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Investors Standing on the Unsteady Edge

By Carl Cronan

Hotel investors are a lot like prospective homebuyers lately. The same knot in the gut applies in thinking a good deal today may be priced lower after awhile.

"A lot of buyers are having difficulty deciding whether to close on hotels now or waiting to see if that same hotel is cheaper in 12 months," says Mike Cahill, president and founder of HREC-Hospitality Real Estate Counselors in Denver and co-chair of the Lodging Industry Investment Council. Cahill compiled this year's LIIC Top Ten, a profile of investor sentiment and attitudes toward the industry in the coming year.

Topping the list, based on a survey of 40 industry executives, is a widening sentiment that lodging real estate values will continue to drop during the next 12 months. Cahill says 39% of respondents believe the decrease will exceed 5%, while another 36% indicate that it will be far less.

Economy hotels are forecast to have the largest value drop, largely resulting from the ongoing debit debacle, according to Cahill, whose brokerage has closed 17 deals so far this year, ranging in value between \$3 million and \$10 million. A lot of potential investors are looking for deals but not closing, while some are choosing to do nothing now, he says.

"Part of it is that people are trying to figure out what to do," Cahill tells GlobeSt.com. He points to a survey question about the current investment cycle, which indicates that 38% of respondents believe this is the "first inning" of a new hotel investment cycle for the first time in four years. However, half believe this is the very end of the current cycle.

Adding to that, he says, 42% believe the current economic downturn will be over a year from now, while an equal percentage think it will last through most of 2009. This could affect buying strategy, he notes, given that many investors who seek cash flow would rather wait until a recession to buy hotels.

Despite the state of the economy, Cahill notes that hotel fundamentals aren't so bad overall. Revenue per available room and average room rates are increasing, even if occupancy is down, he says.

"There's a lot of uncertainty out there," Cahill says. "People are looking at opportunities right now, and I think those people who make the right calls will make a lot of money."

Some hotel brokers are hoping now is the time to take properties to market. For example, New York-based Massey Knakal Realty Services is marketing three luxury boutique hotels in Southampton-the Bentley, the Atlantic and the Capri-at an asking price of \$25 million for all 133 rooms, making up 43% of the township's lodging capacity.

"There seems to be a significant amount of interest in these properties," says Robert Knakal, the company's chairman and co-founder. Bids are anticipated by hotel chains, individual investors, and even some of the celebrities and their agents who still frequent the Pink Elephant nightclub that comes with the properties.

LIIC survey respondents, which include REITs and publicly traded hotel companies as well as influential investors and corporate real estate executives, say the desirability of available properties is lower now than the last two years. Cahill says 46% believe hotels now on the market

are average quality, but 34% believe they're below standards.

Compounding that issue, he adds, 68% believe the quantity of available product is either "below average" and "low." This likely means sellers are holding back from putting more favorable hotels on the market because of decreased value, he says.

Other highlights of the LIIC Top Ten are as follows:

-53% of respondents believe now is a good time to buy select hotels, while another 33% marked maybe, as long as it's a compelling acquisition.

-Many LIIC members stressed that the hotel industry's fundamentals are still good, while others were highly pessimistic on the immediate future and its impending downward impact on profitability.

-Half the respondents believe hotel interest rates will increase over the coming year, while the other half are divided between rates declining or flattening.

-A 61% majority believe unlevered equity rates will increase during the next 12 months, which Cahill says is an indication that investors demand a higher rate of return because hotels are thought to be more risky.

-LIIC members envision new hotel construction peaking next year (36%) with 2010 to follow as another big year (25%).

-Institutional investors favor the Marriott hotel group overall, as they did in the 2007 survey, with Hilton following closely and Starwood ranking third.

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