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LIIC surveys the state of hotel investment market from COVID-19

May 22, 2020 - Front Section

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Boston, MA The members of the hotel industry's preeminent think tank, "LIIC – The Lodging Industry Investment Council," completed a new flash survey April 25th, as a follow-up to our original flash survey from March 15th. How has 40 more days of a global pandemic affected U.S. hotel investment?

The results of our second survey (and comparison to the first survey) provide an excellent snapshot of the rapidly evolving hotel investment market in light of COVID-19.

Mike Cahill, CRE, MAI, FRICS, CHA, and LIIC co-chairman, produced this flash survey. Cahill is CEO and founder of Hospitality Real Estate Counselors (HREC), a leading hotel and casino brokerage and advisory firm (16 offices nationwide) specializing in lodging property sales, debt financing, consulting and litigation support (www.hrec.com). James Few and Christian Walsh, senior associates in HREC's Denver office, assisted throughout the process.

Flash Survey II Results - COVID-19 Hotel Investment:

1. Over a Year for Property Level Hotel Cash Flow to Rebound: In a major switch from our original survey, 91% of LIIC members now believe that hotel asset level NOI impact from COVID-19 will not normalize (a return to 2019 cash flow performance) for at least another year. Previously, 75% anticipated full normalization within a year.

Recession is Here: 94% of survey responders believe 2020 should be considered a recession year. With sadness, it is time to officially say goodbye to the greatest 10-year hotel investment upcycle in our lifetime.

Buyers Cautiously Increasing Activity: Currently, 57% believe the time is right to submit Letter of Intent to Purchase (LOI's) for new hotel investments, a 21-percentage point increase from 36% just 40 days ago. For hotels under contract, results are consistent that 75% of buyers believe the contract should be extended revealing that investors still want to close transactions. 86% of responders believe a buyer is entitled to a re-trade, if warranted, due to anticipated short-term cash flow impact, a 14% increase from the March survey results. The question is “How will sellers respond to a desired pricing re-trade?” While 64% of investors state they are still cautiously underwriting new lodging investments, 74% are taking a wait and see approach at the same time. Shoppers versus real buyers?

Hurdles to Cross for Closing Transactions? A review of both the March and April surveys reveal two dominant concerns that may hinder return of a healthy lodging property transaction market; frozen traditional debt financing and closing of a bid/ask spread between buyers and sellers. The amount of necessary downward pricing adjustment from February 2020 values to facilitate a closed transaction is still in flux. Even once the amount of justified pricing discount is quantified, buyers are still left with the issue of whether sellers will allow their assets to trade at the new pricing or will opt to just hold. On positive notes, hotel investors are getting creative with 20% noting an increase in seller debt financing and 15% of sellers offering preferred equity investment to buyers. Moreover, hard money lenders featuring 8% to 9% interest rate bridge financing are stepping up to the plate quickly.

Hope for Debt to Become More Active: 87% of new hotel purchase and sale contracts (PSA’s) are anticipated to have debt financing contingencies (essentially nonexistent last five years) added in conjunction with longer due diligence periods. The April survey indicates investor concern about the speed of the hotel lending comeback, with 72% expecting no increase in refinancing activity in 2020, a 49% increase in negativity from March. The CMBS (Collateralized Mortgage Backed Securities) market continues to stall, with 86% of buyers and refinancers reporting an inability to get debt quotes.

Top Three Threats to Hotel Investment Remain Constant:

• COVID-19;

• Anticipated Economic Recession; and

• Decrease in Domestic Corporate and Leisure Travel.

Further Lowering of Hotel Transaction Levels Anticipated for Calendar 2020: Over the past 40 days, investors have become increasingly negative on the overall hotel transaction market. In our March survey, only 9% believed the total dollar volume of U.S. hotel transactions in calendar 2020 relative to year-end 2019 would decrease over 50%. Today, the percentage is 32%. The total number of assets forecasted to be sold by year-end 2020 is anticipated to decline over 50% by 36% of responders. More favorably, 25% anticipate a lesser decline in number of assets exchanged (10% to 20% decline) and 30% envision a 25% to 50% drop.

CARES ACT and PPP (Payroll Protection Program): The performance of the CARES ACT and PPP component under the Trump Administration is viewed favorably by 61% of survey responders. 27% believe execution was above average, with 33% viewing it as expected, good and bad.

Hotel Asset Values Drop: Of particular note is the theoretical perceived drop in individual hotel asset value, on average, from February 28, 2020 to April 25. 40% of investors believe a decrease of over 30% has occurred. 25% of responders estimate a decline of 10% to 20% and an equal percentage see a drop of 20% to 30%.

REO Asset Sales in 2021 and 2022? REO (real estate owned) by lenders as a target purchase category by hotel buyers is increasingly being discussed. 56% believe the wave is coming and lenders will take control of hotel assets. However, 44% believe that this REO wave will not materialize, as “extend and pretend” kicks in and loans are worked out without foreclosure.

LIIC serves as the leading industry think tank for the lodging real estate business. The hospitality industry’s most influential investors, lenders, corporate real estate executives, REITs, public hotel companies, brokers and significant lodging equity sources are represented on the council. Altogether, the members of LIIC represent direct acquisition and disposition control of well over $60 billion of lodging real estate.