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RTC Sequel May Be in Hotels' Future

By Paul Bubny



Ford
photo: Michael Ian

NEW YORK CITY-A revival of the Resolution Trust Corp. concept may be what's necessary to get the deals flowing again, said panelists Thursday at the Third Annual RealShare Hotel Investment Summit, which drew about 300 attendees. Panelist Richard Rudd, senior managing director at Allied Advisors, said during the morning's Power Panel session that special servicers cannot keep up with the influx of distressed hotel assets and there will have to be "bulk sales" through an RTC-like vehicle.

His fellow Power Panelist, HEI Hotels & Resorts' Roger Clark, recalled that during the last major downturn of the early 1990s, "you had an active market" thanks to the RTC. At the moment, he said, it's anything but active.

The numbers bear out Clark's description. In a "Lending, Development and Transaction Update" following the keynote address, SVP J.P. Ford of Lodging Econometrics said that single, portfolio and M&A hotel deals reached 1,660, 674 and 1,382, respectively, over a 12-month period at their peaks earlier this decade. Year to date in 2009, the respective figures for these types of transactions are 206, six and zero. Panelists cited declining RevPAR and the continued credit freeze as factors, along with the glacial rate at which distressed hospitality assets are reaching the market.

However, the conference's theme, "The Upside of the Downturn," put the emphasis on finding opportunities. As Geoff Davis, president of HREC Investment Advisors, put it in his opening remarks, "We know it's bad. Get over it and move forward."

Keynote speaker Ross Woods, principal of Hotel Investment Strategies, LLC, urged his audience to disengage their perspectives from the short-term viewpoints favored by most analysts and instead take the long view of the sector. "Fortunes are made in downturns because fortunes are lost in downturns," he said.

Noting that lodging has been the highest-risk of the five major food groups in the past 10 years and is currently the commercial sector hardest-hit by the recession, Woods nonetheless said there are three compelling reasons to invest in hotels. First, hotels have provided the highest income returns at an average 8.9% over the past 30 years; second, they offer significant capital returns in short windows; and third, they provide opportunities for diversification in commingling funds.

Sounding a theme later echoed by other speakers, Woods advised understanding the particulars of each market, as no two respond in exactly the same way to economic drivers. "You should be buying into markets, not hotels per se," he said. Similarly, Clark—who as SVP of acquisitions and development at HEI thinks now is actually an opportune time to buy—said it's "myopic" to look at US hotel fundamentals generally when individual markets might be faring better.

With that said, KSL Capital Partners principal Bernie Siegel said that price will be what drives most transactions, although the intricacies of individual markets need to be considered. One factor that Siegel and other members of the Power Panel agreed would affect pricing—i.e. help keep it down—in the next few years is the tens of thousands of rooms still due to come on line, although not all will end up getting built as both financing and demand remain soft. In that regard, the current



photo: Michael Ian Woods

lack of construction financing is a blessing in disguise, panelists agreed.

During the presentation on "Investing in Distressed Hotels and Loans" that concluded the morning before an afternoon of concurrent sessions, panelist James Luchars, director of AW Capital Management, noted that the era of "kicking the can down the road" is now moving pretty rapidly into monetary defaults. Siegel said in the previous panel that a default rate in the mid-20s was not out of the question. "I don't think we've seen the worst of the perfect storm yet."

Even so, experts on the distressed panel concurred that the pace of assets coming onto market remains slow, and so will the rate of recovery. Bill Reynolds, director and senior advisor at Thayer Lodging Group, said "it's anybody's guess" whether the current distressed market will yield more one-off transactions of portfolio sales.

Responding to a question from moderator Daniel Lesser, senior director at CB Richard Ellis, on how you value hotels today, panelist Michael Medzigian concurred with Siegel's earlier observation that "if you're buying all-equity, that's how you value it." Chairman and managing partner of Watermark Capital Partners, Medzigian noted that he's been saying for a few years now that values will decline 50% peak to trough. Recently, he said, a friend boosted that estimate to a 70% decline, factoring in a 10-year hold period in the face of what promises to be a mild recovery.

Notwithstanding the slow pace of distressed lodging assets turning into REO properties and what Clark called "no clarity" on when debt will return to the market, RealShare panelists saw light at the end of the tunnel. Jack vanHartesvelt, SVP and principal at Kennedy Associates, said that although RevPAR won't start to go back up until after 2010, "when that kicks in, it's going to last for a while." Clark predicted a sharp rise in loan sales over the next six months, while Rudd said transaction activity next year will be "at least twice what it is today."



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