2016 HOSPITALITY LAW CONFERENCE

FEBRUARY 22-24, 2016

CAPITALIZING YOUR PROJECT – MAXIMIZING VALUE

Presented by:

Alexandra R. Cole, Partner

Marc A. Sallette, SVP

&

Olga Lepow, AVP

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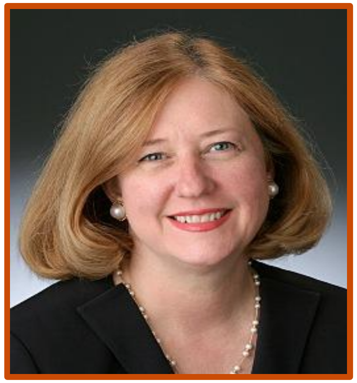
PRESENTERS



Alexandra R. Cole

Partner, Perkins Coie LLP

- Alex Cole focuses her real estate practice in the areas of real estate transactions and development, hospitality, international real estate, project finance and construction law. She is routinely involved in large real estate acquisitions (hotel, office and retail) and represents all the various parties in the construction and development process. Some of Alex's past projects include: Park Hyatt Australia, purchase and disposition of The Carlyle in a transaction including the sale of Rosewood Hotels and Resorts and four other hotels, Fairmont Hotel and Canadian Pacific Hotel merger, acquisition and disposition of Dolce Hotels and Resorts numerous buildings in Illinois Center, Chicago Mercantile Exchange, The Harold Washington Library, California Plaza in Los Angeles, McCormick Place Expansion and Hotel, Underwater World at Pier 39, Warsaw Financial Center, and the construction and renovation of numerous plants, industrial complexes, hotels, shopping centers and other commercial projects in the United States and Europe and the Caribbean.

PRESENTERS

Marc A. Sallette

SVP Hotels Finance, CBRE Capital Markets

- Marc A. Sallette is a Senior Vice President at CBRE Hotels where he leads a nationwide practice focused exclusively on debt and equity financing for clients in the hotel real estate sector. Mr. Sallette has completed over $3.0 billion of real estate transactions in hotel, resort, residential, fractional, office, retail and industrial markets in the United States, Canada, Caribbean, Latin America and Europe.

PRESENTERS

Olga Lepow

AVP Investment Analysis, Destination Hotels

- Destination Hotels – 4+ years focused on business development, grew portfolio with addition of 11 new properties
- LaSalle Hotel Properties – acquisitions totaling $426M

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AGENDA

1. Introduction
2. Where the market is
3. Capital Structure Components
4. Legal and Practical Considerations
5. Case Study Examples

We welcome your questions and participation!

WHERE THE MARKET IS…

1. COMMERCIAL MORTGAGE LIQUIDITY AND COMPETITION HAVE RETURNED IN 2016, BUT MARKET IS INEFFICIENT
2. VOLATILE MARKET FOR CORPORATE BONDS, MORTGAGE SPREADS AND INDEX RATES
3. DEBT UNDERWRITING
4. REGULATORY IMPACTS
5. MARKET DISCIPLINE & TRENDS

Ample but Inefficient Debt Capital; Volatility Remains!

COMMERCIAL MORTGAGE LIQUIDITY AND COMPETITION HAVE RETURNED IN 2016, BUT MARKET IS INEFFICIENT

- Life companies are active again with new 2016 allocations — target loan volume of $65 billion - $70 billion for the year
- Life companies are offering forwards; typically six to nine months out
- Some life companies are using structure to increase LTV to the 75% range (for an increased rate) for quality loans that eliminate CMBS execution risk
- Banks remain active, using their balance sheets for both stabilized and transitional assets; three- to 10-year terms offered
- The CMBS market is choppy and volatile with profit margins and originations dropping; expect price widening and some originator consolidation
- GSEs had a record 2015 and have slightly higher allocations for 2016; will be more consistently in the market this year to minimize spread volatility
- Debt funds are active; cost of this debt dependent upon how high in capital stack
- Mezzanine debt and preferred equity is readily available and competitive; also inefficiently priced

