

# Lender bias against smaller lodging properties

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*In the face of the changing environment in the hotel industry to one of optimism, the authors were interested in discovering in a formal way what the smaller lodging community had to say about the availability of loans to their segment of the industry. The article reports on their investigation of the perception of hoteliers of smaller hotels and motels with regard to negative lender bias associated with the size of a lodging property.*

A survey conducted by Pannell Kerr Forster<sup>1</sup> of lenders in the Southeastern United States in 1993 indicated that hotel and motel loans were the least preferred form of commercial loan activity. This information is not surprising given the number of hotels that were unable to meet their debt service obligations in the late 1980s and early 1990s. The resultant drought of loans to the hotel industry, high internal rate of return requirements, increase in debt coverage ratio, and reduction of loan to values were well documented.

The past three years have shown that the hotel industry is turning the corner, as evidenced by rising occupancies and average daily rates (ADR), healthier financial performance ratios, and an increase in hotel values. Recent hotel and banking literature indicates a cautious optimism in the lending community toward the hotel and motel industry. Yet many hoteliers have said they believe there is still a lender bias against the lodging industry. Further, a number of owners of smaller lodging facilities believe they have been unfairly denied loans.

Testimony to the importance of the small hotel and motel sector of the lodging industry lies in the Smith Travel Research<sup>2</sup> statistics, which indicate that approximately 48 percent of all lodging operations in their database of 28,500 lodging properties have fewer than 75 rooms.

The Smith Travel Research database, the largest database for the lodging industry in the United States, served as the sample for the survey of the owners and managers of 800 properties. Of these, 400

were lodging properties with fewer than 75 rooms and 400 were lodging properties with more than 75 rooms. The survey instrument used was a questionnaire mail survey.

The questionnaire was designed to elicit the following type of responses:

- descriptive information about the property, including questions pertaining to size, location, market segmentation, ownership, age, and franchise arrangement
- asset and income-related information about the hotel, including questions pertaining to net income, net worth, and property value
- questions related to loans for development and purchase of a hotel, including questions related to amount of loan requested, loan denials, collateral, and applicant perceptions about loan denials
- questions related to refinancing of hotel debt, including questions related to amount of loan requested, interest rate, loan denial, loan guarantees, and applicant perceptions about denials

The questionnaire consisted of 20 questions that were primarily close ended, and a few open-ended questions. Efficiency was built into the questionnaire by asking contingent questions where appropriate. For example, if respondents indicated they were denied a loan, they were queried regarding their perception of the denial.

The response rate for the survey was only 6.6 percent; 53 usable responses were received. The responses were analyzed using SPSS statistical software. Due to the nominal and ordinal nature of most of the questions, and the low response rate, the data were analyzed using only descriptive statistics. This included mean, mode, median, frequency distributions, ranges, and standard deviations. In addition, subjective comments by the respondents were scanned to detect common themes.

Due to the low response rate, the results of this research are presented only as a pilot study. No attempt is made to present the results as representative of the population as a whole, though responses were received from 53 hoteliers representing several thousand rooms.

### **Most hotels have 75 or fewer rooms**

The majority (32) of hotels of the respondents were under 75 rooms; the next highest group (11) was between 75-149. Only 10 hotels had more than 150 rooms. The sample contained primarily center city, resort, highway, and suburban hotels. Thirty percent of these properties catered to the business traveler, 50 percent to the tourist segment, and 27 percent to the long-term market. The average daily rate of the responding properties was \$52 and 50 percent of respondents owned their properties between 6-15 years. The majority of the properties (62 percent) are not franchised.

The median annual net income of the responding properties was \$110,500; however, the net income ranged from \$400 to \$1.91 million. The standard deviation was \$506,415. The total net worth also varied broadly between zero and \$6 million, with a standard deviation of \$1.68 million. Finally, the market value of the responding properties varied between \$275,000 and \$10 million, with a standard deviation of \$2.81 million. Only 33 respondents contributed data regarding net income, net worth, and market value. The low response rate is attributed to the nature of the information requested. Many respondents most likely consider this information to be highly confidential.

Seventy-four percent (39) of the respondents indicated they had existing long-term loans. The mean average of these loans was \$2,397,997, while the median was only \$705,000. The majority of the respondents (26 properties or 67 percent) with long-term loans have properties with fewer than 75 rooms; 75 percent of these properties had a room rate of \$30 - \$70.

