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Uncertain factors keep experts on their toes

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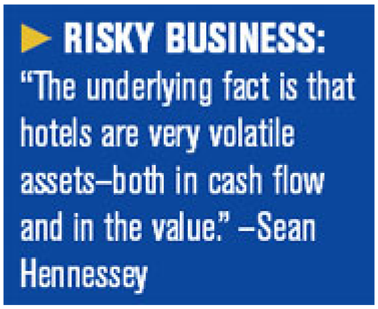

Risky Business

LOS ANGELES—The wide availability of capital and the hotel-valuation process continue to paint a picture of slight uncertainty over the industry's economic recovery.

With business moving forward at what appears, at times, to be lightening speed, hotel lenders, consultants, buyers and sellers remain a little on the cautious side as they try to sort out where the situation is heading. Members of the Lodging Industry Investment Council who participated in two separate roundtables sponsored by HOTEL & MOTEL MANAGEMENT concluded that the only certainty in the lodging industry is that uncertainty remains—and that could mean trouble down the road.

"We're seeing a tightening of spreads, so it's an odd situation from our perspective, where [The Federal Reserve Board] is trying to inch the treasuries up and move interest rates up," said Angelo Stambules, v.p., GMAC Commercial Mortgage. "With the available capital out there, there's still a collapsing of the spreads. At some point, there's going to be a stoppage in the music and someone's going to get left holding something. We're very careful. We're cautious in our underwriting in terms of looking into pro formas."

A rise in the prices paid for hotel assets and the improving performances of hotels has made it more difficult to get a clear picture of the industry, members said.


Angelo Stambules of GMAC Commercial Mortgage said spreads are tightening, which leads to cautious lenders.

"You think you have 50 percent loan-to-value until you say 'Wait a minute ... I've been through a cycle and 50 percent loan to value, what is the value? That property appraised for this last year, and based on last year, what is 50 is 70,' " said Frank Anderson, senior v.p. international head of hospitality & leisure for HSH Nordbank. "The appraisal community is always behind. The values on the same property without major renovation dollars, capital investment—why did the value go up 30 [percent] or 35 percent year over year? The net cash flow didn't, so how did the value go up? I prefer to tap into the limited construction pipeline and get it right the first time and not have to worry about the pylons and new things a hotel needs that are going to crimp the cash flow."

Mike Cahill, principal at Hospitality Real Estate Counselors and one of LIIC's chairmen, said there are several reasons appraisals have been tough to get a handle on.

"Appraisers tend to undervalue in an inflating market and tend to overvalue in a declining market," Cahill said. "[The lenders] get what they pay for. They're ordering $3,000 or $4,000 appraisals on a $10-million asset. How much do you expect in terms of expertise or how much time can someone spend? A lot of the lenders are bringing it on themselves by going cheap on appraisals."

One key thing that lenders, owners and buyers must remember is that appraisers now must give clients the most probable price, not the highest price, when determining the value of a hotel, Cahill said.

"The underlying fact is that hotels are very volatile assets—both in cash flow and in the value," said Sean Hennessey, president of Lodging Investment Advisors and one of LIIC's chairmen. "You can have the situation where the cash flow only appears slightly up from where it was a year ago, but there are other factors that come into play. Expectations of appreciation, cost of capital and so forth can drive the value."

Bernie Siegel, executive v.p. at Lowe Hospitality Group, said his company is among those that are looking to acquire assets.

"We expect strong cash flows even in the case where our [revenue-per-available-room] growth is only 5 [percent] to 7 [percent], we're still targeting at 40 [percent] to 70 [percent] flow-through," Siegel said. "I support the comment that low interest rates are supporting the transaction market. We're only borrowing 60 [percent] to 65 percent mortgage leverage on our acquisitions, but even with that relatively speaking conservative leverage, we're probably manufacturing a third of our [internal rate of return] off the low rates.

"The capital markets are a little bit ahead of the recovery, primarily fueled by low-cost debt," he said. "Most of us would agree that if we're at not career-low cap rates, we're certainly at year-low. Mark [Lomanno of Smith Travel Research] suggested that long-term RevPAR growth is going to stabilize at the 4-[percent] range. I can tell you we're not going to do any deals if we project that."

Rob Kline, president of Oxford Lodging Advisory and Investment Group, said the debt markets have helped fuel the market sustainability.

"In the last 30 to 45 days, there's been a material type in the spreads," he said. "The cost of capital has gone down. That's going to continue to push pricing, especially with more lenders entering this space than there were last year."

Hennessey said new money has been coming to the lodging industry sooner than expected.

"One thing we have seen, working with investment groups in the New York area, a lot of them are coming into the hotel sector for the first time," he said. "To their mind, they're making very attractive yields compared to what they're getting in office and retail and multifamily. They're not anticipating huge rent spikes, but they're not anticipating any downward trends. They know—especially if they saw the last cycle—that as the industry starts to accelerate, the flow-through profitability becomes much better and they don't want to miss that cycle. They're willing to get in a little earlier because they don't want to miss that upturn."

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