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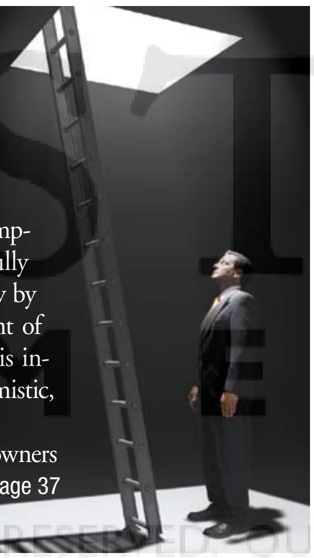
Industry faces economic realities

Financial, real-estate experts shed light on dark times



By Jason Q. Freed
SENIOR EDITOR

NATIONAL REPORT–The two major drivers behind a significant downturn in the hospitality industry—the high cost of debt and decreasing demand—have experts and operators increasingly pessimistic. On a recent webinar presented by Real Estate Forum and sponsored by GlobeSt.com, panelists struggled to predict when the industry would begin to see a turnaround.

"We're going to see more of this limping along through 2010 and hopefully we'll return to some sort of normalcy by 2011," said Geoffrey Davis, president of HREC Investment Advisors. "In this industry, we have a tendency to be optimistic, but we're in for a rough ride."

The panel was made up of hotel owners

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Effects of downturn felt across the board

By Stephanie Ricca
EDITOR IN CHIEF

LIIC LODGING INDUSTRY INVESTMENT COUNCIL

PHOENIX–With the lasting effects of the current economic crisis still unclear, hotel owners, managers and investors continue to speculate how long—and how deep—the industry will feel the pain.

In September at the Lodging Industry Investment Council meeting held in conjunction with The Lodging Conference, members discussed the ramifications of inflation and depressed travel, and the pros and cons of buying assets versus debt.

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INFO CONCIERGE

Six in 10 Americans have difficulty falling asleep at least once a week. Here's what's keeping us up at night:

1. Economic fears **36**%
2. High gas prices **29**%
3. Health concerns **28**%

Source: AmericInn's National Sleep Quality Survey, 2008

Timeshare 'resilient' in troubled times

By Jennifer Kovacs
SENIOR EDITOR

ORLANDO–While the timeshare segment entered the U.S. market in the 1970s, it took off in the 1990s, when when big hotel brands made a foray into the market.

It was an economic time similar to what we find ourselves in today. But as it turned out, that didn't seem to matter.

"We were born to a time like this. It was almost an accidental product. … Our industry has done exceedingly well during times of trouble," said Howard Nusbaum, president and CEO of the American Resort Development Assn.

Nusbaum was among many panelists who presented guarded but optimistic outlooks for timeshare in the midst of economic unrest at the 10th Annual Vacation Ownership Investment Conference held in October at the Peabody Orlando hotel.

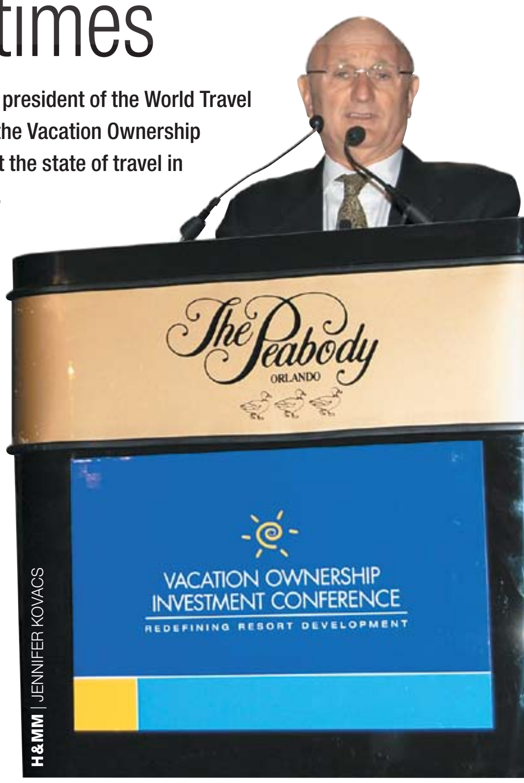
"The prepaid nature of the product allows people to go on using it no matter what is going on," Nusbaum said, adding he believes that will continue to be the trend in years to come.

But no one at the conference went as far as calling timeshare 'recession-proof.'

"It's been resilient," said Craig Nash, chairman and CEO of exchange company Interval International. "People still buy. The way in which it's sold is different. I do think the concept has held up."

