The time to invest in urban markets is now

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According to Britannica, urbanization *"is the process by which large numbers of people become permanently concentrated in relatively small areas forming cities."* Throughout history, people have been attracted to cities as centers of culture, learning and economic opportunity. Urbanization is on the rise all over the globe and currently more than half of the world's population lives in metropolitan areas. As the global population is likely to continue increasing, urban areas are anticipated to grow as well.

Effects of the COVID-19 pandemic hallowed out many U.S. downtown central business districts, and numerous urban cores are no longer considered bustling centers of activity. Much has been written relative to the negative consequences of the continued work from

home phenomenon, resulting in empty offices that have led to a perception of “doom loops” and the death of downtowns affecting numerous major U.S. cities. Walking around New York, and in particular San Francisco, looks and feels starkly different compared to pre-COVID times as reduced levels of business travel, retail store closings, homelessness and elevated levels of crime are taking their toll.

On Park Hotels & Resorts’ Q1 2023 earnings call, Thomas Baltimore Jr., the firm’s chairman, president and CEO, stated: “Turning to our urban markets. We were particularly encouraged by better-than-expected group performance in San Francisco with Q1 convention room nights up over 200% to over 140,000 room nights versus the same period last year.” Baltimore further opined: “When you think about San Francisco, we have no doubt in our view that certainly San Francisco comes back. It’s not a matter of if, but when. I would say, given some of the recent reports that probably is being extended a little and perhaps elongated a little” and “San Francisco historically is a high-beta market, so it goes through these periods of sort of boom and bust. Clearly a tougher period now, but we are seeing it certainly beginning to recover.”

The announcement and accompanying statement are in stark contrast to one month later, on June 5, 2023, when Park announced it ceased making payments toward a $725-million loan backed by two of its San Francisco properties, the 1,921-room Hilton San Francisco and the 1,024-room Parc 55 San Francisco, along with the following statement: “Now more than ever, we believe San Francisco’s path to recovery remains clouded and elongated by major challenges.”

Time will tell if the swift and dramatic shift in outlook is a positioning tactic to negotiate a workout with the lender, who may very well not be interested in foreclosure of the assets.

Though there is little doubt that many U.S. urban markets, including San Francisco’s, path to recovery remains clouded and elongated by major challenges, commercial real estate including hotel investment opportunities in these cities will offer tremendous upside for patient money willing, if need be, to hold assets for upwards of 10 years. Consider two major real estate cycles during the past 35 years. Cracks in market fundamentals commenced in 1989, full implosion occurred during 1990-1991, pain endured until the overall bottom in 1996 and then the bull market began and took off. During the most recent cycle, cracks in market fundamentals began in 2007, full implosion occurred during 2008-2009, pain was endured until the overall bottom in 2012-2013, then the bull market took off again. Where are we today? Cracks in market fundamentals began in 2022 and momentum is building toward another potential implosion.

Furthermore, recall that immediately after 9/11, with thousands of residents having permanently left Lower Manhattan, many perceived no one would ever be willing to work and/or live in a high-rise building again. However, the outflow soon turned into a wave of newcomers, lured by federal financial incentives to live downtown, and by 2005, the

population of Lower Manhattan had grown to more than 43,000, an increase of 25% since 2000. Over the next two decades, with at least $20 billion in public and private investments, Lower Manhattan was not only restored but reinvented, helping to transform it into a flourishing neighborhood whose recovery became an emblem of New York City's resilience.

The best buying opportunities of American commercial real estate including hotels I ever witnessed was during the Savings and Loan (S&L) crisis of the 1980s and 1990s. The situation led to establishment of the Resolution Trust Corporation (RTC), a U.S. government-owned asset management company charged with liquidating primarily real estate-related assets of S&L associations declared insolvent by the Office of Thrift Supervision (OTS). At the time, while countless were skittish about acquiring assets, many that did ultimately made fortunes.

Today, this same opportunity exists in many U.S. downtown markets. Some investors are holding off deploying capital because they perceive "deals will be better next month," while others have entirely given up on New York and San Francisco because of misguided local policymakers. Now is the time for long-term investors to acquire assets in these locales as history teaches us that one can never predict the bottom and only know it six to nine months after the low point was hit and the opportunity is mostly lost.

In addition to courage and patience, savvy investors will utilize a prudent balance of debt and equity to avoid overleverage. Furthermore, they will make use of interim debt and not lock in long-term fixed commitments only to end up with large prepayment obligations when interest rates decline in 2026-27. Property values in 2027 will no doubt exceed the peak of 2021-22 as recoveries always exceed previous all-time highs.

Those who buy now at market pricing in major U.S urban markets and are smart about capital stack structure and coverage with stress tests will win big.

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