VOLATILE MARKET FOR CORPORATE BONDS, MORTGAGE SPREADS AND INDEX RATES

- Commercial mortgage spreads tied to corporate bond spreads – corporate widening has caused spreads to widen for fixed rate loans. Although still attractive, the relative value for fixed rate loans has diminished marginally as corporate spreads have widened.
- Treasury and swap index rates have compressed significantly, which is keeping "all-in" mortgage rates attractive for borrowers
- Fixed-rate, life company balance sheet spreads have risen 20 bps – 50 bps since May 2015 and CMBS spreads have widened even more. The CMBS market is experiencing significant "re-trades"
- LIBOR rates have increased significantly, with the current 30-day LIBOR standing at ± 0.43%
- Swap rates are currently lower than treasury rates due to macro-economic factors and higher capital requirements, as well as an increasing number of companies/investors exchanging floating for fixed rates
- Floating-rate debt (from banks and life co's) remains compelling and competitive, although spreads have marginally increased and lenders are selective
- Pricing discovery is evident across all lenders; and the market remains inefficient

DEBT UNDERWRITING

- Debt yield (8.25% - 9.50% for commercial; 7.0%+ for apartments; 10.0%+ for hotels) continues to be a key metric—LTV is less relevant
- Transitional assets are attracting capital–broad debt options available for core plus and value add. Earn-outs are becoming more common, with the key consideration the lender buying into the business plan
- Core borrowers are focused on low to moderate leverage to secure best pricing and "interest-only"
- As treasury rates have declined, floors are becoming increasingly common. Some lenders quoting interest rates only

REGULATORY IMPACTS

- Basel III, HVCRE and other regulatory issues for banks may constrain some of the lending and put some upward pressure on spreads. Many banks will reduce their construction loan activity in 2016
- Implementation of the new Dodd Frank regulations including Risk Retention and Reg AB will impact the CMBS market and also put upward pressure on spreads. CMBS dislocation possible this year beginning in Q3

MARKET DISCIPLINE AND TRENDS

- Lenders have remained disciplined with lower LTV levels, pricing differentials and less construction loan volume
- Based on the last few years, it appears debt capital has "seasonality"—first half of the year is typically more robust
- Construction loans and construction-to-perm loans are in demand, but non-recourse construction allocations are limited to "best customers"; spec construction loans are still challenging
- Borrowers are seeking greater flexibility and optionality (early rate lock, prepayment, transfers, substitution, etc.)
- Many lenders offer a variety of loan products (as compared to traditional roles)—floating rate loans in high demand
- Best pricing and structure requires a wide and extensive marketing process

INVESTING IN HOTELS – DECIDING ON CAPITAL

Capital structure depends on:

Type of Investor

AND

Type of Asset

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TYPE OF EQUITY INVESTOR

- REITs
- Private Equity
- Hotel Brand
- High New Worth
- Investment Manager (i.e. pension funds, insurance, etc.)

TYPE OF DEBT PROVIDER

- Commercial Banks
- Life/Insurance Cos/Pension Funds/Endowments
- Debt Funds/Alternative Lenders/Finance Cos
- EB-5 Investors (can take form of debt or equity)
- Private Equity, SWF's, Foreign Capital
- Crowdsourcing (typically smaller funds)
- Family Offices/HNWI's
- Public/Private Investors

TYPE OF ASSET

- Value add
- Core plus
- Trophy
- Development and deep turnaround

HOTEL DEVELOPMENT

- Land financing
- Construction financing
- Permanent financing

CAPITAL STRUCTURE FOR DEVELOPMENT

- Recourse (primarily banks) versus Non Recourse
- 30% to 90% LTC leverage is available
- Size dependent (over $30 million is challenging for any single bank)
- Primarily floating rate L+250's (full recourse) to L+1100 (non recourse) with equity participation
- Most common range is 50-65% LTC in L+500 to 700 range with no repayment guaranty and up to 5 years loan term fully extended

