NATIONAL SAN DIEGO HOTELS

Why Post-Renovation Ramp Loans Are A Smart Move

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SAN DIEGO—Hoteliers who procure a ramp loan after renovating and prior to securing permanent financing are essentially cutting the effective interest rates by hundreds of basis points, Mission Capital's Alex Draganiuk tells GlobeSt.com.

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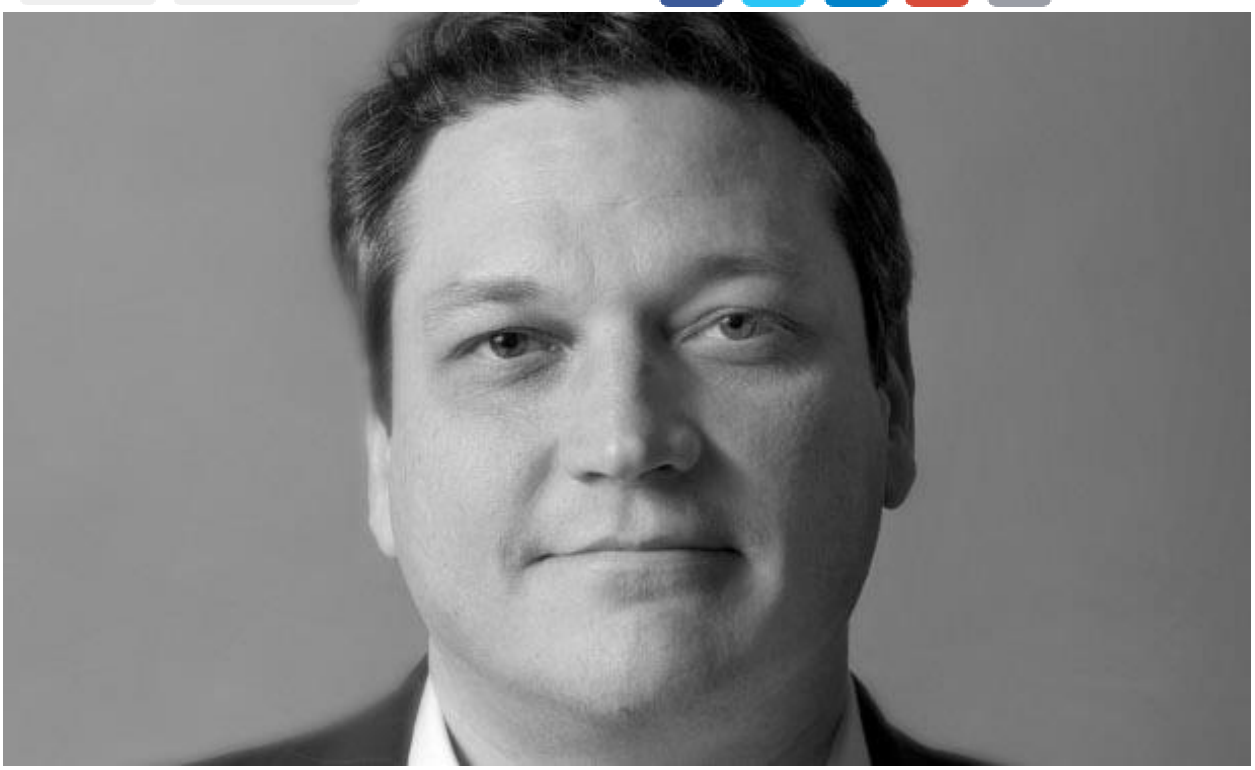

Draganiuk: "Lenders need comfort with a hotel and confidence that the recent renovations are something guests will be attracted to, and which will yield improved property cash flow."

