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Attn. owners and investors; hotels have not experienced a downfall in operating performance

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Hotel brokers across the country are rejoicing that they finally have enough time to fish, swim and play golf. Their golf handicaps are down, they are spending more time with their wives and kids and things are getting crossed off the "honey-do list". October's credit crisis seems to be abating but transactions are not expected to pick up again until well into the first quarter of 2009 leaving brokers with plenty of time on their hands.

It appears now that the first half of 2007 was the absolute peak of the real estate market and that we began a slow withdrawal and decline in transactions after that. By June of 2007 sellers began experiencing a push back in pricing. The slow decline continued into September of this year.

One good thing about the credit debacle of September and October is that the slow decline turned into a death spiral that propelled us to the bottom of the transaction cycle much faster than originally expected. This steep decline should enable the market to move out of the doldrums much faster and it is projected that the transaction markets will improve in the first quarter of 2009.

The important fact for hotel owners and investors to understand is that hotels have not experienced a drastic downfall in operating performance. Hotel guest room demand across the United States is only predicated to drop 2-3%. Profits will be less, but not catastrophically off the cliff. Occupancies in mid-town Manhattan are expected to "slip" to 85%!

The fourth quarter will remain a period of stagnation. Investors believing that they will pick up bargains are waiting for the other shoe to drop. However debt payments are being made. There are presently 30 hotels across New England on a lender watch list. Every one of them are current and making their debt payments. Hoteliers constantly lament that lenders always require more equity for hotel investments and require them to adhere to higher standards than other asset classes. However, during these times, when the market turns, maybe these loans show the best security!

Although the case can be made that the present financial situation isn't as bad as one might perceive, hotel values have definitely dropped several hundred basis points. Investors are reading distress into every asset that is on the market right now. In July an upscale full service hotel in an urban center was drawing interest at a 6.5-7% direct cap rate range. There is no number for that hotel right now because debt is non-existent. There is no market to be made for that investment. In September, O'Connell Hospitality Group closed out an assignment on an upscale hotel in an airport location running over 75% occupancy, when the only offer discussed was over 400 basis points higher than normally acceptable cap rates for similar assets.

Investors have turned to buying debt in an effort to get at the underlying asset. However, balance sheet lenders required stricter terms and those notes are not distressed. Loans that were written and then securitized are extremely difficult to unwind from within the debt pools they were issued. Unless there is a default, the loan servicer, typically the group situated in the "first loss" position in the bond stack, has no incentive to sell the debt for anything less than par.

So we sit. We practice putting into a water glass on the rug. We stare out the window and wonder what everyone else is doing. We change the channel on the office TV from CNBC to Oprah. We say a prayer to St. Joseph, the patron saint of real estate brokers; "Please St. Joseph, give me one more boom... I promise not to mess it up this time."

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