

Downturn could be further off than previously expected

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IN THE details

The past two years have demonstrated exceptional good times for the hotel industry, but those of us who have been through a number of real-estate cycles know that good times and bad times seldom last. The real question is when do we have an inevitable downturn, and why. Reason would seem to dictate we are due for a fall in the hotel sector, but not so fast, considering the following macro trends:

- Worldwide globalization of travel and technology will facilitate the worldwide spread of investment capital. Since the United States is still the safest investment harbor in the world, domestic and foreign capital will continue to flow to the U.S. real-estate sector.
- Operations drive investment. Continued improvement in market fundamentals and improved management skills, coupled with investment return compression, will continue to drive capital to the hotel sector.



- Hotels are the fifth real-estate food group. Investors now consider hotels to be a mainstream investment vehicle, and as such, return expectations are lower than in past cycles because the risks of hotel ownership are viewed as in line with other forms of real-estate.
- The buy market for hotels remains frothy as escalating costs for land and materials make building new hotels, especially full-service hotels, a costly and time consuming challenge. High prices being paid for hotels on a per-key basis still are lower than the cost of new construction in most cases, and provide a more immediate return.
- The residential bubble already has popped in most markets, which will cool off mixed-use development where condos have been used to offset hotel development costs. This again will make it harder to develop hotels and continue to make the acquisition of existing product attractive.
- Business-travel increases will be moderate as the economy cools, Domestic leisure travel will make up the gap despite energy costs.
- If the stock market continues to be mediocre, further cap rate reductions might occur and additional flight capital will find its way to the hotel investment sector.
- Rising labor, energy and insurance costs might neutralize this potential reduction in cap rates; it is getting more expensive to operate a hotel efficiently.
- Interest rates are holding steady, while interest spreads continue to decline and lenders continue to move up the capital stack, with 80-percent-plus now common on conventional senior loans. This makes buying assets attractive, as well as offering the refinance of hotels as an attractive option to a sale. Several sellers have pulled assets off the market in favor of the debt option, further making the availability of good, economic purchase opportunities very competitive.

These factors would seem to indicate that the hotel investment market will stay strong for the foreseeable future. We should have three more good years of robust hotel investment activity in both the sale of assets and the refinance of assets. The constraints on deal volume will be the desire of hotel owners to either take profits, thin their portfolios or favor a refinance option in favor of a sale.

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