



What's Next for Hotels? Analyzing the Hard-Hit Commercial Real Estate Sector

We know the phrase “hindsight is 2020” is about 20/20 vision, but the year 2020 has been anything but clear. A worldwide pandemic, tumultuous election cycle, natural disasters, and Zoom have occupied the majority of our recent memories, taking up the space that summer vacations, concerts, and sporting events were supposed to fill.

The social and economic effects that the pandemic has had on the world and the commercial real estate (CRE) market – and to our attuned eyes here at Trepp, are substantial. Shutdown orders all but halted tourism, and the effects of a closed-off economy impacted CRE property sectors.

This report provides an update on the lodging sector following our research from May 2020.

According to Trepp data, more than 3,100 commercial mortgage-backed securities (CMBS) loans totaling over \$87 billion in outstanding balance are backed by hotel properties across the United States. This makes the lodging sector the third-largest property type by outstanding balance, representing 16% of the overall CMBS universe.

CBRE Hotels Research reported that hotels were able to adapt to the challenges they faced and implement cost-cutting measures early in the summer that allowed them to

achieve a 16.7% gross operating profit (GOP) margin through August. This is less than the 34.3% margin achieved during the same period in 2019 but it was enough to allow hotels to still cover departmental and undistributed costs. The report also noted that total operating revenues were down 63.3% on a per-available room (PAR) basis year over year, but on a per-occupied-room basis, the revenue decline was 31.7%.

STR also examined lodging performance throughout Q3 and noted that hotel occupancy was 48% over the summer and in the early fall months and that revenue per available room (RevPAR) had fallen by -46.1% as of September. Additionally, they found that limited service and rural hotels have seen fewer declines than their luxury and upscale class hotel counterparts. Much of this can be attributed to group-RevPAR seeing declines as high as -94.1% in April, with the number clocking in at -87.1% as recently as September. With federally imposed limitations on travel and corporations canceling large group gatherings at higher-end hotels across the country, the full-service luxury hotels in urban areas have been disproportionately feeling the financial strain.

For instance, in the Houston-The Woodlands-Sugar Land-MSA, the cancellation of large revenue-driving energy conferences like CERAWEEK resulted in a significant impact on the hotel industry.

TABLE 1: TOP 10 METROPOLITAN STATISTICAL AREAS (MSAs) BY DELINQUENT BALANCE

MSA NAME	OUTSTANDING BALANCE (\$)	DELINQUENT BALANCE (\$)	DELINQUENCY RATE (%)	SPECIAL SERVICING BALANCE (\$)	SPECIAL SERVICING RATE (%)
New York-Newark-Jersey City, NY-NJ-PA	3,772,531,645	1,148,685,748	30.45	1,685,292,856	44.67
Chicago-Naperville-Elgin, IL-IN-WI	1,798,706,165	1,027,357,608	57.12	1,043,676,171	58.02
Los Angeles-Long Beach-Anaheim, CA	3,797,847,945	1,027,036,885	27.04	1,250,036,885	32.91
Houston-The Woodlands-Sugar Land, TX	988,023,356	751,192,200	76.03	683,738,336	69.20
Portland-Vancouver-Hillsboro, OR-WA	723,348,597	565,733,622	78.21	565,733,622	78.21
New Orleans-Metairie, LA	964,813,869	399,988,561	41.46	371,696,325	38.53
Miami-Fort Lauderdale-West Palm Beach, FL	4,300,716,330	363,021,246	8.44	336,303,227	7.82
Nashville-Davidson-Murfreesboro-Franklin, TN	1,071,302,851	325,262,348	30.36	339,651,498	31.70
Dallas-Fort Worth-Arlington, TX	1,478,267,481	320,273,783	21.67	283,778,376	19.20
Seattle-Tacoma-Bellevue, WA	1,043,832,317	285,026,787	27.31	285,026,787	27.31

Source: Trepp

Trepp data notes that the delinquency rate for hotel CMBS loans in the Houston-MSA came in at 76.03% in October. It is important to note that the Houston metropolitan is home to many oil and gas companies and that any downturns in the energy sector will have a broad-ranging impact on the local economy.

