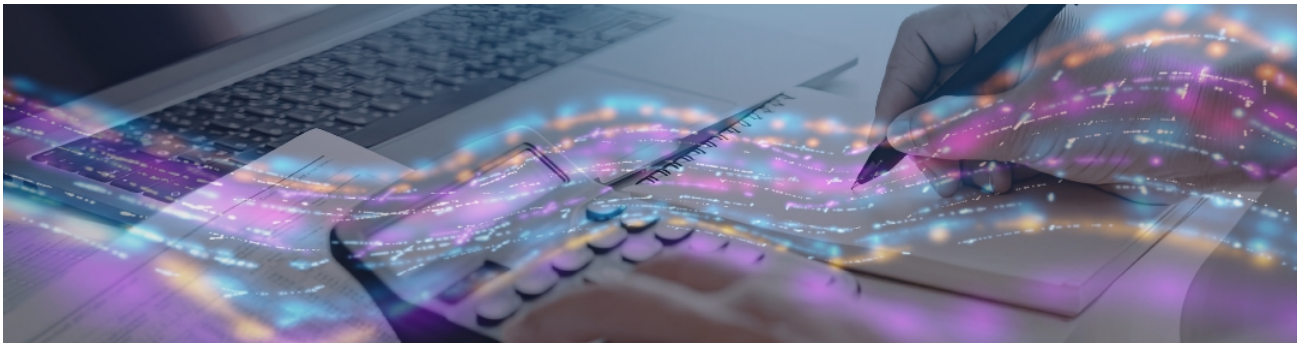
HVS

MARKET REPORT

Financing in a Higher-for-Longer World: How Hotel Owners Can Still Close Deals

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The financing environment has reset and is unlikely to fully reverse. Owners closing deals today have stopped waiting and started working—cleaning up operating statements, proactively managing capital stacks, and presenting well-documented asset stories. Rate is only one variable; others, such as NOI, loan structure, asset condition, and preparation, remain within owners' control. For owners willing to work, deals are getting done.



There's no question that the financing landscape for hotel owners has fundamentally shifted. Interest rates have fallen below their recent peaks, but we don't expect a return to the sub-5% borrowing environment that defined the 2010s. Persistent inflation, a resilient labor market, and ongoing geopolitical uncertainty have kept benchmark rates, namely Treasury yields and secured overnight financing rates (SOFR), stubbornly elevated. For hotel owners and buyers, the average borrowing rate for a stabilized, cash-flowing asset currently sits in the 6% to 7% range, and the market consensus is that meaningful relief is not coming anytime soon.

Yet despite these headwinds, deals are getting done. Owners are refinancing maturing debt and buyers are closing deals. The difference between those who are succeeding and those who are sitting on the sidelines often comes down to preparation, creativity, and a willingness to work with the current conditions rather than against them.

Understanding What Lenders Are Actually Testing

Interest rate affects how much a hotel owner or buyer can borrow. It helps to understand exactly what lenders are evaluating when they size a hotel loan. Two measurements drive the assessment: loan-to-value (LTV) and debt service coverage ratio (DSCR).

LTV is relatively straightforward and equals the loan amount divided by the hotel's appraised value or purchase price.

Most lenders today are comfortable in the 55% to 65% range for stabilized assets. Staying on the conservative end of that spectrum gives borrowers meaningful leverage when negotiating other loan terms.

DSCR, however, is where the most important conversation takes place. It measures the hotel's net operating income (NOI) against the annual debt service (principal plus interest). In the current environment, lenders typically require a DSCR of 1.30x to 1.50x, meaning the hotel's NOI must cover 1.3 to 1.5 times the annual debt obligations. That cushion gives lenders confidence that the asset can weather a softening in performance without jeopardizing loan repayment.

What makes DSCR particularly important is that most variables remain within the owner's control—and that's where the real opportunity lies.

Maximizing NOI Before You Go to Market

NOI, sometimes referred to as EBITDA, is revenue minus operating expenses, before debt service, depreciation, and income taxes. It is the single most important number in a loan package, and lenders will underwrite the trailing 12 to 24 months of actual operating results, not projections or pro formas.