Nash sat on a panel of industry leaders who offered insights on how to get deals done in coming years and keep making sales.

See **Timeshare** | page 32



Jean-Claude Baumgarten, president of the World Travel & Tourism Council, spoke at the Vacation Ownership Investment Conference about the state of travel in current economic conditions.

H&MM | JENNIFER KOVACS

Downturn

Continued from page 1

All members agreed consumer confidence is down as a result of this fall's bailout activity and the stock market ups and downs that accompanied it.

Even before September's events, some members reported evidence of weak travel.

"I did some research this summer on travel to New York City, and international travelers represent 19 [percent] to 20 percent of NYC roomnights but account for 53 percent of the spend," said Tom Naughton, SVP of acquisitions at Sunstone Hotel Investors. "So the multiplier effect of European or London travelers going home without the empty suitcases they brought over filled with purchases … is pretty big."

Naughton said New York is an interesting city to analyze in terms of its dollar value for travelers and hotels.

"We have 15 percent of our EBITDA in New York so it's something I track pretty carefully," he said. "If the dollar does move like it did, up 10 percent against the euro and the pound recently … you could have a double whammy in New York if the dollar goes up and you have a corporate downturn."

H&MM | STEPHANIE RICCA

Cheryl Boyer, president of Lodging Advisors, and Douglas Dreher, president of The Hotel Group, shared a laugh at the Lodging Industry Investment Council meeting held in September.

The inflation scenario

LIIC participants wondered aloud how the federal government's bailout plan and growing deficit might affect inflation.

"I wish I could calculate it because we're already double what [the Consumer Price Index] is," said Chad Crandell, president of Capital Hotel Management. "How could energy and food prices go up as much as they have and inflation still be at around 3.2 percent? I think the fundamental inflation rate for the average consumer is significantly greater than what CPI is being reported at."

"If you were buying a hotel today, how would you factor in inflation increases?" asked Mike Cahill, president and founder of HREC–Hospitality Real Estate Counselors.

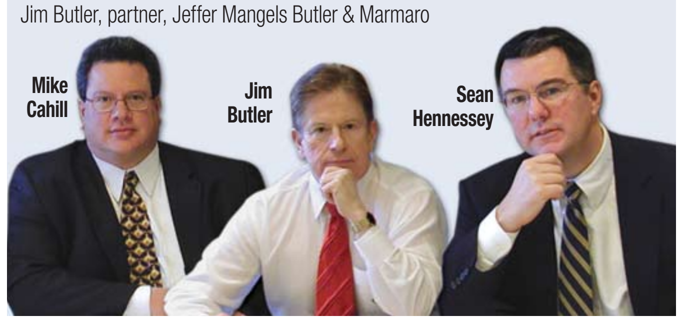
"Short term, I don't think we have inflation issues," said Rob Stiles, EVP, principal and head of the Western region for Cushman & Wakefield Sonnenblick Goldman.

"I think inflation is going down, short term. Commodity prices are falling, and I think that's going to have more of a correcting impact on inflation. Long term, we have to have more inflation. There's going to be too many competing users without it. So either we have sort of a continuing credit crisis or there's a bigger money supply," Stile said.

LIIC's mission

The Lodging Industry Investment Council (*www.liic.ws*) is the premier think tank in the hotel industry. Its members include a diverse mix of 70 influential leaders in the real estate and finance fields. Membership is by invitation.

- **Co-chairmen:** Mike Cahill, president and founder of HREC—Hospitality Real Estate Counselors; Sean Hennessey, CEO of Lodging Investment Advisors; and Jim Butler, partner, Jeffer Mangels Butler & Marmaro



Notes vs. real estate

"The sellers of notes are much more motivated than the sellers of property," said Patrick Deming, managing director of Eastdil Secured. "Let's just cut to the chase. Sellers of paper for the most part are selling for a reason—they have to raise liquidity.

"You have performing paper, sub-performing paper, nonperforming paper, all sorts," Deming said, adding most of the paper his company sees still is performing.

"How many people are going back and trying to buy their own paper?" Cahill asked the group.

"Everybody," said Steve Kisielica, principal of Lodging Capital Partners. "We closed on our first piece of paper from an existing loan, and it's a 30-plus [internal rate of return] for a not-bad place in the capital stack," he said.

In terms of property buys, most of the group was silent about acquisitions because they're not happening at the rate they were a year and a half ago.

"We haven't bought a hotel in two years, but we've tried heavily over the last six months," said Bernie Siegel, principal with KSL Capital Partners. "No one's doing deals. Reality is setting in."

