

Daniel Lesser

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Contributing Thought Leader

Daniel Lesser

President & CEO

LW Hospitality Advisors LLC

GlobalHotelNetwork.com: Where do you see the best opportunities for hotel investment or development?

Daniel Lesser: What started as a bursting of the U.S. housing bubble between 2006 and 2007, and mushroomed into a failing subprime mortgage/credit market, ultimately resulted in the worst financial crisis since the Great Depression of the 1930s. Ten years ago, the Great Recession of 2008/2009 was ushered in by a full-blown international banking crisis sparked by the collapse of blue-chip investment banks Bear Stearns and Lehman Brothers. *Through the end of Q1 2019, Wall Street is enjoying another heyday as profits for commercial banks are at a record high, the stock market is in its longest bull run in history, and the U.S. economy continues to steam ahead as it approaches the longest post-World War II expansion with uninterrupted growth. Furthermore, the globe is awash with diverse pools of debt and equity capital that increasingly favors real estate as a preferred vehicle for returns on and of capital.*

Investors frequently ponder where we are in a cycle. Is the current economic climate most like 1995, 1999, 2000, 2003, 2008 or 2016? While history often rhymes, the reality is we are in 2019, which presents its own set of idiosyncratic risks and opportunities. Many economists have opined that expansions do not die of old age, rather they expire due to an unpredictable event(s) such as shocks to oil prices and/or the bursting of asset bubble(s).

As the U.S. economy goes, so goes the nation's lodging sector fundamentals. Although the hotel industry has been operating at peak levels for several years, accelerated supply growth, which has been readily absorbed in most markets due to the expanding economy, has contributed to weaker than normal average room rate growth. Furthermore, despite shortages of and escalating costs of labor, on average nationally hotel owners and managers have sufficiently controlled other operating costs to achieve the highest levels of gross operating profit margins in more than fifty years. With this said, due in part to rising minimum wage rates, profit margins of numerous assets situated in major U.S. markets have contracted.

While the U.S. lodging industry is complex and forever changing, as of the middle of 2019 draws near, consider the following sector SWOT analysis.

STRENGTHS:

- The hotel industry is enjoying a tenth consecutive year of increasing profits while continuing to achieve record setting rooms revenue metrics;
- Notwithstanding muted revenue growth coupled with upward pressure on expenses, the sector has been attaining exceptional operating efficiencies, productivity and margins;

- America is the world's beacon for safety and security, attracting visitors and investors from throughout the world;
- Gross domestic product (GDP) of the U.S. economy grew at a 3.2% annualized rate in the first quarter of 2019;
- As of the end of April 2019, the Conference Board Consumer Confidence Index® stands at 129.2 (1985=100);
- Despite recent stock market turbulence, the longest bull market in American history is still intact as the S&P 500 is trading at all time high levels;
- Rising affluence in emerging economies is leading to expansion of the global middle class leading to increased numbers of travelers and expenditure of tourism dollars in the U.S.;
- Nationally, hotel room night demand has been increasing within the major segments, namely corporate, group meeting/convention, and leisure;
- Limited availability of construction finance and building labor shortages has resulted in new hotel supply increases nationally remaining below long-term averages;
- On a relative long-term basis, U.S. interest and capitalization rates remain low;
- Copious amounts of debt and equity are available from a broad array of sources;
- Hotel asset prices remain robust with little if any investor anticipation of near-term value erosion;

WEAKNESSES:

- U.S. travel and immigration bans create negative postures and restrictions on foreign visitation;
- Trade wars may create negative pressure on inbound overseas tourists to the U.S.;
- The lodging sector is overly segmented with travelers confused by continued rollout of new hotel brands;
- Airbnb now has twice as many downloads as 10 of the top hotel company apps combined;
- Labor shortages and rising influence of unions create upward pressure on wages and benefits;
- Hotel property tax burdens and insurance premiums have increased dramatically;
- Safety and security issues pertaining to hotel guests and employees are becoming ever more challenging;
- Hotel bed bug infestations across the country are on the rise;
- Guest privacy and anonymity has resulted in lodging facilities becoming attractive locations for human trafficking;

OPPORTUNITIES:

- The Tax Cuts and Jobs Act of 2017 created new incentives for investment into certain communities that have been designated as Qualified Opportunity Zones by the U.S. Treasury Department;
- With daily tenancies and continuous repricing of room rates, investment in lodging assets represent a terrific hedge against future inflation;
- Increasing amounts of bleisure travel;
- Sector pivot to a customer-centric pricing model;
- Reduction of third-party commission rates;
- Opportunities to acquire and renovate/reposition +/-35-year-old full service hotels at an all-in basis equal to or less than the cost to develop new select service assets;
- Opportunities to acquire exterior corridor 1950/60's motels and renovate/reposition into cool/hip experiential products;
- Modular construction allows for efficient, cost effective, and high-quality development; • Continued expansion of industry sustainability and eco-friendly initiatives; • Technological advances continue to increase operating efficiencies; • Increased legal restrictions on short term home sharing rentals; • Creation of experiential hotel lobbies and/or food and beverage facilities that are not available through home sharing rentals;
- Hotel industry expansion into the home sharing sector;
- Hospitality mergers and acquisitions activity anticipated to remain robust;

THREATS:

A variety of factors can cause the next downturn including but not limited to a(n):

- U.S. corporate debt bubble burst;
- weakening global growth;
- slowing U.S. housing market;
- increase in oil prices;
- dramatic and/or swift rise of interest rates;
- rise of commodity prices due to increasing import tariffs;

Airbnb has been overhauling its business model to further take on the hotel and travel industries;

Pop-up hotels and nomad-focused hostel/hotel/coworking spaces.

While the fundamentals of the U.S. lodging industry are simultaneously favorable to buy, sell, refinance, and develop a variety of lodging product types, and the near-term outlook for lodging remains positive, given a myriad of global and domestic issues that can rapidly develop into full blown crises, short term

future industry performance is fragile.

In order to remain competitive, cutting edge hotel market participants routinely consider the sector's highly fluid Strengths, Weaknesses, Opportunities, and Threats. While the aforementioned SWOT analysis covers a broad array of factors on a macro basis, it is extremely important to consider how each one may impact the future performance of an individual hotel when underwriting an acquisition or development opportunity.