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CMBS Credit Focus

Hotel Reserves: Key Performance Driver after Pandemic-Driven Depletion

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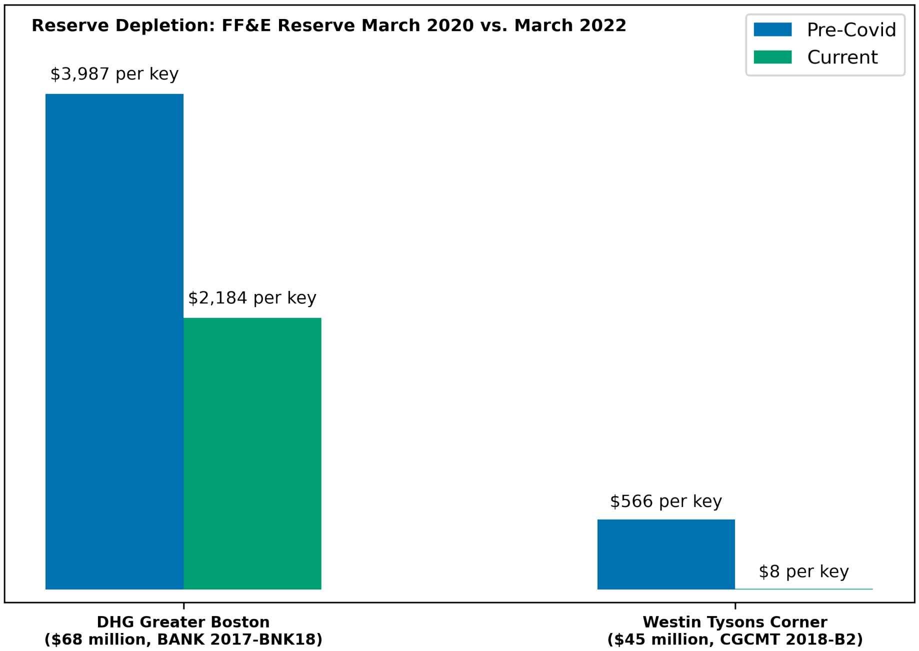
Hotel Reserves to Drive Performance on "Cured" Loans

Hotel reserves could become a key driver of loan performance, as borrowers now emerge from forbearance and modification agreements. Servicers widely allowed the use of reserves for debt payments during the pandemic. Deferral of reserve payments was also prevalent. Amid the gradual recovery of the hotel sector, it appears loans vary quite a bit in their reserve situation.

For example, in the $68 million DHG Greater Boston Hotel Portfolio (BANK 2017-BNK8), after receiving Covid-related relief, the borrower started to repay deferred reserves back in December 2020. The Furniture, Fixtures, and Equipment (FF&E) reserve balance of the three-hotel Boston-area portfolio reached $548K last month. In contrast, in the $45.2 million Westin Tysons Corner loan (CGCMT 2018-B2), the borrower needs to start replenishing deferred FF&E reserves only in June 2023. The hotel, which reported T12 occupancy of 26.9% in Q3 2021, currently has a meager $3.1K FF&E reserve. Its last reported Property Improvement Plan (PIP) reserve showed zero balance, compared to $137K in that reserve as the pandemic started.

Figure 1 Hotel Reserves Plummet During the Pandemic, Not All Replenished



Source: MCIA and Academy Securities

Hotel Reserves: Key Performance Driver after Pandemic-Driven Depletion

Healthy reserve levels could prove especially important amid (1) pandemic-driven long closures, (2) deferred capital improvement needs, (3) upcoming franchise renewals, and (4) guest retention expenses. Hotel owners may face growing pressures from various stakeholders, following a period when lenders and franchisors were generally sympathetic to the owners' struggles.

The Westin Tysons Corner also spotlights business/group-oriented hotels – a segment that is seeing a slower recovery compared to leisure-oriented hotels. The 407-room full-service hotel in Falls Church, VA, generated 75% of its pre-pandemic demand from commercial, meeting, and group categories. Despite going through a significant renovation between 2018 and early 2020, Westin may need additional investments to restore its business-driven demand. Fully depleted reserves clearly pose a challenge. At issuance the borrower had to deposit monthly FF&E reserve equal to 4% of annual gross revenues.

The current reserve levels of some of large hotel loans modified during the pandemic underscore the variation across properties (Figure 2). Portfolio loans such as Starwood Lodging Hotel Portfolio (GSMS 2017-SLP, GSMS 2017-GS8, and GSMS 2018-GS9) and Ashford Highland Portfolio (AHT1 2018-ASHF) show sharp reserve drops. Other loans, such as Fontainebleau Miami Beach (FMBT 2019-FBLU) have a larger reserve level compared to the March 2020 level.