### **Some have experienced denials**

Thirteen hoteliers indicated they had been denied loans in the past three years. Eight of the 13 (62 percent) had properties with fewer than 75 rooms. Four (31 percent) had lodging properties with 75-149 rooms. Therefore, the vast majority of the hoteliers (92 percent) denied loans had lodging properties with fewer than 150 rooms. Just over 60 percent of respondents (32 of 53) have hotels with fewer than 75 rooms and 64 percent who were denied loans in the past three years have lodging operations with fewer than 75 rooms. Therefore, it appears that approximately the same percentage of hoteliers who responded to this survey were from smaller hotels and were denied loans.

Of the 13 hoteliers denied a loan in the past three years, seven have franchised properties. The amounts of loans requested by these 13 hoteliers ranged from \$250,000 to \$5.25 million, with an average of approximately \$1.6 million. The value of the collateral offered according to the owners ranged from \$500,000 to \$7.5 million, with an average of approximately \$2.5 million. The existing loans of these hoteliers ranged from zero to \$5.5 million. The average amount of existing loans was \$1.6 million. Thus, the average loan amounts requested of \$1.6 million plus the existing average loans of \$1.6 million exceed the average collateral of \$2.5 million. The requested amount and their existing loans were less than 80 percent of the value of the collateral in only three cases. Therefore, it appears the vast majority of hoteliers simply did not have the collateral to justify their loan requests. According to P. Quek, the average loan to value ratio in the early 1990s was approximately 68 percent.<sup>3</sup>

Hoteliers denied loans were asked why they believed they were denied the amounts requested. More than one reason was provided by

**Table 1**  
**Hoteliers Receiving Loans**

<b>Size</b>	<b>Number of Loans</b>	<b>Percent</b>
< 75 rooms	8	53.3
75 - 149 rooms	4	26.7
150 - 249 rooms	1	6.7
250 - 499 rooms	2	13.3
Total	15	100.0

several respondents. It is interesting to note that 85 percent (11 out of 13) believe that there is some form of industry bias. Three respondents each listed inadequate debt cover and lender required higher equity contribution and two each mentioned a specific problem related to property and a local bank merged with a larger bank.

#### **A number of respondents have refinanced**

Thirteen of the respondents received long-term loans for new development/purchase in the past three years; they ranged in size from fewer than 75 rooms to between 250 and 500 rooms. Eight (62 percent) of those receiving loans had properties of fewer than 75 rooms. Only four had franchised lodging properties.

Fifteen (28 percent) of the respondents indicated they had refinanced their property in the past three years. Fourteen of those indicated they had refinanced the desired amount; one was dissatisfied. The amount of refinancing varied from \$250,000 to \$22 million, with a mean average of \$5,240,500 and a median loan of \$1,025,000. The interest rate varied from 7-7/8 percent to 12 percent for fixed rates. The average was approximately 10 percent. The length of the refinancing loan was from five to 20 years. The mean average was 11 years, while the median was 15. Eleven of the hoteliers (73 percent) had to personally guarantee their loans. Of the 15 loan recipients, six owned franchised lodging properties (40 percent) while the remaining 60 percent owned non-franchised properties. (See Table 1)

Even though these 15 respondents received refinancing, the process was not always easy. Four respondents voluntarily indicated they had been refused financing by other financial institutions. They were not specifically asked this question. All four indicated they had been turned down by two or more financial institutions before they successfully negotiated their refinancing. All four respondents said that they believed it was due to being part of the lodging industry.

Finally, respondents who were denied refinancing were queried regarding their perceptions for the denied refinancing; 13 indicated

**Table 2**  
**Reasons For Denial of Refinancing**

<b>Response Categories</b>	<b>Responses</b>	<b>Percentage</b>
Industry bias	8	61.5
Inadequate debt cover	2	15.4
Lender required higher equity contribution	1	7.7
Specific problems related to property	1	7.7
Discrimination related to ethnicity	1	7.7
Discrimination related to education level of owner	1	7.7
Discrimination related to operational sophistication	1	7.7

**Note:** Based on open-ended responses from all respondents.

they had been denied refinancing, varying from once to more than five times. The reasons for the denials of refinancing as stated by respondents are shown in Table 2. Many respondents (8 of 13 denied refinancing or 61.5 percent) believed there was industry bias, and a minority of hoteliers indicated a form of personal discrimination in ethnicity, education, or sophistication.

#### **Results cannot be generalized**

At first glance, it may appear from reading the statistics that the lending community is biased against the smaller hotels. However, it is important to view these results in their entirety. The sample size of the 53 hotels is not a representative sample of the population of small hotels in the United States. Therefore, no attempt is being made to generalize the results.

