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NYU Lodging Conference recap: Cycle talk - where are we in the cycle?

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The first week in June provides not only a sneak peak toward summer fun, but also offers the opportunity to rub elbows with hospitality professionals, along with tourists from all over the world, in Times Sq. for the annual NYU Hotel Investment Conference. Unlike past years, the weather was cool and rainy allowing people to run around the city attending meetings without sweating through their suits. Unfortunately, I left the city on Thursday morning, a few hours before the highly publicized punch up between Minnie Mouse and Hello Kitty outside the Marriott Marquis where the conference was held. Oh well, you can't win them all!

The hottest question at the conference by far, was where are we in the cycle? Translation, how long will the good times last? In my opinion, one of the leading indicators of how well the hotel business is doing is the excessive investments in receptions and cocktail parties at extravagant locations. Although I was unable to attend all the events, my inbox was littered with invitations. This is a trend that started a few years ago as we rose from the ashes of the 2009 recession, and continues to pick up speed. Whether it be last year's event at NYU where statuesque models in bright red dresses carried pyrotechnics in one hand and bottles of premium vodka in the other, or fireworks exploding at the Lodging Conference in Phoenix last October, superfluous events are the current norm. But for how long?

The fundamental economics behind the success of the hotel business starts with the supply and demand curve. The hotel business was decimated by the 2009 recession due to an over-supply of hotel rooms in many markets. When we look back at the go-go days of 2006 and 2007 we see fresh equity, cheap debt and inexperienced hotel developers and operators jumping into the hotel business hoping to make a quick buck. So when the financial crisis hit and people literally, stopped traveling, rooms sat empty and owners were unable to pay their pays bills. Many of these owners built or purchased hotels using inflated appraisals and convinced banks to loan them 80% (or more) of the cost. Using excessive bank leverage, along with record low interest rates is an OK plan while times are good, but a devastating strategy when demand falls off the cliff.

As everyone knows, hotels specifically, and real estate in general is cyclical. In the hotel business we point toward specific macro-economic events which triggered a recession. Prior to the 2008 financial crisis we experienced a downturn following the 9-11 terrorist attacks, the late 90s featured the tech bubble, the early 90s suffered from the savings and loan crisis and the 70s included both high interest rates and inhibited travel due to the supply and price of gasoline. Although we cannot predict the next crisis, we can learn from prior mistakes. But the question remains, will investors, developers and lending institutions remember the low rent "pity" parties we threw for ourselves in 2009 and 2010 or will they charge into deals with blind optimism fueled by premium cocktails and fireworks?

The investment decisions being made today are determining how the industry will react to the next economic blip. Fortunately, hotel demand continues to outpace supply, according to the data. Through 2017, most are forecasting supply growth less than 2% with demand in excess of 2.5%. That said, if you listen to franchise development team members and overzealous developers, there are hotels in planning and design seemingly on every corner of the United States. For example, I recently called a franchise development friend on behalf of a mixed-use developer inquiring about the availability of a premium limited service franchise in a tertiary market south of Pittsburgh. A good site in a healthy, albeit not robust, market according to the Smith Travel five year trend. The response - "we would like to work with you but we've got three applications for a variety of our franchises in the past 6-months." Honestly, a terrifying response that felt a lot like the summer of 2006.

Despite red flags, hotel numbers continue to impress. For example, according to Smith Travel, hotel occupancy is at an all-time high, 65%, as compared to previous peaks of 63.1% in 2007 and 64.9% in 1995. Average daily rate is even more impressive. Rate is anticipated to grow more than 5% in 2015 as compared to 4.5% in 2014. As of 2014, rates are 11% ahead of prior peak and consistent with the prior peak when adjusted for inflation.

Hotel fundamentals continue to trend positive and most prognosticators believe there are 2-3 "good" years ahead for the hotel business barring any unforeseen "black swan" events. Assuming that theory is correct, what steps should brands, investors, operators and lenders take to prevent a systematic collapse of our business when the inevitable downtown hits? First and foremost, we need to remain diligent and conservative in regards to due diligence and sponsorship. Let's not fool ourselves by making every deal work by simply increasing the rate and occupancy and running Pro Formas with endless 5-8% year over year growth with market penetrations over 150%. Finally, lenders must remain focused on the strength of the sponsor/operator and the subject market and stay out of the "over leverage" business.

Although I left Times Sq. without first row seats to the Minnie Mouse versus Hello Kitty battle, I did take home a better of sense of what to expect from the hotel industry over the next few years. My only hope is that when the gratuitous roof top parties come to an end, the economic fundamentals of our business are strong enough to withstand the next cycle. Best of luck to everyone on their hotel projects and I'll see you at the next cocktail reception!

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