CAPITAL STRUCTURE FOR EXISTING ASSETS

- Fixed – stable, income producing
- Floating – transitional, bridge
- Subordinate Financing (mezz/pref equity)

DEBT METRICS: STABILIZED HOTELS

	Banks	Life Companies	CMBS	Mezzanine Debt
Term	5-7 years; couple at 10 years	7-10+ years	10 years	3-10 years
Amortization	25-30 years; no IO likely	25-30 years; no IO likely	30 years; can do IO with shorter amortization and/or lower LTV	Interest Only
Rate				
Interest Rate Spread	S + 200 - 225 bps	T + 160 - 180 bps	T/S + 325 - 350 bps	L + 800 - 1000 bps
Index Rate	Swap Rate	Treasury Rate	Swap Rate	30-day LIBOR
Underwriting				
Loan-to-Value	60 - 65%	55 - 65%	65 - 70%	Up to 80%
Debt Yield	11% - 13%	9% - 12%	9.5% - 10.5%	7% - 8%
Reserves	4% FFE	4% FFE	4% FFE	4% FFE
Sample Lenders	Bank of America, Union Bank, HSBC, Wells Fargo, JP Morgan Chase	MetLife, Pacific Life, New York Life, Cornerstone, PPM, Prudential	Morgan Stanley, Goldman Sachs, CIBC, UBS, Deutsche Bank	Washington Holdings, Ares Management, Oaktree Capital, AEW, Pearlmark

DEBT METRICS: TRANSITIONAL HOTELS

	Banks	Debt Funds	Mezzanine Debt/Pref Equity
Term	3-5 years including extenstions	2-5 years including extenstions	co-terminus with senior
Amortization	Primarily Interest Only	Interest Only initial term; can have amortization during extensions	Interest Only
Rate			
Interest Rate Spread	L + 350 - 450 bps	L + 450 - 650 bps	L + 1000 - 1300 bps
Index Rate	30-day LIBOR	30-day LIBOR	30-day LIBOR
Underwriting			
Loan-to-Value/Cost	55% - 65% (initial)	65% - 75% (initial)	Up to 80% (initial)
Debt Yield	8 - 10% (initial)	7%-9% (initial)	6% - 7% (initial)

INVESTMENT STRATEGY

- Hold period
  - Determines length of initial financing
- Capital Investment
  - Determines type of financing available
  - Can affect cash flows
  - Does capital investment need to financed?
- Cash flows
  - Stable
  - Significant increase

KEY MONEY

- Brand accretive asset
  - Good location
  - Strong product quality
  - Correct property profile
- Good location
- Investment strategy involves maintaining product quality
- Long term hold

LEGAL CONSIDERATIONS
(and some practical as well)

- Know yourself – it matters for who you choose as a lender or equity partner
  - Are you a long time holder?
  - Are you a trader?
  - Are you a §1031 exchange party?
  - Are you a fund with a finite horizon?
  - Are your principals individuals?
  - Are your principals foreign nationals?

LEGAL CONSIDERATIONS
(and some practical as well) (cont'd)

- Know your lenders

  - Local bank
  - CMBS conduit lender
  - Insurance company
  - Private equity / mortgage fund

LEGAL CONSIDERATIONS
(and some practical as well) (cont'd)