It should be noted that the majority of respondents were not denied a loan in the past three years. Most of those denied loans (10 properties) did not have enough collateral to qualify for a loan. During the period of the study, the loan to value ratio required by banks was approximately 68 percent for new loans,<sup>4</sup> according to Quek.

The majority of respondents stated "industry bias" as the predominant perception of why loans were not granted. This perception needs to be interpreted with caution. The hotel industry attracted a number of non-hoteliers after the passage of the Economic Recovery Tax Act of 1981 (ERTA). These new operators were attracted to the industry mainly because of tax benefits. They were not hotel operators in the true sense. At the same time the deregulation brought the savings and loan industry into the commercial real estate market. Like the operators they, too, were unfamiliar with the hotel business. Looking

at the problem from this perspective, the issue at stake may be one of lack of communication and understanding of each others' business. When an operator does not speak the bankers' "language," it is very easy to perceive them as being biased. At the same time, bankers not familiar with the hotel business may feel uncomfortable. The recent history of hotel loan defaults has increased the criteria for loan approval.

Another factor that may have increased the perception of lender bias toward small hotels was some changes by the Small Business Administration (SBA). SBA loan guarantees traditionally have been a strong source of small hotel financing. Approximately 50 percent of all hotels purchased which had fewer than 100 rooms were financed with SBA loan guarantees according to the Hotel and Motel Brokers of America (HMBA).<sup>5</sup> The original \$1 million guarantee was reduced to \$500,000. This reduction certainly might create a perception of bias against smaller hoteliers.

### **Industry performance is important factor**

When evaluating the performance of the hotel industry, it is important to look at both performance and hotel values. Occupancies have shown an improvement, growing to 66 percent in 1994 from 63 percent in 1992. At the same time, supply has increased very little during this period. However, the market value per room of hotels sold at \$37,000 is still well below the 1988 levels of \$80,000, according to Butler, Benudiz, and Rushmore.<sup>6</sup> Due to the mixed results, it is understandable that lenders project "cautious optimism" in such a lending environment.

The 1994 edition of the HMBA Transactions report has compiled a report which indicates a breakdown of the 387 hotels that changed hands in 1994 by tiers as follows:

- limited service (fewer than 150 rooms), 241 hotels or 62.2 percent
- full service, 120 hotels or 31.0 percent
- luxury, 26 hotels or 6.8 percent

It is a fair assumption that the majority of these transactions used banks to finance their purchases. This makes one fact clear; although it cannot be categorically denied that a lending bias exists against small hotels, they are certainly receiving a reasonable amount of financing.

Due to the size of the sample, the results of the survey are not conclusive. However, the results can be interpreted within the framework of the secondary analysis. The small sample makes this a pilot study and provides much room for further research. Analysis of the literature does not provide direct evidence of lender bias against smaller

hotel properties. However, lenders having been recently "burned" due to failed hotel loans are requiring more stringent standards of loan approval. Combined with reduced SBA loan guarantees, this may have contributed to the image of lender bias. A lack of understanding of each other's business leaves much room for improved communication between lenders and small hotels. This, in the final analysis, may be the root of the perception of bias problem.

What are the implications of this for the small hotel owner? Given the recent negative experiences of the lending community with hotels, the hoteliers should understand the lender's point of view. By learning what the credit approval process for lenders requires, they can strengthen their loan applications. Given the competitive pressures on the lending community, especially with non-banks now making hotel loans and rising hotel occupancies and average daily rates, hotel lenders will entertain strong loan applications. Furthermore, the small hotel owner should not be disheartened by the first negative response from a lender. The survey showed that even those who were eventually approved were turned down at least once.

### References

- <sup>1</sup>Patrick Quek, "Lending on Hotel Projects," *Lodging* (July-August 1993): 13-14.  
<sup>2</sup>Smith Travel Research, Hendersonville, Tennessee.  
<sup>3</sup>Patrick Quek, "Purchasing Hotels with Unobscured Vision," *Lodging* (September 1994): 15-16.  
<sup>4</sup>Ibid.  
<sup>5</sup>*Transactions* (Kansas City: Hotel & Motel Brokers of America, 1995).  
<sup>6</sup>James R. Butler, Jr., P. Peter Benudiz, and Stephen Rushmore, "Hotel Lending in the 1990s: Amateurs Beware," *Cornell H&RA Quarterly* (December 1994): 41.

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