What's the Deal By Daniel Lesser
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State of the union

(The views and opinions expressed in this blog are strictly those of the author.)

Many perceive today's U.S. lodging investment market to be in the late stages or "extra innings" of an elongated market rise. With hotel transaction volume and pricing having peaked in 2015, and while not a fan (no pun intended) of using the baseball analogy to describe an investment market, I believe it more appropriate to label this point in time as the bottom of the first inning of a new investment cycle.

The nearly nine-year recovery from the Great Recession is one of the longest periods of economic growth in modern U.S. history. While some experts have been predicting a looming recession for more than a year, macroeconomic indicators do not suggest any decline in the near future, and many foresee a strong, stable economy.

Although the eight-year bull market in the U.S. lodging industry shows signs of slowing, the sector posted record metrics during 2016 including: 65.5% occupancy, US$124 average rate, US$81 RevPAR, 1.8 billion available room nights, 1.2 billion occupied room nights, and US$149 billion in room revenue. Q1 2017, compared with Q1 2016, indicates a continued increase in every major category of measurement.

Hotel prices peaked during 2015, and with uncertainty leading up to the November 2016 U.S. presidential election, values at best remained flat and at worst declined by as much as 20% in certain markets. A surge of enthusiasm during the last two months of the year and through Q1 2017 has subsided, and hotel prices remain at best flat and at worst 10% off the most recent peak.

While growth headwinds are challenging, hotel real estate valuations remain robust given a deep and broad buyer pool that positions the asset sales market to favor sellers. Relatively conservative lending endures, driven by equity contribution requirements of no less than 30% of transaction prices. With significant skin in the game, borrowers are carefully considering potential acquisitions and sellers are holding firm on pricing. A resultant capital markets stalemate has limited transaction activity, resulting in a highly disciplined market.

While some parts of the world are experiencing unconventional monetary policies such as negative interest rates, enormous pools of capital are circling the globe searching for yield. History has proven that at a market basis, patient money invested in U.S. transient lodging provides compelling risk adjusted returns. Furthermore, while little anticipation exists for inflation to occur during the foreseeable future, the constant repricing of hotel room nights offer a hedge against any rise of prices for goods and services that may develop over the long term.

If my opinion – that at midyear the U.S. hotel investment market is in the bottom of the first inning of a new investment cycle – ultimately proves correct, remember you heard it here first. If, on the other hand, the sector falls off a cliff before the end of this decade, disregard the sentiment expressed within this blog.

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