As a result of the recent turmoil in global stock and bond markets, there is no shortage of pontificators articulating downside economic risks and predicting near-term recession. Generally, anxiety appears to be the flavor du jour as fewer market analysts are forecasting economic growth and prosperity. The reality is no one can state with absolute certainty that the economy is headed into a downward cycle.

The U.S. appears to be in a fully mature phase of the cycle, where commercial real estate including hotels is trading at peak levels. Values and prices are beginning to flatten and during the near term are expected to level off. While many perceive we are experiencing the tail end of the commercial real estate up cycle, for the most part, property fundamentals remain strong and near-term returns anticipated from income are showing no signs of stress. However, investors are beginning to underwrite lower returns from asset appreciation as a result of the aforementioned timing of the cycle.

CMBS appears to be causing the real estate lending community the greatest anxiety at present. As overall market volatility has negatively affected spreads, some market participants are concerned that there will be insufficient CMBS issuance to refinance the more than $200 billion of vintage ten-year loans that will be maturing through 2018. During the near term, hotel owners will encounter a more challenging debt financing environment with higher interest rates and tighter underwriting standards as traditional lenders respond to the repricing due to increasing risk across most debt capital markets, in addition to new capital surcharge regulations on the nation’s largest banks. Nontraditional lenders specializing in mezzanine debt and preferred equity including private equity, hedge funds and mortgage REITs are well positioned to backfill any void. The shadow banking system offers greater flexibility than commercial lenders to take down entire debt stacks and sell off senior pieces of debt while retaining the riskier, higher return mezzanine portion.

Globally, there are numerous crosscurrents through which investors must navigate including volatility in world financial markets, increasing tensions in the Middle East, and unusually low oil prices. Fear of America’s still recovering economy tumbling is being driven by headlines that are talking the market down. The longer this phenomenon occurs, the more likely perception will become reality and the risk of
economic recession will rise. The fact is that currently there is little if any empirical evidence that the US economy is in danger of falling into recession, defined as two consecutive quarters of negative GDP growth. While the world is currently experiencing a profits recession, commercial real estate including hotels is predicated on economic fundamentals and over the long term the sector continues to offer potential.

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