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Hotel Investors have gone “Pencils Down” - by James O'Connell

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James O'Connell

Is that the sound of air flowing from a balloon? Could it be someone snoring? Maybe it's just a big sigh of relief from analysts after they learn their underwriting workload has been cut. Hotel investors have decided to step back and wait for the dust, kicked up by the financial markets, to settle before they get back in.

Interest rates have jumped over 200 basis points in the past three months. It took a while for the train to stop, but it appears everyone, investors as well as lenders have headed for the beach and they won't be back until after Labor Day. We're in the "Dog Days" of summer and uncertainty rules the day. Unable to make qualified projections, investors have taken a "wait and see" attitude. So now we all wait. While we wait, it's "Pencil's Down."

At least the hotel performance throughout New England has been excellent. The rock-solid leisure transient and leisure group segments continue to be the bedrock of core hotel demand. But corporate group and corporate transient segments have begun a steady march forward. According to Pinnacle Advisory Group, in their "Pinnacle Perspective", for Year To Date June 22', the Boston hotel market's Revenue Per Available Room (RevPAR) increased 253% over 2021! That shows the return of the long awaited corporate transient business, convention center events and an increase in post pandemic urban leisure demand is well on its way back.

After the summer recess, we'll see if the "Work From Home" phenomena has become a long term fundamental trend.

I've always wanted to know the correlation between leisure demand and the number of Duck Boat tickets sold! I'm guessing that there is a direct relationship!

Other markets around New England continue to post excellent performance numbers. Cape Cod, Portland, North Conway, Newport, are all experiencing year-over-year improvements which is an excellent trend since 21' was a record year!

HotelAVE distributed their Q2 "Hospitality Dashboard" this month. They project corporate, convention and international demand growth will continue to accelerate. But inflation adjusted room rates will not ascend higher than 2019 levels. They also confirm that lenders have taken a "wait and see" approach.

With so much uncertainty, why not take the time off? Are we in a recession or not? Are gas prices going to continue to drop or will there be a resurgence once the fall rolls around? Will further interest rate increases be required to curtail inflation? If a 100 basis point increase in lending rates could cause a valuation to be off by several million dollars, why not head for the boat and go for a sail?

The only thing certain in this market is that investment risk is intolerable right now. Why not head to the Cape and count Great White sharks! Hotel investors would rather a three mile backup at the Bourne Bridge than accept the risk of underwriting a deal, only to find out their lender won't go along

with it or that required equity has jumped from 30% to 40%, fully collateralized!

We believe that the market has to get through September before the investment market establishes some firm footing. Once the Federal Reserve bumps rates in the fall, pricing can be better judged and valuations can be conveyed to owners with more certainty. Ten months of actual performance, that in all likelihood will be very good, will assuage lenders and investors can jump back in.

The last slow-down, 2008-09 was caused by illiquidity in the market. Sixty percent of homeowners had negative equity in their homes. The present situation was caused by historically high government spending compounded by world events and supply chain issues. There is plenty of capital on the sidelines just waiting to know which way to move and how much risk to apply to certain deals. We aren't very far away from gaining that certainty.

New England hotel operators should continue to enjoy their performances. The rest of us should grab a towel, chair and cooler and head to the beach! See you in September!

James O'Connell is a principal of HREC Investment Advisors, a national hospitality and real estate company specializing in hotel brokerage and capital markets transactions. He is charged with managing the New England region and works with over 50 HREC hotel brokers in 15 offices around the country.

In June of 2,000, Jim founded O'Connell Hospitality Group, LLC a regional hotel brokerage company which exclusively represented hotel REIT's, institutional investors, private equity firms and high net worth individuals. He and his team are responsible for over \$1Billion in hotel transactions.

OHG merged with HREC Investment Advisors in September, 2016. Jim remained a Principal within the newly expanded firm. He has spent his entire career selling hotels and credits his initial experience of managing hotel dispositions for the former Bank of New England and RECOLL Management Corp.

He is a 1982 graduate of Massachusetts Maritime Academy and holds a Master's License for Unlimited Tonnage Vessels. He is a devoted husband celebrating 30 years of marriage and is the proud father of two very successful, fine young men.

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