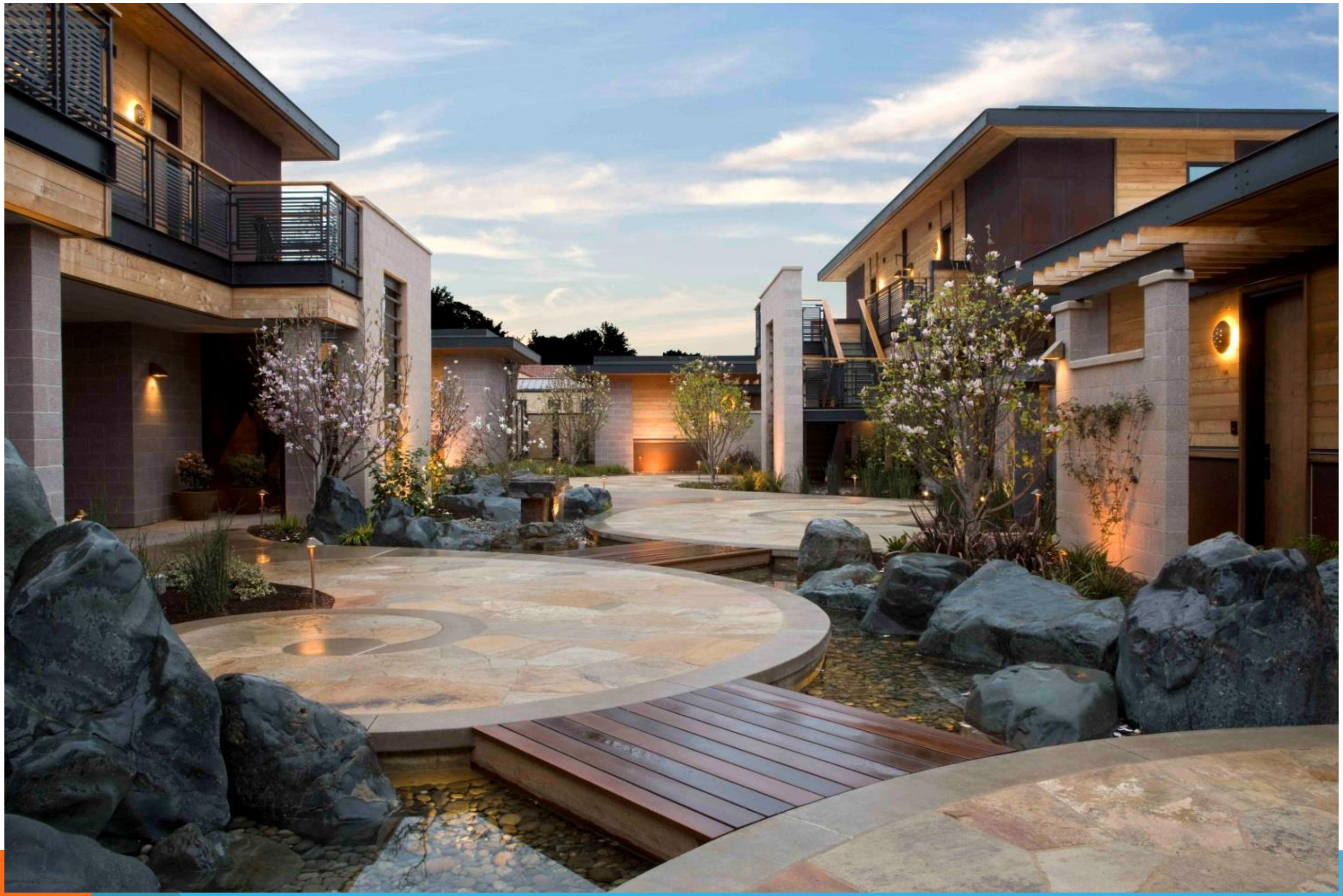
- Know your equity partners

  - Have you dealt with them previously?
  - Are they institutional or more entrepreneurial?
  - Have they invested in this asset class previously?
  - If you have some EB-5 money, new market tax credits or historical tax credits or other such incentives in the deal – have they done these deals before?

LEGAL CONSIDERATIONS
(and some practical as well) (cont'd)

- Complexity = more players = more $ and restrictions
  - The more levels of debt, equity and incentives more people including lawyers reading every document and on every call
- Is non-recourse really non-recourse?
  - At what cost?
- Is this loan really assumable?
- What will each of these players require of your manager?

