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Hawaii Hotels Face Fewer Visitors, More Debt

By KRIS HUDSON

For the hotel industry in the continental U.S., this downturn is the worst since the Great Depression. But the Hawaiian resort industry is taking a beating that's even more severe.

Hotel-room demand in the state has declined sharply at a time when the number of expensively renovated rooms is rising. Thus, occupancy at Hawaii's resorts dropped to 66.9% in the first eight months of this year, the lowest level since the same period in 1993 and down from this decade's high of 80.7% in 2005, according to Smith Travel Research. Meanwhile, revenue per available room has fallen nearly 25% in the past two years and now averages \$150.75.

That combination means a number of Hawaii's resorts no longer generate enough revenue to pay the mortgages on their properties. Distressed debt tied to hotels is rising across the nation, but Hawaii has more troubled hotel debt per room than any other state, about \$23,256 compared with \$5,083 in California and \$5,345 in Florida, according to statistics based on data from Real Capital Analytics. Overall, Hawaii's distressed debt tied to hotels totals nearly \$1.6 billion.

Real Capital classifies as distressed any loan that's in foreclosure, receivership or bankruptcy or has been revised by the lender to help the borrower.

This isn't the situation investors anticipated when they began buying up Hawaiian resorts during the real-estate boom. Between 2004 and 2008, dozens of resorts traded hands at prices that ran as high as \$800,000 a room, according to Hospitality Advisors LLC, a Honolulu-based hotel-consulting and management company. In many cases, the new owners planned costly expansions and renovations designed to upgrade the aging resorts and offer a higher level of service, and then brought in managers with prestigious brand names to operate the hotels.

Major renovations of existing hotels are common in Hawaii because construction of new resorts has been limited since the 1980s because of steep land prices and local governments' opposition to expansion. "So the name of the game is to buy, renovate and reposition," says Joseph Toy, president and CEO of the hotel-consulting company Hospitality Advisors, based in Honolulu. Many of the resorts that changed hands in recent years were built by Japanese owners in the 1980s.

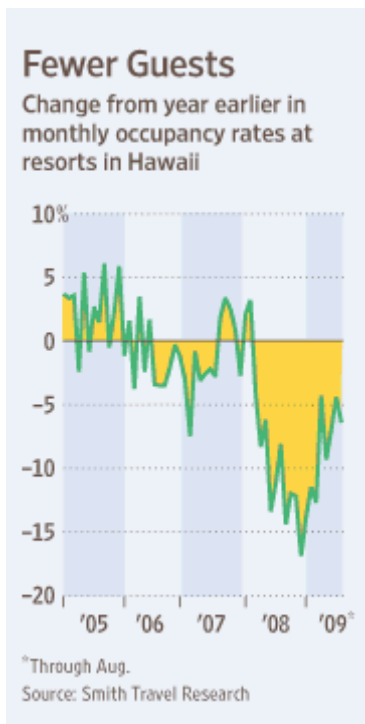
But practitioners of that pricey repositioning strategy now find themselves in a bind due to the recession, the capital crisis and Hawaii's tourism downturn. "The operating numbers have cratered, the underlying fundamentals aren't very good, and you have a whole bunch of problem loans," says David Carey, president and chief executive of Outrigger Enterprises Group, which owns 30 Hawaiian hotels, none in foreclosure.

Morgan Stanley, for example, teamed up with a local developer in 2007 to buy the 310-room Maui Prince Resort and 1,300 adjacent acres for \$575 million. By this year, the resort's annual revenue had fallen 50% from 2007

levels, its monthly operating losses were nearly \$1 million and plans to build luxury communities on the 1,300 acres had fizzled, according to a lawyer representing Wells Fargo & Co., the trustee of the resort's \$192.5 million mortgage. Wells Fargo put the resort in receivership last month. A Morgan Stanley representative declined to comment.

On Hawaii's big island, Westbrook Partners LLC, Farallon Capital Management LLC and Lodging Capital Partners LLC bought the 540-room Fairmont Orchid Hawaii in 2005 for \$250 million. They spent \$20 million to renovate the resort, but by this year it could no longer support its \$230 million mortgage. The owners, who declined to comment for this story, forfeited the resort to lender Barclays Capital in June.

Local owner Anekona Real Estate Development has lost four hotels to lenders in the past year, including the 203-room Ilikai hotel made famous in the opening scenes of the 1970s television show, "Hawaii Five-0." IStar Financial Inc., which held the Ilikai's \$60 million mortgage, foreclosed on the hotel last July. Anekona representatives couldn't be reached for comment.



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On Maui, a partnership of resort developer GenCom Group, Goldman Sachs Group Inc.'s Whitehall Street Global Real Estate LP and Highgate Holdings paid \$175 million for the 548-room Ritz-Carlton Kapalua Bay in 2006 and undertook a \$160 million renovation. Last April, the owners defaulted on the resort's \$260 million mortgage from bankrupt Lehman Brothers Holdings, according to a disclosure by one of the investors in a Securities and Exchange Commission filing. GenCom representatives didn't return messages seeking comment.

Vacationers and travelers probably won't notice changes because the lenders in most cases hire new, interim management companies to oversee the properties and work to preserve their business.

The world-wide tourism downturn has been particularly harsh in Hawaii because of its remote location and its upscale focus. The number of domestic and international visitors to Hawaii has fallen 12% since 2007. Rising fuel prices and the March 2008 shutdowns of Aloha Airlines and ATA made air travel to—and throughout—Hawaii both challenging and expensive for tourists, leading many in the U.S. to take cheaper trips to closer locales like Mexico.

And the long-running decline in Japanese visitation—down from 2.4 million in 1997 to an expected 1.2 million this year—has been exacerbated by Japanese fears of the swine flu virus.

The tourism slump is hitting Hawaii's economy hard. The state's unemployment rate has risen to 7.5% from 2% before the downturn, with many of the job losses coming in tourism-related industries, Hawaii-based economist Paul Brewbaker says. Hawaiian hotel jobs have fallen to 35,100 from 39,200 three years ago, he adds. Retail sales are down roughly 15% from 2006 levels.

Many Hawaiian resorts have remained in the good graces of their lenders but are still suffering. Dell Inc. founder Michael Dell's MSD Capital and partner Rockpoint Capital LLC paid \$502 million in 2006 for the 243-room Four Seasons Hualalai hotel and 8,800 acres for residential development.

Since then, the hotel's annual cash flow has sunk to \$7.9 million from \$20.6 million, and occupancy has fallen to 54% from 87%, according to reports from the servicer of the hotel's securitized mortgage. Some of the drop resulted from \$40 million in renovations that temporarily closed some rooms, Hualalai executives say.

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