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News

Roundtable participants take industry pulse

By John P. Walsh
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NEW YORK—Members of the Lodging Industry Investment Council met in conjunction with the New York University investment conference in June at a HOTEL & MOTEL MANAGEMENT-sponsored roundtable to discuss lodging-industry issues, including overbuilding, consolidation, operational cuts and the industry's resilience.

Participants were: Rich Conti, president and c.o.o. of Boykin Lodging Co.; Cheryl Boyer, a financial advisor for PricewaterhouseCoopers LLP; Frank Nardoza, chairman and c.e.o. of REH Capital Partners LLC; Jim Merkel, managing director for RockBridge Capital; Jim Butler, partner with the law firm Jeffer Mangels Butler & Marmaro; and Geoff Davis, president of HREC Investment Advisors.

H&MM: Are lenders and developers doing a good job of preventing the hotel industry from being overbuilt?

Conti: It's overbuilt, and they're building in major markets in Houston, the not-so-major markets like Omaha, [Neb.]. They're building 1,000-room hotels and 400-room hotels, and economy hotels are still getting financed and built, even in markets where occupancies, such as Dallas, are in the low 50-percent. The sophisticated lenders look at what they're doing, but in the economy sector, there are still local lenders lending in markets with 50-[percent] to 60-percent occupancy and not really understanding the hotel industry.

Boyer: A lot of these projects were underwritten when the market dynamics were different, especially some of the larger projects that are going on right now.

H&MM: Will there be more consolidation in the hotel industry soon and what companies or types of companies are likely to merge or acquire? Also, what effect will the inconveniences of travel have on the lodging industry?

Nardoza: If we can see two solid quarters of [revenue-per-avail-



Jeff Carter, principal of Carter Hospitality Advisors [left] and **Michael Blahosky**, first v.p., regional director, CB Richard Ellis, participated in the H&MM-sponsored roundtable during the New York University investment conference.

room] increases, then you'll see a little more activity in mergers and acquisitions. We're not sure if we've hit the bottom yet. ... There may be some transactions in the short run that are prompted by sell or lose. They're in Chapter 11, and they aren't going to readily come out of it, and their only option is to merge or sell. You might see some of those. To get the big megadeals done, there's got to be some level of sustainability in the performance of the industry.

Conti: What's interesting is we went on orange alert in February, and we felt it for 20 days of lower bookings coming in. We went on orange alert again, and the effect period shrunk. Unfortunately, that will probably happen to us like it's happened in England. Eventually, we'll just get used to it, and the economy will just keep going. It's a sad thing to say because you don't want that to happen, but you get used to things and move on, and it won't affect your business in the longer term.

Butler: Some make an analogy that life goes on, despite almost daily terrorist bombings. The problem is the economy of Israel is paying a terrible price for this. We may get used to it and continue life as normal, figuring it's inevitable, but we'll pay a heavy price if it is.

Boyer: The inconvenience of travel has become ingrained. If you have to travel, you accept it, and you have to modify your behavior. For other people, they just look at it as a hassle. If they can, [they] avoid getting on a plane. It's that

permanent feeling that the inconvenience of travel is going to be there. So whether the alert goes up to orange or goes back down to yellow, it's going to have less of an effect. If something happens in terms of screening procedures or other things at the airport to make it even more restrictive, that will have more of an effect. Likewise, if things get better, that would have more of an impact rather than the shifting of codes.

H&MM: Is there anything else left for full-service hotels to cut operationally? Are they adding things back?

Conti: If you look at a number of the companies, Marriott International, Hilton [Hotels Corp.], and you look at the first quarter of this year ... what you see is that the margin decline this year over last year is huge. Marriott reported a 300-basis-points margin decline. The highs were in the 575-basis-points margin decline on house profit. The cutting happened after 9/11 and a lot of companies cut and refigured how they operated hotels. You can't continue to do that. You have to provide a certain service level. If you have done it and it was in effect in 2002, that's why the margins are not there in 2003. The logical cutting has taken place.

The big companies are sophisticated, and they move quick. The [real-estate] investment trusts and the public companies move quick. I don't think there's a lot of room left to cut on the expense side. Then you're getting incremental increases that are affecting your basis points that you can't control. Energy costs are up because the rates are up. That's across the board. You can't cut that. The labor is pretty tight, and that's the biggest expense dollar in the hotel.

