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LIIC's Top 10

Jun 7, 2004
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Members of the Lodging Industry Investment Council are surveyed yearly to develop a list of the major hotel investment opportunities and challenges for the coming year.

The members of LIIC represent buyers and sellers and control billions of dollars in lodging real-estate. The hospitality industry's most influential investors, lenders, corporate real-estate executives, real-estate investment trusts, public hotel companies, brokers and significant lodging equity sources are represented on the council.

This year's survey was compiled by LIIC's co-chairman, Michael Cahill. Cahill is president and founder of HREC-Hospitality Real Estate Counselors, an advisory and brokerage firm (*www.hrec.com*).

LIIC's Top 10 issues for 2004:

1. Hotel values are predicted to continue to increase 5 percent to 15 percent during the next 12 months with pre-9/11 levels possible for certain assets within two years. However, watch out for the possible negative impact on asset value from another domestic terrorism attack, international political unrest or an unforeseen strong uptick of interest rates. Overall, LIIC members are highly optimistic about the coming year.

2. The volume and quality of (especially upscale) hotel assets on the market are anticipated to increase significantly as existing owners exit seeking to redeploy their capital, causing a release of pent-up inventory that was not brought to market during the recent downturn. The "diamonds in the rough" will be increasingly difficult to buy at rock-bottom prices. Multiple members predict that the sheer volume of transactions during the next year might approach peak 1998 levels.

3. When asked when the next "peak" of the hotel investment cycle will occur, there was no common answer. Responses ranged from "we are peaking now" to 2008.

4. Hotel buyers need to be extremely cautious about deferred maintenance and capital expenditures, especially for midmarket hotels and lodging facilities that have been hit hard by the downturn with minimal or negative cash flow. Also, large product improvement plans from major lodging franchisors are a threat to investment yields, especially when a change of ownership occurs.

5. The majority of LIIC's members anticipate interest rates to remain flat or increase slightly during the next 12 months. Low interest rates are expected to help fuel continued hotel valuation increases. Some concern exists over a strong increase in interest rates after the presidential election.

6. Equity investor return requirements will continue to slide downward with stabilization occurring at the end of 2004 when property-level cash flow begins to increase. Leveraged equity internal rates of returns in the low to mid-teens will remain commonplace for institutional-quality assets. A parallel trend with cash-on-cash returns is predicted.

7. Hotel investors need to closely watch the expense areas of: deferred bonuses and compensation expected from senior hotel management, higher overall payroll expenses as staffing returns to normal levels, energy expense escalation (above inflation) and workers' compensation expenses (especially California).

8. At the luxury hotel level, the trend toward mixed-use development will increase dramatically. Condo-hotel rooms, fractionals and timeshare units will be common parts of the luxury hotel development process.

9. In general, hotel occupancy levels are forecasted to increase 3 percent to 5 percent during the next year. LIIC members anticipate average room-rate growth to lag occupancy increases and average roughly 2 percent to 3 percent during the coming year. Almost across the board, LIIC members cite the need for hoteliers to rein in the Internet distribution channels to help push average daily rates.

10. Lodging investors should be on the lookout for new supply additions, which are anticipated to increase significantly in

2006 and 2007. This pace of new development is expected to exceed that experienced by the lodging industry in the mid-1990's.