Volume 217, Number 20

AN ADVANSTAR PUBLICATION

Hotel & Motel MANAGEMENT

The Leading Newsmagazine of the Hospitality Industry since 1875

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November 18, 2002

Think tank points to positive signs

Roundtable participants optimistic about recovery

By Jeff Higley
EDITOR-IN-CHIEF

PHOENIX—Everyone in the lodging industry is waiting for a sign that signifies the much-ballyhooed recovery is on the way.

Participants in two roundtables involving members of the Lodging Industry Investment Council said they believe the sign could come at any time. Some of them said the sign already has been seen, given that there are so many buyers with capital chasing hotel investments during these rough economic times.

"Every asset that comes on today's market seems to have anywhere from 12 to 15 qualified bidders that the brokerage community is willing to take to the owner to present an offer," said Larry Shupnick, senior v.p. of development and acquisitions for MeriStar Hospitality Corp. "So, while we might be sitting here and saying the occupancy and the [revenue per available room] isn't going to grow until maybe 2004, we have to look at the cycle like 1990 and '91; if you add capital and can invest it

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Think tank

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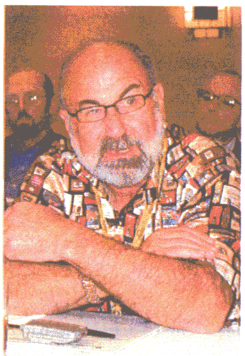
today, you can make some very good buys in major cities."

"There is a great buying opportunity right now," said Allen Ostroff, principal of Hotel Dynamics.

"We're seeing a lot of flight capital coming from other investors coming into the hotel industry, from shopping center owners, from oil companies, people who hadn't invested in hotels previously because they can't get their yield in other forms of real-estate or investment, and they're redefining how hotel deals are being underwritten and which deals they're looking at," said Geoff Davis, president of HREC Investment Advisors. "Maybe they are willing to look at tertiary markets. Maybe they're willing to look at limited-service. Maybe a 12-percent cash-on-cash return is a good return to an investor like that."

Some investors are willing to take a return of less than 12 percent, which puzzles C.A. Anderson, managing director, hotel group for Cornerstone Real Estate Advisors.

"People are buying lodging properties [with return-on-investment percentages of 7 to 9 percent]," Anderson said. "Why would you buy a hotel at 7, 8 or 9 right now, unless there was a strategic or trophy property reason? There are so many better value-added opportunities, even in real-estate, than there are to buy a hotel and take that



Larry Shupnick of MeriStar Hospitality said assets on the market currently have 12 to 15 qualified bidders despite the economy.

kind of mitigated risk."

An influx of new investors presents other problems.

"We see the problems with people who haven't really understood the business and have entered into the tertiary markets with the wrong brands, and we're going to continue to go the other way," said Angelo Stambules, v.p. of GMAC Commercial Mortgage.

Jeff McKee, account executive for GE Capital, said banks still are active in most markets, which makes the opportunity for acquisitions more attractive.

"Pension funds are coming back in, and the securitization and conduit markets are starting to fill up," McKee said. "There's a push to put product out the door and get loans out the door."

However, as developers look to banks for financing, they still are finding a pretty high ceiling for the cash investment needed.

"Developers are not used to thinking about 65-percent equity," said Jim Butler, partner with Jeffer, Mangels, Butler & Marmaro and LIIC's vice chairman. "That's probably a pretty optimistic view of what it takes. Development is way down. It's much harder to justify the feasibility of a project today. We're seeing a greatly reduced number of developers get [fewer prospects] financed through a handful of unique ways."

That means creativity is needed, said Todd Siegel, director for Hyatt Development Corp.

"In equity, with the current market situation and the [projected] numbers for the near term, there isn't enough [opportunity] in these hotels to attract the equity," Siegel said. "You need to look for subsidies. It's coming from the cities, it's [tax increment financing] money, it's rebate of taxes or doing tax-exempt bond deals, which a lot of these cities are turning to in order to get these deals done."

No enhancements

A form of financing that has disappeared from the hotel landscape is credit enhancements from chains, participants said.

"A lot of the major chains have withdrawn that because of other issues they may be having with pressure in the public markets that have prohibited them from throwing that on the table; even [mezzanine] debt that they would have done in the past," said Rob Koger, president of Molinaro Koger. "That extra 10 [percent] to 15 percent on a development makes all the difference because the equity is hard to get when you're penciling out a new Hyatt at $250,000 a room. That's a hard number to underwrite today if you're an investor."

Shupnick said there's a simple explanation why this option is no longer available.

"The thing that's probably taking away the ability of the brands to credit enhance is that debt covenants have changed tremendously in public companies' borrowing situations related to what happened after 9/11," Shupnick said. "A lot of the [credit] enhancements were there before they could give freely because companies were prospering a lot more and were meeting their obligations under the loan agreements. They didn't have any problem saying, 'I'll guarantee 15 [percent] to 20 percent of this with GMAC or GE or whomever.' They can't do that anymore because they're under very stringent restrictions because the RevPAR and the income is down in the company. Consequently, they don't have that extra slack in the balance sheet."

All of this adds up to hotel owners being careful as they navigate the choppy waters of transactions.

"In this market, you can spend a lot of time marketing assets that don't sell unless the seller has a reason to sell," Koger said. "The worst reason to sell is that he can get his number. That's a guy who probably doesn't have any real interest in selling unless he can get the top price, which is very hard to achieve today."

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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.

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Editor's note: This is part one of a two-part series. Coming in our Dec. 9 issue: LIIC members look at where the lodging industry fits into the real-estate market.