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2008 - hotel investment forecast stability returns to the markets

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Good deals that make fundamental sense are getting done and will continue to be completed in 2008. Hotel transactions based on low equity, overly aggressive projections without regard for new supply additions, won't. In 2008, we won't be scratching our heads asking ourselves; "At that price, how are they going to produce a return?"

When the CMBS market dissolved in June of 2007 all of the froth got blown off the top of every deal. Those based on froth died. The investments that showed returns based on realistic projections were completed and will continue to be transacted in 2008.

Does this mean that your hotel has lost value? Our answer is that your hotel was never worth as much as you thought, if you based your opinion on sales comparisons that were driven by cheap, non-recourse debt. In 2007 the market was, in fact, "frothy" and inflated asking prices were put on properties in order to find that "needle in the haystack" buyer. All the needles have been found. The buyers that are out there never left, they remained on the sidelines confident in the fact that this day will come and opportunities to acquire quality assets based on realistic expectations would return.

Next month the Federal Reserve will probably cut interest rates again in order to stave off or forestall the crisis in the residential mortgage markets. However, a 100 basis point swing in the rates isn't the concern for hotel investors. It is the crackdown of the debt coverage ratios which have increased from 1.10 to 1.50, the requirements to fund equipment reserves up from 3% to 5-6% of gross income as well as funding reserve accounts against seasonal fluctuations in cash flow. These are the realities of the debt markets in 2008.

Without a market to sell their bonds, the CMBS lenders have taken a hiatus. Several have gone into hiding with Brittany Spears. Traditional lenders that keep loans on their balance sheets have been inundated with loan requests and are picking the best of the best. Lenders that have to live with the loans they made are putting out money to borrowers with good track records and sound business plans.

We are bullish on several hotel markets in New England. While factors such as the tightening of credit has caused irrational exuberance to evaporate, fundamentals such as room demand brought on by a 1 million s/f convention center (BCEC) operating at 100% capacity makes us feel good about 2008 in Boston and surrounding areas. According to Pinnacle Advisors, Boston will end 2007 well over a 75% occupancy and an average room rate of solidly over $220. Cambridge occupancy could end up over 80%! That will put us in the top five cities in the United States for hotel performance, right behind New York City and Las Vegas.

We believe that Boston will remain at the top of the charts because new supply additions will not be forthcoming. The last wave of new hotel supply to hit Boston was accompanied by a residential condominium component. The sale of condo's enabled developers to regain their invested equity quickly and also gave them the ability to lay off fixed expenses to the hotel operations. Once the residential market cratered, so did the plans for new, stand-alone hotels. Construction costs have risen so high over the past three years that even with robust occupancies, room rates are not high enough to justify the construction of a traditional full service hotel. The equity returns cannot be achieved. This bodes well for existing hotels.

Hotels outside Metro Boston, along I-495 and in central and western Mass. will continue to scrape by. Demand has not measurably increased. Investors look at hotels in these areas based upon existing cash flow and factor in required capital expenditures. Many markets struggle to break the 60% occupancy mark and rates exist well below $100. These factors have held back significant new supply additions. Developers understand that they can't build a hotel for $130,000 per room and charge $79.00 per night room rates, at least not for long.

Our hope for 2008 is that governor Deval Patrick will be the first head of the state in a long time to understand how important tourism dollars are to Mass. We hope that he will fund and empower the office of tourism to attract large groups that consider traveling to the interior of Mass. and assist the convention centers in Worcester and Springfield to bring in quality conventions and conferences that produce room nights for the area hotels. We hear a lot about spending for Life Sciences. How about a 2008 Life Science convention in Worcester? "Bio Square" is situated next to the DCU convention center and four quality hotels.

Our prediction is that we are going to hear much more bad news about banks and the credit markets. 2007 will probably be shown as the peak for hotel transactions. 2008 will mark the end of the credit market shake out and the start of a new upward cycle.

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