrictions based on poor historical financial performance for the asset under consideration.

Grace: Fixed-rate loans in the capital markets are still being offered with aggressive structures and terms. While interest rates are rising in tandem with long-term treasury bonds, we have seen some very aggressive terms during 2018 regarding leverage and cash flow underwriting. Included with some fixed-rate capital markets executions have been layers of mezz debt. The appetite of mezz lenders has been for larger loan sizes (mezz components of at least \$5 million) and shorter-terms

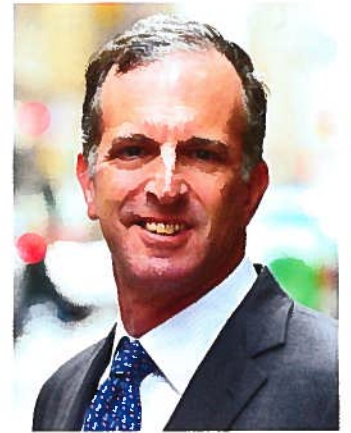
(five years). Importantly, the term of the underlying first mortgage and mezz must match up. Floating rate debt has been available for ground-up construction projects in primary and secondary markets, albeit at declining leverage (loan-to-cost). As for other types of debt, private equity bridge lending is still readily available for experienced operators with strong business plans and plausible short-term exits.

Sonnabend: We are doing a lot of floating-rate financing. Many borrowers are looking to execute a business plan, and that is the best type of financing for them. Fixed-rate lenders are looking for stabilized assets and are tightening underwriting standards. There is a great demand for mezzanine debt to go along with both fixed- and floating-rate deals.

Wright: Our team/rating agencies, have collaborated for over three decades to produce loans which are viable in “any” economic and/or political crisis.

By participating in one component, or the entire capital stack (variously termed/ priced tranching), we have developed a product for any robust or eroding market scenario (no matter the existing market outlook). Better yet, as a balance sheet/direct lender, we enjoy the flexibility and autonomous management style that community banks were known for restructuring good borrowers in bad times, and through no fault of their own.

We do not own/operate hotels and, therefore, have no desire to foreclose at the first opportunity. All borrowers should clearly investigate the background and verify references that a lender is not controlled by such operators of hotel assets (as a “sidecar” business or a “loan-to-own” lender).



Michael Sonnabend
PMZ Realty Capital LLC



Jon Wright
Access Point Financial