New year hotel transaction outlook: Smooth sailing

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Life looks good in the world of hotel real estate.

“As we sit today, I don’t see anything that would result in negative impact,” said David Sonnenblick, co-founder and principal of Sonnenblick-Eichner Company, a real estate investment banking firm. “Rates may bump around a bit, but all major lenders and investors have capital. We still see things being very attractive in 2018.”

Shane Vahey, director of real estate business development at New England Hotel Realty, said he expects a bit of acceleration in the first two quarters.

“And that’s based on the Lodging Conference vibe,” he said. “I’ve had conversations with [real estate investment trusts] and ownership groups: what they’re doing and what they will dispose of and where they're headed with portfolios.”

Supporting Data

Public REITs accounted for 32 percent of transaction volume in the third quarter of 2017, according to the JLL “Investment Quick Look.” REITs (nontraded and public) and private-equity funds accounted for nearly three-fourths of transaction volume.

However, current figures put overall transaction volume behind projections: JLL’s outlook for

2017 expected total U.S. hotel real estate transactions to reach approximately $29 billion. But the market might fall short of the prediction because investment dollars totaled just $16.8 billion in the third quarter. Concurrently, foreign hotel investment is on the decline in year-over-year comparisons, partly attributed to increasing government restrictions on China.

Real Capital Analytics reported that deal volume was down 58 percent, year over year, in the third quarter, due in part to comparison to Anbang Insurance Group Company's $6.5-billion acquisition of Strategic Hotels & Resorts in Q3 2016. Through the third quarter, full-service hotel investment is down 33 percent, year over year.

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>
> — MGAC (@MGACinc) October 19, 2017

The limited-service segment showed the only growth for the quarter: deal volume was up 19 percent in year-over-year comparisons and 17 percent, year to date.

And yet, optimism remains.

“What's happening as we get to this grandfatherly cycle age, a lot of mergers and acquisitions have been completed, institutional groups that have wanted to trade and looked for market peak opportunities have been able to accomplish that,” said Eric Belfrage, senior VP of CBRE Hotels. “Now single-asset owner/operators are looking at it as a good time to sell and to buy. So there is a higher number of transactions that relate to lower dollar amounts.”

Dan Lesser, president and CEO of LW Hospitality Advisors, said he believes that 2015 was the market peak and we could even be back at the beginning of a new cycle.

“Compared with 2015, U.S. hotel (sales) transaction activity continues to be muted as bid/ask spreads remain sufficiently wide, pushing sellers to opt for refinancing as opposed to disposition,” he said.

Forward-Looking Metrics

And while money on the 2017 books might show a slow start to 2018, several indicators tell a convincing story that hotel real estate—refinancing and sales—will continue to transact.

Vahey watches the construction pipeline.

“The pipeline can be an indicator of the hospitality industry, if interest rates are low and guestroom demand is strong, developers are inclined to build new hotels.

“Developers are attracted to a market that has strong demand and they look to build hotels that serve a specified need,” he added.

The total number of forecasted 2017 openings represents a 12-percent increase over the actual openings in 2016, according to Lodging Econometrics, the non-real estate brokerage sister company of New England Hotel Realty. In its third-quarter summary, it forecast 1,146 projects with 130,633 rooms will open in 2018 and another 1,153 projects with 134,990 rooms will open in 2019.

Additionally, institutional investors and REITs could note a supply increase and decide to get out of that market, Vahey said. “They will get their money out and go to a market with more opportunity for better [internal rate of return]. It’s happening now.”

Timing is another issue.

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> — Apostolos Klitso (@apostolos_kl) October 23, 2017

Private equity firms will likely dispose of assets that were purchased in 2013 and 2014 and are reaching the end of their intended holding period, which will spur additional transaction activity, according to Mark Wynne Smith, global CEO of JLL’s Hotels & Hospitality Group.

“Owners who adopted a wait-and-see approach in 2017 will bring quality assets to market as the industry becomes more comfortable with this extended cycle,” he said.

Gross operating profit performance also can help paint a picture for transaction activity, according to Belfrage. CBRE Hotels’ Americas Research tracked that changes in hotel profits (defined as gross operating profit) are correlated to the volume of transaction activity. In sum, as profits remain strong, as they are projected to do in the next few years, hotels will continue to transact.

Economic factors also are painting a good picture of 2018, Lesser said.

“The nearly nine-year recovery from the Great Recession is one of the longest periods of economic growth in modern U.S. history,” he said. “Macroeconomic indicators do not suggest any decline in the near future, and many foresee a strong, stable economy.”

And tax reform could be a boon: “We believe that tax cuts will have a net positive effect on hotel financing activity as we anticipate meaningful compression in credit spreads, resulting from incremental [gross domestic product] growth and a stronger operating environment,” Wynne Smith said.