William Reynolds, managing director and chief acquisitions officer of Thayer Lodging Group, agreed, pointing out Thayer Lodging's normal buying behavior. "Thayer's never been a terribly aggressive buyer," he said. "There's no reason to buy anything. We're looking at a lot … but we're going to be in this stasis period for a while."

MORE COVERAGE:
▶ For more on September's LIIC meeting, see "The rate debate" in the Nov. 3 issue.

Amid the United States' current scenario, international investors are starting to emerge, some LIIC members noted. But the question remains as to what current asset-holders will do in the long run.

"We all learned how to play musical chairs in first grade. That's what we've been doing the last few years, when there were a lot of quick trades," Stiles said. "You got into a deal, re-flagged and got out. There was no value to staying in a deal."

"There are a lot of people holding hotel assets that don't want to be long-term [owners] and they'll have to hold on to them for three to five years," Deming said. "There's going to be a big wave of transactions 24 to 36 months out."

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Chad Crandell, [from left], president, Capital Hotel Management; Jeff McKee, managing director, Premier Capital Associates; and Bernie Siegel, principal with KSL Capital Partners, discussed how the recent economic downturn may affect the industry.

H&MM | STEPHANIE RICCA

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Economy

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and operators, as well as valuation and research experts. They said the high cost of acquiring capital is slowing the transaction market.

"Folks say there is no financing available. I don't know if I agree with that," said Daniel Lesser, senior managing director for CB Richard Ellis. "There is financing available at very low loan-to-values."

Lesser and others said purchases are requiring much more equity and lower loan-to-value ratios. A buzzword during the webinar was "recourse," or the act of banks requiring borrowers to pledge collateral, typically real property, for which the borrower is personally liable if he or she is unable to continue making payments.

Lesser
CBRE

"Everything said about recourse applies to us," said John Hamilton, SVP of acquisitions and business development for Pyramid Hotel Group. "If you look at a calendar starting in January 2008, each month you go forward you add more recourse to the deals we've done. We went from zero percent in January to 25 percent now."

Davis said any economic stimulus plans, including the recent financial bailout plan, have hoteliers hoping the capital markets will open up in the beginning of 2009. But, he said, the effects remain to be seen.

Lesser added a positive note, saying that because new plans call for lower interest rates, owners with a fair amount of capital can buy back their debt at lower costs.

Operation tactics

Mark Woodworth, president of PKF Hospitality Research, said his company is predicting occupancy to drop 4 percent year-over-year by the end of 2008, and declines will be "even more severe" in 2009. And those who continue to travel, he said, are trading down segments. Hamilton used Pyramid's wide-ranging portfolio to provide examples, saying a typical Ritz-Carlton Hotel Co. guest is now booking with Westin Hotels and Resorts or Sheraton Hotels & Resorts.

So how do operators survive the downturn?

"What you did in the up market determines if you survive in the down market," Davis said.

Training and renovating were things that should have been done when the industry was peaking, Hamilton said, and companies that reinvested would be in a better position to ride out the downturn.

"It's war out there today," said Mark Laport, president and CEO of Concord Hospitality Enterprises. "We have spent tens of millions of dollars on our portfolio and our goal is to shift [market] share by having the best product. You've got to over-communicate to the staff that it's all about winning. We talk about it every day."

Davis
HREC

All panelists agreed revenue-management techniques have drastically improved since the most recent downturn, which will help prevent rate cutting and help keep control of the industry.

"You have to know what your business is going to be a month out and staff accordingly," Hamilton said.

Woodworth
PKF HOSPITALITY

Owners and operators also can study their property taxes. "This provides an opportunity to challenge assessments," Lesser said. "Every dollar that gets saved in a process like this goes to the bottom line."

Cause and effect

Other travel industries affect the hotel industry's climate.

For example, airline capacity cuts will directly correlate to occupancy drops in certain markets, Woodworth said.

"There is a very clear relationship between changes in airline capacity from point A to point B and occupancy in hotels at point B," he said.

"If the announced cutbacks hold true for 2009, that would represent a one-point loss of demand for the industry as a whole."

Woodworth said the concern about the cost to fuel a jet has lessened since September, but destinations such as Hawaii, Phoenix and Las Vegas still will feel the effects of increased airline costs. Drive-to markets already are proving to be more resilient, Davis said.

Another interesting factor to consider is perceived overspending and its effect on the resort market.

Hamilton said his company is very concerned about decreasing big business travel, such as the $440,000 trip American International Group executives took after the insurance company was bailed out by the federal government.

"We're seeing attrition and cancellations in those areas," he said. "We're concerned with the resorts."

Laport said his company also is seeing attrition in travel from the financial sector.

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