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What is the state of the hotel capital markets? Certain markets are performing relatively well

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The boom in the record volume of hotel transactions between 2005-2007 has ended. The number of hotel transactions in excess of $10 million during the first half of 2008 declined almost 70%, according to Jones Lang LaSalle Hotels, from that which occurred in 2007. The 2008 transaction volume is bolstered by several transactions that were scheduled to occur during the fourth quarter of 2007 but were delayed until the first quarter of 2008. The last three quarters of 2008 will probably see transaction volume decline by 80% when compared to the same period in 2007, possibly more.
2007 was a truly extraordinary year in terms of the number of large hotel transactions and the values of the hotels sold, as well as for other major real estate asset classes, but what's happening now is not merely a cooling off. Its difficult to assess the value of a hotel since there are so few trades and, generally, there is a 10%-20% gap between seller's and buyer's opinion of appropriate pricing.
What happened?
The proverbial chickens have come home to roost and not just with respect to hotel real estate or commercial real estate generally. The financial system and consumers of the United States are in the process of a massive deleveraging after years of easy credit and balance sheets being overtaxed with debt. To a certain extent this applies globally. While the "credit crunch" triggered by the US residential mortgage market fiasco garners the headlines and focus of the media, excessive use of debt and ever more complicated financial derivatives designed, supposedly, to "manage risk" has been pervasive in the business world and in households. It will take an extended period of time, measured in years, and $100s of billions more of write-offs/losses to unwind the excess.
Consumer spending accounts for approximately two-thirds of national GDP. Households have been, and are continuing to be, whipsawed by high energy prices, rising inflation in general, declining home values in many markets, too much personal debt (mortgage debt, home equity loans, credit cards, car loans, student loans etc.) and a weak job market. And they're not saving enough for retirement. Consumers are retrenching and this is unlikely to be a short term trend. The business world relies on credit from the financial system to operate and grow. Banks and other financial institutions are conserving their capital to deal with internal balance sheet issues just to survive, significantly restraining corporate America's growth. The combination of these factors represents a significant negative for the US hotel industry.
A weakening demand picture from the above factors is exacerbated by looming capacity reductions by US airlines, in response to the high cost of jet fuel, and aggressive price increases being attempted by the airlines and rental car companies, with some success, following several years of aggressive price increases by the hotel industry. Said simply, the cost of travel has materially increased while the desire/need to travel has declined. Even the buoying effect of the weak US $ is being challenged as, if anything, the UK and Europe are in a worse mess economically and their

currencies have declined 10%+ against the dollar over the last 60 days. That, too, is likely to be an extended trend.

The hotel demand issues noted above are evidencing themselves in weakening hotel fundamentals. After three years of unprecedented REVPAR growth 2005-2007, REVPAR will, at best, in our opinion, be flat during 2008. Year-to-date through July, REVPAR has increased only 1.3%. Occupancy has declined 2.5% while Average Room Rate has increased 3.9%. We expect Occupancy to continue to decline at this level or somewhat worse the remainder of this year and ADR growth is moderating significantly. We would not be at all surprised for 2008 REVPAR to finish below 2007. We expect national REVPAR during 2009 to be worse than 2008. We do not expect 2010 to evidence a robust turnaround, either.

To be sure, there are certain markets performing relatively well. New York, San Francisco and Boston are still recovering from radical market declines in the wake of 9/11 terrorist attacks and tech-bubble implosion as well as benefitting from the weak dollar while Houston is strong due to the booming energy market. Relative good news also can be found in the supply picture which is much more benign than the past two cycles, as supply growth as a percentage of national inventory over the last five years is less than half that experienced in the five years leading up to the last two cyclical market peaks/transition points (1990 and 2000). The silver lining of this situation is that what was a rapidly building supply pipeline is now receding.

So, the next several years will not feel good for most hotel owners, particularly those that took advantage of high proceeds (LTV) loans with unusually flexible terms that were available in the market 2005-2007. In our view, lenders were more aggressive than equity during this period of extraordinarily easy credit and were taking equity risk while offering historically low interest rate spreads. Revenues will be flat to down, generally, while expenses will be rising materially. However, it will take time for any meaningful amount of stress to develop, and it may never happen, as most loans granted during the easy credit period were toothless with respect to default covenants that would give lenders the right to seek early repayment or foreclose. And many of the lenders that do/will have those rights aren't interested in taking action because they have so many, worse problems to deal with. Unless your lender is taken over by the FDIC.

It's a weird, uncertain time.Henry Vickers, Jr.