CASE STUDY – BARDESSONO



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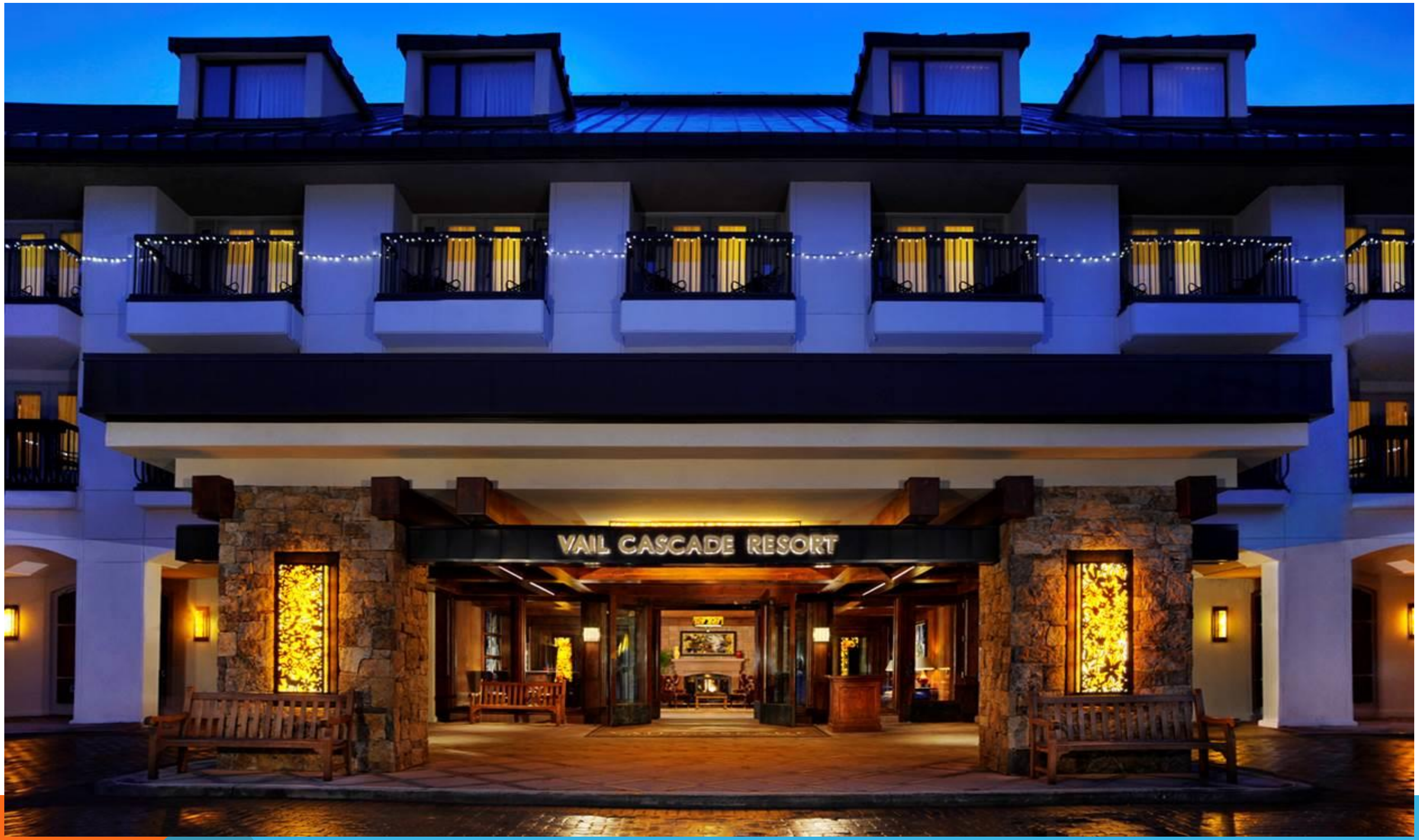
CASE STUDY – VAIL CASCADE RESORT



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