This means the operational decisions being made today will directly determine borrowing capacity 12 to 24 months from now. For owners who are serious about their next round of financing, the time to start preparing is well before a lender ever enters the picture. The areas worth looking at for improvements are as follows:

Labor and Staffing: Labor typically represents 35% to 40% of a hotel's total revenue, making it the single largest expense category and the area of greatest opportunity. Thoughtful departmental profitability benchmarking, cross-training initiatives, and smarter scheduling practices can move NOI meaningfully without compromising the guest experience.

Revenue Performance: RevPAR improvement flows directly to the bottom line, making revenue optimization one of the highest-return activities an owner can undertake ahead of financing. A careful evaluation of channel mix, direct booking conversion rates, and yield management practices can uncover meaningful upside.

Expense Classification: Distinguishing between recurring property operations and maintenance expenses and legitimate one-time, non-recurring items is often overlooked. Major equipment replacements, property damage repairs, and similar extraordinary events should, to the extent allowable under standard accounting practices, be capitalized rather than expensed. Keeping your normalized NOI clean and well-documented makes the lender's underwriting process smoother and the loan package more compelling.

Property Condition: A hotel with deferred maintenance signals risk to lenders and appraisers alike. Addressing physical obsolescence before financing isn't just aesthetic—it directly supports the asset's appraised value and the lender's confidence in its remaining economic life.

Franchise and Management Contracts: If the franchise agreement or management contract is set to expire within the proposed loan term, an owner must address it before going to market. Renewing or renegotiating these agreements in advance would eliminate a common pushback from lenders.

For a more detailed discussion of hotel NOI and cost management practices, see this recent article by Marcus Lee, ISHC, with HVS Asset Management.

Managing Debt Service: Rate and Amortization

Debt service is a function of loan amount, interest rate, and amortization period. While market rates are largely outside any borrower's control, the structure of a loan offers far more room for negotiation than most borrowers realize.

Amortization: Most commercial banks and balance sheet lenders are currently offering 20- to 25-year amortization schedules. A longer amortization period lowers annual debt service and improves DSCR. Lenders grant longer amortization to well-maintained assets with strong operating histories. Secondly, keeping the loan amount within a conservative LTV range—say, below 55% or 60%—will persuade lenders to offer the longest amortization period possible, or even an interest-only loan.

Interest-Only Periods: CMBS lenders will frequently offer interest-only for the full five-year loan term on qualifying assets. The tradeoff is prepayment inflexibility, as CMBS loans are subject to defeasance or yield-maintenance provisions that make early exit expensive.

Expanding the Capital Stack

In a higher-rate environment, senior debt alone may not be sufficient to make a transaction work at an acceptable return. Increasingly, sophisticated hotel owners are turning to alternative capital sources to bridge the gap.

Mezzanine Debt and Preferred Equity: These subordinated instruments occupy the space between senior debt and owner’s equity in the capital stack, filling the gap when senior debt alone falls short. They carry higher rates, typically in the 12% to 14% range, but in the right circumstances, they can be the difference between a deal that works and one that doesn't.

SBA 504 Loans: For smaller transactions involving owner-occupied assets, the SBA 504 program is worth considering. The below-market fixed rate on a meaningful portion of the capital stack produces an attractive blended rate that overcomes DSCR restrictions.

Bridge-to-Permanent Financing: For assets in transition, whether due to a recent renovation or brand conversion, bridge loans provide the short-term solution needed while the hotel stabilizes. Because of the transitional nature of the loan collateral, bridge loans are underwritten using lower DSCR thresholds. Executing a clean refinance into permanent financing 18 to 24 months later, once trailing performance fully reflects the stabilized operation, is an effective strategy for owners willing to think in stages.

The Bottom Line

The financing environment has reset, and it's unlikely to fully reverse. The owners closing deals today are the ones who stopped waiting and started working—cleaning up their operating statements, managing their capital stack proactively, and engaging lenders with a compelling, well-documented story about their assets.

The encouraging truth is that rate is just one variable in this equation. NOI, loan structure, asset condition, and preparation are the others—and those remain firmly within an owner's control. For owners willing to do the work, the capital markets are open, and deals are getting done.

At HVS Capital Markets, we translate market and financial data into insights that drive better capital outcomes. For assistance identifying lenders with the most competitive terms for your asset type and market or evaluating your hotel's operating performance ahead of your next financing, we invite you to reach out to Emil Iskandar with HVS Capital Markets.