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News

Price discovery (aka value) must emerge before recovery can begin

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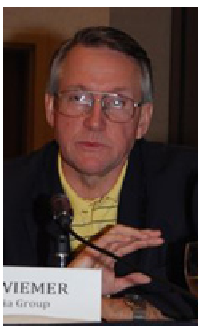
GRAPEVINE, Texas—Establishing the value of a hotel in today's economy is a little like playing darts blindfolded at the local pub—you know the general direction to throw but no one is certain exactly where the dart will stick.

Speakers at last week's ninth annual Fishing for Solutions: Servicing Hotel Loans conference in suburban Dallas reached a general consensus that it's good to be skeptical if anyone tries to put an absolute value on a hotel. The hip term is "price discovery"—but speakers agreed no matter what it's called, it must be determined before a significant recovery can occur.



Robert Wiemer, The Plasencia Group

"There are very few transactions … You can't really pinpoint where value is," said John Martin Hall, director-mortgages for MetLife Real Estate, which has a US$35-billion debt portfolio and wants to dip its toes in putting out hotel debt. "There's been a huge drop in (net operating income) in hotels, and it will be a long (recovery) process through 2011 and possibly 2012."

Hall said MetLife will start its new hotel-lending program by focusing on trophy assets with low leverage. It will start slowly, with about US$200 million in funding available.

Other speakers also questioned how hotel values can be established during the worst economic crisis since the Great Depression.

"When that market fell apart you saw values cut in half because it was valued by future cash flows and escalators that didn't occur," said Jackie Brome, senior VP of Capmark Finance. "We're seeing substantial reductions in the value."

"We need a reset in valuation," said Robert Wiemer, a senior VP with The Plasencia Group. "There's not as much shock in this cycle. Everybody's expectation of what is coming is realistic, but valuation is local. There's no science these days. It's the cold reality of what somebody will pay."

Michael O'Hanlon, senior VP and director of Capmark Finance's asset management/special servicing department, said he is skeptical about appraisals because they tend to use historical performance as a cornerstone, and recent history hasn't been kind to hotels.

"Brokers are closer to valuations than appraisers," he said.

Whether a hotel owner is trying to establish a value of an asset to sell or to deal with a lender, O'Hanlon said there's one clear-cut thing the owner must do: "Get the (broker's opinion of value) before you sit down to negotiate and understand what you have."

No deals

Hall said a major hurdle in the appraisal category is there have been few hotel deals to set market rates.

"We look at historical. … We go back further than two or three years back. Look at (the asset's performance during) its peaks," he said. "It's hard to value hotels, in fact any property type. There's just no trading in any asset class. When you have hardly any trades, you can't peg value."

Tom Corcoran, chairman of FelCor Lodging Trust, reminded the audience there's a distinction between the liquidation value of a hotel asset and its true value, and neither owners, lenders nor special servicers should be confused by the differences.

Adam McGaughy, Jones Lang LaSalle Hotels

The liquidation value is the estimated amount of money for which a hotel quickly could be sold, particularly in a distressed scenario. The true value is the amount of money a buyer would pay for an asset during "normal" economic times.

"A lot of people want to steal the property," said Adam McGaughy, a senior VP with Jones Lang LaSalle Hotels. "At the end of the day, it's about getting bids, creating the market, and the market will create the price."

Rick George, a principal with HREC Investment Advisors, said the simple fact is the appraised value might be exactly right.

"If you're comfortable as an asset manager that these guys turned over every stone … and they are 25 (percent) to 30 percent below the perceived value, then that's what the value is," he said. "There's nothing we can do."

Peter Holmes, COO of Hotel Broker One, said values have been somewhat set at properties in the US$5-million range because there have been a number of deals involving properties in the limited-service sector. He said those types of properties, such as older Hampton Inn hotels, have been trading at capitalization rates of 15 and 16.

"The vulture buyer is still the No. 1 buyer," he said. "They're sitting there smacking their lips."

Holmes and other speakers said an interesting trend is those “vulture buyers” are battling each other to get the lowest price—quite a turn of events from a couple of years ago, when it seemed like price was no object in most hotel deals.

“The key to value is getting well below replacement costs,” Holmes said. “Show the buyer that there’s value upside, and the buyer’s willing to pounce now.”

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