What's the Deal By Daniel Lesser

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Price erosion in New York's hotel market

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

While perceived as one of the world's top hotel markets, during the past 10 years numerous challenges have developed for New York City lodging operators and investors. Consider the following:

• New room supply has dramatically increased, with roughly 113,000 available rooms in NYC today compared with 76,000 rooms during 2008, an increase of almost 50%. An additional 24,000 rooms are under development. The city's hotel building boom has contributed to declining room rates in contrast to an increase in most of the top 25 U.S. hotel markets;

• Airbnb is less than a decade old and today is valued at more than US$31 billion, a mere US$7 billion less than Marriott International, the world's largest hotel company. While there are varied opinions as to the breadth and depth of the impact of Airbnb and other short-term home sharing platforms on the lodging industry, there is little doubt of the negative pressure it has exerted on NYC hotel room pricing power;

• The New York Hotel and Motel Trades Council is a powerful union that during the recent past engineered an unprecedented labor/management relations agreement in terms of length and scope. NYC hotel labor rates and benefits are comparatively high, and combined with stringent work rules, this has caused hotel operating expenses to increase while revenues are decreasing;

• A strong U.S. dollar has positioned inbound travel to NYC to be expensive for foreign visitors;

• Property taxes are a large and growing expense for NYC hotels, with many now experiencing liabilities equal to more than 10% of total revenue.

There are now several examples of NYC hotels that have experienced price/value erosion compared with the recent 2015 market peak.

• The Royalton New York was acquired recently for US$55 million (US$327,000 per room) by a joint venture between Rockpoint Group and Highgate. During 2011, FelCor Lodging Trust purchased the 168-unit Royalton New York for US$88 million (US$525,000 per room), a 38% decline in value during the six-year hold period;

• Kash Group, in partnership with Shel Capital, recently purchased the Morgans Hotel for US$41 million (US$350,000 per key) with plans to convert the property into micro-unit residential condominiums. The hotel was officially closed on July 14. FelCor Lodging Trust bought the 117-unit Morgans Hotel in 2011 for US$52 million (US $445,000 per room), a 21% decline in value during the six-year hold period;

• During Q4 2016, a joint venture lead by Highgate acquired for just over US$350,000 per unit the 618-room Affinia Manhattan NYC from Pebblebrook Hotel Trust;

• In mid-2016, KHP Capital Partners (KHP) sold the 205-key hotel at 70 Park Avenue for US$67.6 million

(US$330,000 per room). KHP acquired the property in 2006 for US$88.5 million, a considerable decline over a decade-long hold period;

- Rumor has it the Standard Highline Hotel is being purchased by Gaw Capital Partners for US$340 million, or 15% less than what the property was in contract to sell for in 2014, although the deal never closed.

It is important to note that while there has been pricing erosion of some hotels, not all NYC transient lodging facilities have experienced value declines during the recent past.

Despite the near-term negative pressures previously identified, over the long term NYC will continue to be a top global target of hotel investors for the following reasons:

- NYC displays strong economic indicators supported by diverse industries including banking, financial services, professional/technical services, health care, media, advertising, retail trade, information technology, fashion, entertainment, tourism, and real estate;

- Several major infrastructure revitalization and new development projects will enhance NYC's profile and solidify its position as the capital of the world;

- NYC is the economic and cultural center of America, attracting visitors and investors from throughout the globe;

- During the past decade, NYC's outer boroughs have experienced dramatic gentrification and emerged into appealing business and tourist destinations;

- Despite the massive influx of new hotel rooms, annual NYC hotel occupancy levels remains consistently above 80%, more than 15 points above the national average;

- Obtaining construction financing for a new hotel development in NYC is becoming increasingly challenging as the financial feasibility for additional rooms is diminishing. The number of permits filed for new hotel construction has already begun to decline in Manhattan;

- While Airbnb and other home-sharing services have infiltrated the market, their existence is no longer an explosive growth phenomenon;

- Subsequent to a prolonged period of strength, Credit Suisse global equity strategists believe the U.S. dollar is entering a long-term bear market.

It appears a floor is starting to build in the NYC hotel market and once the latest wave of new hotel development is absorbed by 2020, NYC room rates and property values will rise once again. I believe the fact that Highgate and BD Hotels, successful contrarian hotel operators and deal sponsors, are once again investing in NYC lodging real estate speaks volumes relative to long-term positive prospects for the market.

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