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Market trends: Hotel transactions will see a big improvement over past 12 to 15 months

July 15, 2010 - Front Section

"We are not overbuilt we are under demolished" a common expression that has been around for quite a long time, however, it may never have been as appropriate as it is in this day and time. Among many transitions that have taken place in the past few years there is none as big as the differentiation between the quality brands and the older franchised hotels. There are still too many exterior corridor motels, exterior corridor two story hotels, and now too may two story interior corridor hotels like the Ramadas and the Holiday Inns of the 60s and 70s now usually operated within any one of the many family of franchises. Many of these older hotels should have come out of the market or should soon, they usually are in the best locations and now the land value is probably higher than the value of the hotel from an income approach; the problem is that in this economy there are not many takers for new retail space, automobile dealerships, franchised restaurants, etc. all businesses that can pay higher price for vacant land then hotel developers. Each city or town is beginning to look like "Anywhere USA," not because of all the same franchises but because of the "for lease" and for sale signs scattered along Main St. This segment of the economy needs to come back before we will really see the reduction in guest rooms that will benefit everyone in the hotel business.

Another trend that for some time has been reshaping the hotel markets has been the huge demand for Hilton and Marriott hotels in the upper brand limited service and select service segments. The Real Estate Investment Trusts (REITs) and many private equity groups are again seriously looking to purchase properties such as these. It appears that they are willing to pay a very fair price for the quality properties with the thought that revenues and therefore bottom lines have no where to go but up. On a recent trip on the east coast I spent two nights in very well maintained Hampton Inns, the rate in Savannah, Georgia was $99 and in Winchester Virginia the rate was $89. Considering these rates the other lower tier franchises in the market are going to have a very difficult time competing, how much lower will their rates need to be in order to take business from the Hilton and Marriott properties, for many too low to survive.

Again many of the REITs and private equity groups are back in the market and they have a lot of cash. Some are just looking for really good product at a fair price; as an example we have a few hotels under agreement at a 7% capitalization rate but I think the buyer is feeling that it will really be closer to an 8% or 9% rate when looking at 2010 year end numbers. Interestingly in discussions with many of the high quality hotel appraisers here in New England there is not much credibility given to using 2009 numbers in the determination of current values. There are groups looking for distressed properties but clearly lenders are looking differently as to how they handle the distressed hotels versus the early 1990s. Forbearance agreements have become plentiful and most lenders are looking for other means to handle non-performing assets. They feel if the management in place is doing the best they can that there has to be other alternatives to foreclosure or short sales. In many cases they are looking at alternatives; the FDIC recently sold the notes to a number of hotels that were in the non-performing class, however, the FDIC maintained a 60% equity in the notes that were sold. In my opinion finally something done by our government that makes sense, why take all the loss now when there is an opportunity to recover some time in the future.

The owner operator market continues to be very difficult. This pertains to properties in the 40 to 75 room range that have brands such as Best Western, IHG, Wydham and Choice, etc. as well as some that are run as independents. The Indian American market has even slowed down but much because the well priced properties are hard to find, most hotels for sale over the past year or so have had PIP issues, or mortgages that were higher than current value. Another problem has been that many owner operator hotels are purchased with equity from the sale of personal residences and not only have values decreased but sales of homes has slowed, a double edged sword for sellers in this category as equity in ones home was usually the down payment. Also in this market segment are many hotels with outdated or misguided food and beverage operations. Buyers are becoming increasingly concerned about these type of properties, some offer the opportunity for lease but the type of tenant available for these operations can often be an even bigger problem, of course, if a pad site is available and the food and beverage operation in the hotel can be eliminated the hotel will be much more saleable.

It looks like we are on a slow upswing; I have heard many say that 2011 and 2012 will be much better; I hope they are right but it is not clear yet what will drive our economy, however, 2010 for hotel revenues and for closed hotel transactions will certainly be a big improvement over the past 12 to 15 months and hotel values have started a slow and steady upward trend.

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