Nardoza: ... In talking with some of the executives of the large hotel companies, they're dusting off some of those projects trying to figure out if we're moving on to phase two of some of these cost take-out projects, where they're working on the corporate infrastructure.

Boyer: ... [Hotels] have had to start adding back staff because they've cut so far down that they're not able to function efficiently. They're inching back up on the labor side.

Nardoza: One thing I have seen, and a lot of these properties we're looking at for acquisition, the ones held by the larger companies, it's clear they cut back on all [capital expenditure] spending immedi-

ately going back after 9/11. That's now one of our No. 1 concerns. What are the cap-ex issues going forward? There's been a complete Band-Aid approach going on in a lot of the hotels we're looking at for acquisitions.

H&MM: What are some of the positives the industry is doing now as a result of the past two years?

Nardoza: Some of the cost take-outs are permanent. There's just a permanent thinking about a better way of doing business. Be it how you clean hotel rooms to how you do engineering, there's just more understanding now about what's necessary in running hotels. There's some permanent re-engineering process changes that have occurred that will stick. They're just good business practices that have been thought of.

Davis: On the investment side, owners are coming to the realization that they need to cut their values and clear out some inventory of lesser-performing assets, which allows for companies to focus on the better-performing assets, and also, in terms of the debt side, lenders have gotten more conservative, which is good for the industry in general.

H&MM: From a lender's perspective, what are your thoughts about the industry's resilience, and what is a good investment?

Merkel: You have to look market to market and at specific opportunities. We're looking at what these properties did during the downturn. You can go from market to market and see how strong business was. That's what we're looking at, the historical performance of the property. We're looking at the big brands. We focus on the middle market—the Residence Inns, Courtyards and Hilton products. We're looking at the major brands that are going to be able to deliver brand value to that property and create real-estate value through brand contribution.

Davis: Whether it's lending or investment, what everyone's looking for is some attribute that makes that deal unique, whether it's barriers to entry or someone's ability to deliver on a business plan or the economics going in, the loan to value, etc. Every story has to have backing behind it. On top of that, you have to look at the market.

Merkel: We're looking at all the pieces of this puzzle. Do you have the right operator, the right asset, and does the story fit? Can they

deliver on the story, is it solid? Is it a full-service operator trying to do a limited-service property or vice versa? There are a lot of great Courtyards and Hamptons that can do the full-service product, and they might be a great opportunity. We've passed on several opportunities that we liked the hotel asset, we liked the market, but didn't think the sponsor was the right fit and could deliver on the business plan. We focus a lot on the sponsor. We've seen bad hotel projects do very well with the right owner-operator, and we've seen great projects do poorly with the wrong one.

Nardoza: One thing I've found being in the market to raise different types of debt, it seems that the market has become much more specialized than it has in the past. For a lot of these difficult deals, you have specialty lenders that deal with those products and price those loans accordingly. Then you have the basic turnaround people.



John Stetz, regional director, franchise sales, InterContinental Hotels Group, and **Kate Henriksen**, director, RLJ Development, discuss issues affecting the lodging industry at a roundtable during the New York University investment conference.

There you have the bridge loan and mezzanine players. And then if you have a hotel that is already cash-flowing and doesn't need big turnaround [with] cap-ex, then there's a whole slew of different sources there depending on whether you're interested in recourse or nonrecourse debt, whether you're willing to go with a conduit-type program that locks you in for a longer term. The point is there is a lot of loan availability out there, but it's become much more specialized trying to figure out who are the players in each of the buckets and within those discrete those further.

Merkel: There's a size barrier. There are a lot of lenders out there that focus on the \$30-million loans and up and won't touch anything less. Then there are a lot of middle-market lenders that are \$5-million to \$30-million lenders. In that segment, you don't have a lot of lenders that go nationwide. You have a lot of regional banks and regional lenders that may focus on the asset that's in their back yard so it means something more to them. We're seeing a lot of those.

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LIIC's mission

The Lodging Industry Investment Council is an industry think tank that meets three times annually to discuss hotel finance, development and operations issues. Its 70 members include consultants, lenders, operators, developers, educators and legal professionals.

Co-chairmen for LIIC are Mike Cahill of Denver-based Hospitality Real Estate Counselors and Sean Hennessey of PricewaterhouseCoopers' New York office. Vice chairman is Jim Butler of Jeffer, Mangels, Butler & Marmaro, a Los Angeles-based law firm. LIIC's Web site is www.liic.ws.

