
**PRESENTATION TO THE 16TH ANNUAL REAL PROPERTY, PROBATE AND
TRUST SPRING SYMPOSIA**

HOSPITALITY REIT FINANCING

APRIL 2005

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OVERVIEW

Overview

- Hospitality REITs became a popular means of owning hotel real estate in the early 1990s, as appropriate tax structures were developed.
- Hospitality REITs may not operate hotel properties directly-room rents are deemed to be bad income for REIT income tests.
 - Hotels must be leased to third party tenant or REIT-owned taxable REIT subsidiary (“TRS”).
 - Hotels must be operated by an “eligible independent contractor”.
- May be structured as “straight” REIT or UPREIT.
- There are 18 publicly listed hospitality REITS with a total equity market cap of approximately \$16 billion.
 - There are also a handful of non-listed public hospitality REITs that raise money through syndication networks.

DEBT FINANCING

Debt Financing

- Overview
 - Hospitality REITs utilize both property level and entity level debt financing, similar to other REITs.
 - Leverage levels tend to be lower than traditional asset classes due to volatility of income stream.
- Property level debt financing
 - Construction loans
 - > Recourse-traditional construction loan with recourse to REIT.
 - LTVs up to 80% depending on hotel type, location, sponsor, take-out financing, etc.
 - Larger loans may be syndicated.
 - Much smaller universe of commercial banks than other asset classes.
 - REITs may also use working capital revolver in lieu of asset specific construction loan.
 - > Non-recourse
 - Lower LTVs-up to 65%.
 - Higher interest rates than recourse loans.
 - More typical for off-balance sheet ventures than for on balance sheet REIT investments.
 - Adequate contingency, interest reserve and retainage more critical.
 - Lenders likely control disbursements and more focused on monthly property inspections
 - Sponsor guarantees non-recourse carve-outs.

Debt Financing

- Mortgage debt
 - > CMBS/Conduit loans
 - Large loans (\$50+ million) may be securitized separately and underwritten to different standards.
 - LTVs up to 80%.
 - Floating rate maturities up to 5 years (typically 2+1+1+1 or 3+1+1).
 - Fixed rate maturities up to 10 years.
 - Fixed rate loans generally costly to prepay; structural items driven by ratings agency guidelines.
 - Floating rate loans will provide higher leverage and more aggressive underwriting standards. Typically require the purchase of an interest rate cap.
 - Post-deal restrictions on modifications to properties.
 - Loans are underwritten on trailing 12-month EBITDA, adjusted for adequate reserves, management fees and expenses.
 - Appropriate debt service coverage ratio in conjunction with loan to appraised value are used to determine loan amount.
 - CMBS lenders typically want three years of operating history.
 - Hotel concentration in a securitization pool is typically limited to 10% to 15%.
 - Investment grade determined at lower leverage levels than for other property types.
 - Mezzanine or senior sub structures are available.

Debt Financing

- > Life insurance companies
 - Generally fixed rate loans, although many institutional lenders have a small basket for floating rate issues.
 - Maturity sweet spot from 7 to 10 years.
 - May provide for more customized structures and prepayment flexibility.
 - Smaller universe of institutions will lend to the sector.
 - Many lenders focus only on full service hotels.
 - Acceptable franchise and management agreements are critical documentation.
- > Mezzanine debt
 - Used in conjunction with mortgage debt to achieve LTVs of up to 95%.
 - May be structured as preferred stock interest due to restrictions on second mortgage loans contained in senior mortgage loan documents.
 - May also be used to boost LTVs for construction loans.
 - Terms generally 18 months to 10 years. Minimum prepayment lock-out of 12 months.
 - Both fixed and floating rate are available.
 - All-in debt service coverage ratio of 1.15 to 1.25 times typically required.

Debt Financing

- Entity level debt financing
 - Revolving credit facilities
 - > Larger, more established REITs utilize revolving lines of credit to finance most investment activity; line is refinanced with combination of term debt, bonds, mortgage debt or equity.
 - Secured lines more common for smaller and more highly leveraged REITs.
 - Fewer covenants and restrictions on REIT's activities due to existence of collateral.
 - Unsecured lines utilized by larger and more lowly leveraged REITs.
 - Requires borrowing base and corporate level credit covenants.
 - Corporate bonds
 - > Larger REITs may utilize unsecured bonds to term out line of credit balances.
 - Only one hospitality REIT is currently investment grade rated.
 - Hospitality REITs have relied on high yield offerings, which require more restrictive covenants than investment grade bonds.
 - > Hospitality REIT bond maturities may extend up to 12 years, and generally do not allow for prepayment without yield maintenance penalties.

EQUITY FINANCING

Equity Financing

- Overview
 - Public REITs tend to rely on entity level raises to fund equity needs, rather than a property-by-property approach.
 - In certain circumstances, property level equity financing may still be utilized.
- Property level equity financing
 - OP Units
 - > REITs that are structured as UPREITs may issue OP Units to sellers as a means of providing sellers with deferred recognition of gains.
 - > Also allows REITs to match fund acquisitions with attractively priced equity.
 - > OP Units may be structured as either common or preferred interests.
 - Joint ventures
 - > REITs may acquire larger assets off-balance sheet in partnership with institutional investors.
 - > Combination of asset management fees and higher leverage may result in higher equity returns.
 - > Non-core assets often acquired through JV structures.
- Entity level equity financing
 - Preferred equity
 - > Perpetual preferred
 - Increasingly common financing tool, even for REITs with riskier credit profiles.
 - Combines fixed coupon and liquidation preference characteristics of debt with permanence of equity.

Equity Financing

- > Convertible preferred
 - Similar to perpetual preferred, but allows investor to convert into common shares at agreed upon conversion price.
- Common equity
 - > Most prevalent form of equity financing for hospitality REITs.
 - > Access to common equity market is key driver for acquisition activity by hospitality REITs.