Figure 2 Large Modified Hotel Loans: Pre-Pandemic vs. Current Reserve Levels

Portfolio Loans

Loan	Deal	Reserve Balance[1] March 2020	Reserve Balance[1] March 2022	Loan Balance[2]	Maturity
Starwood Lodging Hotel Portfolio	GSMS 2017-SLP; GSMS 2017-GS8; GSMS 2018-GS9	$44.3 MM *($4.2k/key)*	$25.9 MM *($2.4k/key)*	$800.0 MM	October 2022
Ashford Highland Portfolio	AHT1 2018-ASHF	$5.3 MM *($1k/key)*	$0.9 MM *($0.2k/key)*	$720.7 MM	April 2025
JQH Hotel Portfolio	AHPT 2018-ATRM	$40.1 MM *($6.9k/key)*	$31.9 MM *($5.6k/key)*	$635.0 MM	June 2025
New York Hospitality Portfolio	UBSCM 2018-NYCH	$4.7 MM *($4.3k/key)*	$12.7 MM *($12k/key)*	$290.0 MM	February 2024
Hammons Hotel Portfolio	CGCMT 2015-GC35; CGCMT 2015-GC33; GSMS 2015-GC34; GSMS 2015-GS1	$6.3 MM *($3.4k/key)*	$15.2 MM *($8.1k/key)*	$233.3 MM	September 2027

Single Asset Loans

Loan	Deal	Reserve Balance[1] March 2020	Reserve Balance[1] March 2022	Loan Balance[2]	Maturity
Fontainebleau Miami Beach	FMBT 2019-FBLU	$9.4 MM *($6.5k/key)*	$10.8 MM *($7.5k/key)*	$975.0 MM	December 2024
Hilton Orlando	HILT 2018-ORL	$0 MM *($0k/key)*	$14.5 MM *($10k/key)*	$475.0 MM	December 2024
Gansevoort Park Avenue	CGCMT 2012-GC8; GSMS 2012-GCJ9	$10.8 MM *($43k/key)*	$0 MM *($0k/key)*	$124.2 MM	June 2024
Hilton Nashville	CGCMT 2015-P1; WFCM 2015-NXS3	$4.2 MM *($13k/key)*	$6.1 MM *($18k/key)*	$110.6 MM	August 2025
Marriott Hilton Head Resort & Spa	WFCM 2016-LC25; CGCMT 2016-C3; CD 2017-CD3; CD 2016-CD2	$3.9 MM *($7.5k/key)*	$4.3 MM *($8.3k/key)*	$85.9 MM	October 2026

(1) Reserve balances include all reserve account type monies except taxes, insurance and ground rent
(2) Loan balance as of March 2022
Source: MCIA, Bloomberg, Academy Securities

Hotel Mods and Forbearance Widely Allow Reserve Depletion

Modification templates that servicers released during the pandemic clearly confirm that reallocation of reserves was a key relief borrowers received (sometimes the only one). Some specific common terms included:

- **Borrower access to almost any reserve type.** Borrower access was not limited to FF&E reserves. For example, the mods of Grand Hyatt Seattle ($133 million, COMM 2017-COR2, COMM 2018-COR3, and JPMC 2019-COR4) and Navika Six Portfolio ($76.5 million, MSC 2018-L1 and BANK 2018-BN14) allowed access for 90 days ("access period") to any reserve funds to keep the loans current. Interestingly, in Navika the borrower had to fund shortfalls if the reserve funds were not sufficient to fully service the debt.
- **Payment deferrals on reserves.** The mod templates also allowed borrowers to defer payments on any reserve accounts, typically also for a 90-day period.
- **Borrowers cannot access tax or insurance escrows.** Relief agreements explicitly restricted borrowers from accessing tax and insurance escrows, or deferring payments on those escrows.
- **Replenishment to follow the "access period".** The agreements usually required borrowers to start replenishing reserves following the typical 90-day access period. Still, in some cases, such as on Westin Tysons Corner, servicers significantly pushed back the replenishment timing.

Hotels Not Out of the Woods

Dwindling reserves could be a challenge not only for cured hotel loans. To be sure, the sector has seen significant performance improvement in recent months. Hospitality overall delinquency levels dropped to 7.1% as of March remittance, compared to 16.1% a year ago, according to Morningstar (the hotel delinquent volume saw the sharpest YoY decrease across the property sectors, dropping 54.3%,).

But some hotel borrowers still request, and receive, Covid-related forbearance and modification reliefs. Recent examples include the $77 million The Westin Book Cadillac (BMARK 2020-B17 and CGCMT 2020-GC46) and the $39.7 million Hotel Eastlund (CSAIL 2017-C8). The Westin saw an assumption and modification in December 2021, according to the servicer. The 453-room full-service hotel in downtown Detroit, MI, was closed from April to June 2020. In Eastlund, the servicer recently closed a modification on the 168-room hotel in Portland, OR. The mod arrives after the parties appeared to have been negotiating a forbearance agreement earlier in the pandemic.

The reporting of most recent hotel mods is sparse on the actual terms of the agreements. But if many of those agreements follow the blueprint of the hotel mods earlier in the pandemic, we expect to continue seeing reallocation of reserves, and potentially the same kind of reserve depletion that cured loans now report.

Track "Loan Level Reserve" Servicer Report

Tracking the ongoing status of loan reserves is not straightforward. The Loan Level Reserve/LOC report ("V" report) that the master servicer produces is the main data source for reserve levels. The loan periodic update ("L" data file) also reports the reserve balance (IRP field L104), but without a breakdown of the various reserve types. Casually looking for the reserve report across several large hotel loans shows that the file is occasionally not populated. The CREFC IRP package notes that a loan should appear on the report only if it has ending reserves or activity (reserve deposits or disbursements) at the reporting period.

The IRP package lists 13 types of reserves (Figure 3).

Figure 3 IRP Package Reserve Account Types

Code	Reserve Type
1	Replacement Reserve
2	FF&E Reserve
3	Repair Reserve
4	Tenant Reserve
5	Environmental Reserve
6	Capital Improvement Reserve
7	Seasonality Reserve
8	Deferred Maintenance Reserve
9	Debt Service Reserve
10	Ground Rents Reserve
11	Leasing Reserve
12	Letter of Credit
13	Other

Source: Commercial Real Estate Finance Council (CREFC)

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