SAN DIEGO—**Hoteliers** who procure a ramp loan after renovating and prior to securing **permanent** **financing** are essentially cutting the effective interest rates by hundreds of basis points, **Alex Draganiuk**, director in the **debt** and **equity** finance group at **Mission Capital Advisors**, tells GlobeSt.com. The firm's team of Draganiuk, **Gregg Applefield** and **Lexington Henn** recently represented property owner **SD Carmel Hotel Partners LLC** in securing a three-year loan from a private-equity fund as a $20.75-million ramp loan for the **Hotel Karlan**, a 174-key, soft-branded **DoubleTree by Hilton** located in northern San Diego. The first-mortgage financing will replace the property's renovation loan and a preferred-equity loan.

After acquiring the property in 2014, the sponsor implemented comprehensive renovations to the property, enhancing guestrooms, common areas, food-and-beverage outlets and meeting and spa facilities.

According to Applefield, "In today's market, it's not uncommon for hoteliers to procure a ramp loan post-renovation prior to securing permanent financing, and the sponsor turned to us because of our extensive experience in this arena. Through a strong marketing effort, we were able to provide the sponsor with numerous competitive offers, including fixed-rate and floating-rate options with very high leverage for a **hotel**."

The multimillion-dollar renovation includes remodeled guestrooms, a new dining concept, completely upgraded state-of-the-art spa with fitness center and two upgraded pools with outdoor cabanas. Hotel Karlan also features six distinct meeting spaces, totaling more than 14,000 square feet, as well as a pre-function space and an event lawn for weddings, musical performances, and other social events. Additionally, the hotel features a 4,000-square-foot ballroom.

We spoke with Draganiuk about the ramp loan and any obstacles to getting one.

GlobeSt.com: Why is it a smart move for hoteliers to procure a ramp loan post-renovation prior to securing permanent financing?

Draganiuk: Most of the ramp loans we have arranged are taking out higher-cost-of-capital non-recourse construction or renovation loans, so we are effectively cutting the effective interest rates by hundreds of basis points for our clients. In recent years, many hotel deals have included renovation components as buyers have attempted to improve or rebrand their assets. When financing an **acquisition** with a **renovation**, lenders are typically underwriting a combination of a lower in-place net operating income, as well as a potential disruption in cash flow, which can constrain the amount of debt lenders are willing lend, while yielding a higher interest rate. After the renovation is complete, the cash flow rarely stabilizes immediately, as it takes some time to reap the benefits of the renovation, and the owner is usually not yet able to secure a permanent loan, which typically requires a good nine to 12 months of stabilized operating history. At this stage, a ramp loan becomes appropriate, as refinancing the property can allow you to obtain additional loan proceeds, a reduction in rate, and/or eliminate any contingent liabilities related to a renovation or construction loan.

Hotel Karlan has undergone a multimillion-dollar renovation that includes remodeled guestrooms, a new dining concept, completely upgraded state-of-the-art spa with fitness center and two upgraded pools with outdoor cabanas.

GlobeSt.com: What are the obstacles, if any, to getting this type of loan?

Draganiuk: The primary obstacles with obtaining a ramp loan immediately post-renovation include proof of concept, limited in-place cash flow, and the potential recapture of equity invested in a property. Lenders need comfort with a hotel and confidence that the recent renovations are something guests will be attracted to, and which will yield improved property cash flow. To convince lenders that a sponsor is going to be able to increase performance, we work closely with our clients to study the market extensively. We then compare the property to competing hotels and explain how the reinvestment will enable it to outperform competition or at least sufficiently penetrate its new competitive set. We also use quantitative metrics to build a story showing that, while cash flow is not fully stabilized, there are a variety of strategies the owner can implement to achieve his business plan and meet projected performance levels.

GlobeSt.com: What else should our readers know about ramp loans in these situations?

Draganiuk: In addition to traditional lenders, there are a number of new entrants in the space. Many lenders prefer the opportunity to lend on assets that have already successfully completed the initial component of their business plan, because they have limited uncertainty compared with a construction/renovation project. Additionally, lenders are often looking to underwrite hotels at today’s room rates, at market-level operating margins, without assuming a hotel is significantly outperforming competitors. To the extent the underwritten metrics work at these levels, lenders are more willing to take out a **construction** or renovation loan with a new ramp loan.