The disruption to their economic system has caused hardship for hotels like the \$76.2 Hilton Houston Post Oak (JPMBB 2014-C25). After being valued at \$126.2 million in 2014, the value was lowered in October to \$57.5 million, adding to a long list of lodging loans that have seen their appraised values reduced. The loan was sent to special servicing and is likely “deed-in-lieu (DIL),” according to special servicer comments from August.

While the Houston-MSA is just one example, many other MSAs across the United States are seeing significant distress in the form of delinquent loans, transfers to special servicing, valuation declines, increased instances of borrowers handing back assets to lenders, and loans with issues refinancing at maturity.

After Record Highs – Slight Regressions in the Delinquency Rate

Since reaching a record high of 24.30% this past June, the lodging delinquency rate fell in each of the months that followed. October was no different, posting a delinquency rate of 19.43%; a 351-basis point drop from September.

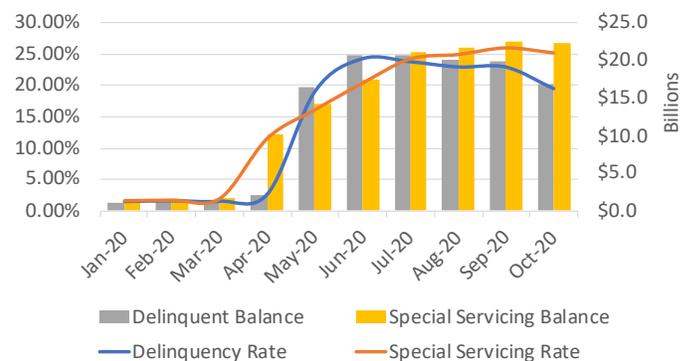
Breaking down the delinquency rate by lodging subtype can also help to pin down where the distress has been most prevalent. Since March, the limited-service hotel sector has seen the highest amount of distress amongst the property subtypes, with its delinquency rate peaking in July at 27.23%. In October, limited-service hotels posted a delinquency rate of 24.83%. CBRE noted that rural and resort hotels have benefited from drive-in visitors making use of amenities rather than out of state tourists making use of rooms – helping to explain some of the deficiencies that limited-service hotels have been facing.

Extended stay and full-service hotels have fared a bit better, with delinquency rates of 14.59% and 17.46%, respectively,

for October. October marks the fourth consecutive month that the overall lodging delinquency rate has fallen.

It is important to note, however, that there has been downward pressure on CMBS delinquencies with many loans reverting to “current” status as a result of forbearances being granted, and borrowers being authorized to use reserves to bring debt service payments up to date. According to Trepp’s forbearance report based on September remittance data, over 64% of all forbearances that have been granted in the CMBS market thus far can be attributed to hotel loans, totaling more than \$8.5 billion. On top of that, the percentage of lodging loans on servicer watchlist rose every month since February, with that number reaching 45.54% in October – indicating that almost half of all lodging loans are being monitored for potential hardship.

GRAPH 1: LODGING DELINQUENCY AND SPECIAL SERVICING TRENDS IN 2020



Source: Trepp

An example of a loan that was previously marked as delinquent but that now reflects a current status is the \$147 million Canyon Ranch Portfolio (COMM 2014-UBS5), which is backed by properties in Tucson, AZ and Lenox, MA. In May, the borrower faced difficulties in making payments due to COVID, and in June, after turning 60+ days delinquent, it requested relief that was approved by the special servicer. The loan reverted to “current” status in July under the agreement that relief be provided in the form of the borrower using reserve funds to cover debt service payments from April to August. Per the side letter agreement, the borrower will repay reserves by December 2020.

The forbearance period for the Canyon Ranch Portfolio loan ended in August and the loan was able to stay current, however, with reserves repayment pending and the lodging sector still struggling, borrowers may have to reengage in talks with servicers for further financial assistance. This is certainly not the only loan with an expired forbearance deal, and as the lodging sector continues to face headwinds, it will be important to monitor how borrowers and lenders react to further difficulties.

