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Hotel REITs Seek to Conserve Capital to Ride Out Downturn

Tight Credit Creates Need to Cut Dividends, Halt Investment Plans

By ANTON TROIANOVSKI

NEW YORK -- Hotel companies, which have been struggling all year with reduced travel demand and tight credit conditions, are now facing a new challenge: how to conserve capital.

Companies are expected to cut dividends, pull back from planned investments and take other bold steps to increase liquidity, all in an effort to ride out the economic downturn.

While stock prices for most real-estate investment trusts are suffering, the stocks of hotel REITs are getting hit hardest. So far this year, the total return for hotel REITs has dropped 42.3%, far outpacing the 14.4% decline in the overall Dow Jones Equity REIT Index.

"I don't think any [REIT] group is going to suffer from the same pain that we expect in the hotel cycle," said William Crow, a REIT analyst at Raymond James & Associates.

FelCor Lodging Trust, which is based in Irving, Texas, and owns 85 mostly upscale hotels, including many that carry the Embassy Suites flag, last week cut its dividend 57%.

Some analysts expect Strategic Hotel Capital, based in Chicago, to be next. Already, Strategic, which owns 19 luxury and upscale hotels, has said it will walk away from a \$36 million investment in the Aqua Building in Chicago that is connected to its Fairmont Hotel.

In the past few weeks, the challenges facing some hotel REITs have grown more serious. Companies that hold high-end hotels are fretting about losing high-rolling investment-banking customers. And companies with significant debt coming due between 2010 and 2012 might have trouble refinancing if credit stays tight, analysts say.

"With hotels, people feel like they're playing chicken with a train," said Jeffrey Donnelly, a REIT analyst for Wachovia Securities.

Hotels historically tend to be one of the more volatile sectors in real estate and are sensitive to economic trends. REITs with relatively high leverage may face the additional challenge of refinancing at a time when credit is extraordinarily tight, say analysts. In addition to FelCor and Strategic, analysts are concerned about Ashford Hospitality Trust Inc., which is highly leveraged, and **Hersha Hospitality Trust**, which has debt coming due.

FelCor and Strategic declined to make an executive available to comment. Ashford didn't return a phone call seeking comment. Hersha couldn't provide a comment on Tuesday.

In a research note last week, Newport Beach, Calif.-based Green Street Advisors said that FelCor's "largest hurdle" would come in 2011, when the company's credit line and about \$500 million of unsecured debt comes due. John Arabia, a lodging REIT analyst for Green Street, said FelCor and Strategic would be able to refinance that debt as long as financing becomes more available in the next year or two.

"So as long as the credit markets return to a normal environment where lenders are lending rationally, they won't have any problems," Mr. Arabia said. "In the event that the credit markets stay impaired through 2011, then it would be highly likely that those companies would be forced to find alternative sources of capital."

Future availability of capital is the big question looming over the hotel market. Tight credit disproportionately affects highly leveraged companies over those with more conservative balance sheets.

One company that analysts worry less about is [Host Hotels & Resorts](#), which owns 129 hotels, mostly under the Merritt brand. Host has a debt-to-asset-value ratio of 39%, according to Green Street. (Felcor and Strategic are leveraged at 64% and 63%, respectively.)

At a Pension Real Estate Association conference in Chicago last week, Ed Walter, Host's chief executive, voiced confidence in the company's ability to ride out the storm and remain competitive in the tight credit market. "So when we think about the future from Host's perspective, we feel a lot is coming our way," he said.

Investors don't appear to be convinced. Host's stock price is down 43% so far this year, in line with the broader indexes for hotel REITs.

The bright spot for the industry is that analysts expect a quick recovery once the economy gets back on track. Supply growth will peak next year, said Mr. Crow of Raymond James, meaning that once the economy recovers, the supply will meet rising demand relatively quickly. "I don't anticipate that happening anytime soon, but it will happen nonetheless," Mr. Crow said.

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