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HOTEL INVESTORS GET BACK IN THE GAME

Economy and industry fundamentals favor investment in hotels.

By Rick Takach

There are a number of hotel industry fundamentals that remain favorable to investors, suggesting that now is an excellent time to consider this segment of real estate.

They include the following:

• *Constrained supply.* It was difficult, if not impossible, to fund new construction during the downturn. As construction lenders remain cautious in all sectors of real estate, there is still a scarcity of new product.

• *Properties under duress.* Even with improved occupancy and operations, a large number of properties are struggling with financing as they recover from the downturn. Many owners have been unable to invest in facility upgrades, staff development, and sales and marketing initiatives because of operating expenses and debt service requirements. In particular, as remodels and renovations come due, distressed properties can make good acquisition candidates. Repositioning and rebranding with new financing and management can come in considerably below replacement costs.

• *Strong fundamentals.* Occupancy rates remain strong and future above-average gains in RevPAR are expected to result primarily from growth in average daily rates. This is generally the point in the hotel cycle that signals significant potential for growth in valuations.

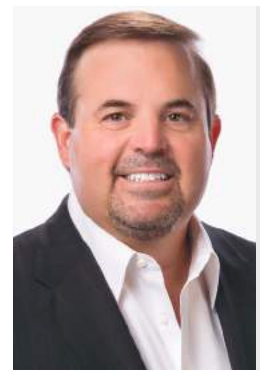
• *Interest rates versus inflation.* Interest rates remain attractive for qualified borrowers. At the same time, in the event that we experience mild inflation in the years to come, new owners can take advantage of any increases in valuation that result. Plus, the ability to adjust rates continuously is an inflation-hedging benefit of hotels.

West Coast Attraction

States in the Western U.S. remain positioned especially well for real estate investment for several reasons, the first being strong population trends. Utah and Washington were among the seven states with the highest population growth rates from 2010 to 2012, while California and Oregon remain in the top half of states for overall population growth.

With respect to valuation, seven of the 10 markets with the highest increases from 2010 to 2011 were out West, according to HVS Global Hospitality Services. This included Hawaii.

Perhaps with the exception of California, individual state economies in the Western region remain strong and pro-growth. The West Coast also continues to benefit from its Asia connection, both in terms of its importance as a trade conduit and through direct investment by overseas interests. Those exercising EB-5 Class visas could become an important source for new investment in the hospitality sector.



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Making the Wise Buy

With respect to the trends just discussed, hotel acquisition remains a location-specific, property-specific play. It is incumbent upon investors to conduct exhaustive due diligence with respect to existing and prospective financing; existing and prospective management; impending need for capital investment; and competitive, position-related to geography, product type and branding.

Most importantly, new ownership must have a concrete operational game plan prepared and ready to be executed. Nothing can negate sound financing or astute market timing quicker than timid or neglectful management. With all this in mind, current market fundamentals make it a great time to jump into the hotel game. ■