TABLE 2: FIVE LARGEST DELINQUENT LODGING LOANS

LOAN NAME	CURRENT LOAN BALANCE (\$)	DELINQUENCY STATUS
CLNS Portfolio	624,000,000.00	Non Performing Beyond Maturity
Atrium Hotel Portfolio	480,000,000.00	90+ Days
Courtyard by Marriott Portfolio	332,000,000.00	Non Performing Beyond Maturity
Ashford Portfolio	316,000,000.00	90+ Days
New York Hospitality Portfolio	300,000,000.00	30+ Days

Source: Trepp

In short, although the delinquency rate has begun to drop, rising forbearances and the high number of loans on the watchlist and with the special servicer provide mixed signals on the future of the lodging sector.

A Clearer Indication of Distress: Special Servicing Rates

In trying to get a complete picture of the lodging sector, another metric to consider is the special servicing rate. Since many loans with missed debt service payments reflect a “current” status due to forbearance agreements, special servicing rates provide more transparency regarding the distress of loans across the sector.

In September, the Trepp Special Servicing Rate rose 44 basis points to 10.48%. In the same time frame, the lodging special servicing rate rose 105 basis points to 26.04%, its highest reported rate on record.

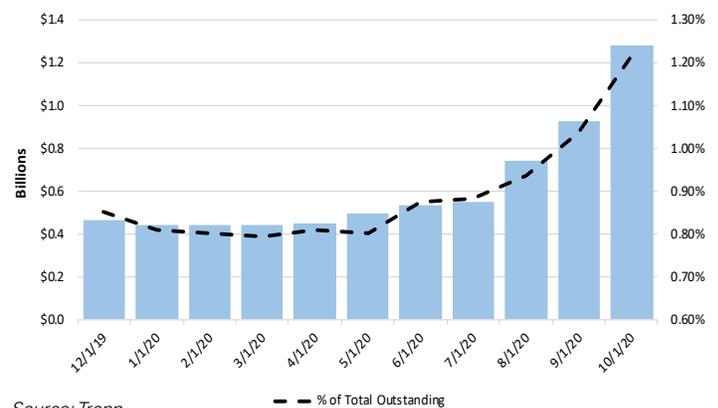
In October, both the Trepp Special Servicing rate and the lodging special servicing rate fell slightly, to 10.28% and 25.45%, respectively. This number represents over \$22 billion in lodging loans that have been transferred to a special servicer.

An example of a loan that has never been marked delinquent but had difficulties meeting debt obligations is the \$174.4 million Equity Inns Portfolio (COMM 2015-LC23). The loan was originally slated to mature in October 2020 but received an extension until 2022 as part of a forbearance agreement. It was originally transferred to special servicing in May for COVID-related imminent maturity default but was later modified with a two-year extension. Special Servicer commentary notes that the loan has since been returned to the Master servicer.

Appraisal Value Cuts and Property Repurposing

As we mentioned in our report “The Great Financial Crisis vs. COVID-19,” another data metric that invested players will watch closely are the total dollar amount of appraisal reduction amounts (ARA) that are being assigned as they can serve as an estimate of losses upon loan resolution. Normally, as CMBS loans become more distressed, new appraisal valuations are being done on the properties, and this has certainly held over the past five months as the number of revaluations rose sharply.

GRAPH 2: LODGING ARA TIME SERIES DURING COVID MARKET CRISIS



Source: Trepp

When examining ARA across the lodging sector property owners and lenders should be wary of the value behind their hotel properties. The cumulative ARAs on outstanding lodging loans have increased to \$1.28 billion as of October, from \$436.9 million in March. This is in line with our report in September that noted the value of lodging properties that have been reappraised since March have fallen -28.9% in comparison to their value at securitization. Appraised values are likely to continue to fall, as low performing hotels are unable to maintain the same level of maintenance or upkeep, and lack of expected income would make them hard-pressed to create substantive improvements.

Due to rising vacancies that have been difficult to fill, property owners must come up with creative solutions that include the repurposing and redevelopment of existing space to adapt to a rapidly changing CRE landscape. As malls struggle to fill their big-box retail spaces, they have begun to transform the spaces into industrial or office spaces for alternative uses of vacant space. In lodging, we have seen an early example of this by Amazon.

The largest hotel behind the \$415 million BREIT Select Service Hotel Portfolio (BHPT 2019-BXHP) – the Residence Inn Arlington Pentagon City in Virginia – was purchased by Acorn Development, a subsidiary of Amazon, for \$148.5 million in September. According to Commercial Observer, the hotel will be torn down and rebuilt to create more space for its Virginia HQ2 headquarters.

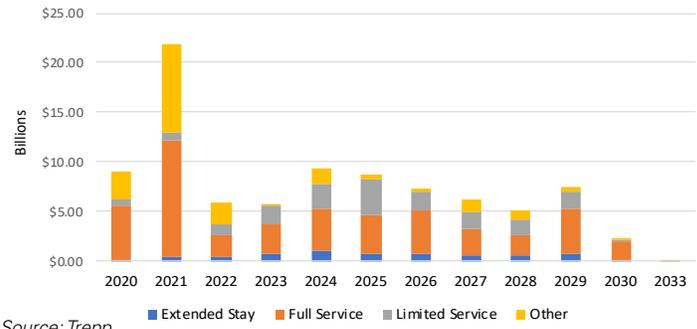
As more hotel loans begin to experience losses and borrowers look for ways to maintain revenues, it remains to be seen if we will see more reconversions of hotel properties for other uses.

Hotels Maturing in the Near Future

Another area that should put borrowers on alert is the volume of lodging loans coming due as the sector struggles. Trepp data notes that by the end of 2021, \$481 million in extended-stay loans, \$17.1 billion in full-service loans, \$1.5 billion in limited-service loans, and \$11.7 billion loans classified as other are due to mature, amounting to over \$30.9 billion in outstanding balance – almost 36% of the sector’s current outstanding balance. This, on top of the large number of appraisal reductions taking place in the sector, has the potential to leave lenders with higher losses than anticipated once these loans reach maturity.

Major players in the hotel segment have been forced to reassess the value of their properties and have shown an increasing willingness to give up ownership. Ashford Hospitality Trust has reached forbearance or modification agreements for nearly \$2.7 billion of debt, 72% of its outstanding debt, according to *Commercial Real Estate Direct*. They have begun to slowly

GRAPH 3: HOTEL CMBS LOANS MATURING BALANCE BY YEAR OF MATURITY



Source: Trepp

reduce their holdings in attempts to provide the most long-term value for shareholders and acknowledged that they will be handing back the keys to some of their lodging properties – a topic we evaluated in depth.

So, What’s Next for the Hotel Sector?

All in all, the lodging sector has been met with challenges since widespread COVID-19 protocols were adopted in March. Its delinquency rate spiked and stayed consistently above 19% since May of this year, forbearances reached record highs, and the special servicing and watchlist rate indicate that distress in the sector continues to be rife. Many property owners may seek to wind down their hotel exposures given the current pullback in travel and begin to operate with a mindset more in line with that of Ashford Hospitality Trust – potentially reducing the amount of future investment in the sector.

While the slight decline in the special servicing rate is a positive sign, it is still notably higher than the most recent reported lodging delinquency rate and may better serve as an indicator for troubled loans. The volume of property value haircuts continue to rise and a large number of loans in the sector are due to come to maturity in the next year. Looking forward, it will likely take time for tourism and hospitality demand to rebound to pre-pandemic levels even with significant progress on the vaccine front in the coming year.

For more information about Trepp’s commercial real estate data, contact info@trepp.com. For inquiries about the data analysis conducted in this research, contact press@trepp.com or 212-754-1010.

About Trepp

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