Why buy hotels now?

After several consecutive quarters of declining occupancy and RevPAR, hotel investors are naturally feeling bruised and battered. The vast majority of hotel owners and operators I talk to on a weekly basis state that their hotel investment posture is "to sit tight, do nothing, and wait to see what happens with the economy and hotel revenues." Unfortunately, this strategy will cause many hotel owners to miss a rare opportunity to buy at a low price point in the hotel investment cycle.

Presently, the market value of midscale and budget oriented hotels is approximately 30% below the peak price levels of 2007. This price decline results from weak demand, new supply, and the reduction in available debt money. This convergence of factors, which has shocked the market, will not continue indefinitely. Indeed, HVS, a leading appraisal and consulting firm, has predicted hotel values will peak again in 2014.

Looking back at previous down cycles, I am reminded that many of today's leading hotel developers and operators made their initial fortunes by buying at the bottom of the market in the early 1990s (after the 1991 recession & overbuilding) and again in the early 2000s (after the 9/11 attack). Many leaders in AAHOA had the courage and foresight to buy poorly performing hotels at low prices, which they were able to sell in a few short years for very large gains. It is important to remember how the hotel industry-wide losses that averaged $4.2 billion during 1990 & 1991 were soon replaced by profits that averaged $7 billion during 1994 & 1995.

No economist or hotel expert can predict the exact timing or rate of economic change. Nonetheless, the expected recovery will come. The consensus is that the RevPAR and profit growth will be quite dramatic starting in 2011 (partially due to very little new supply growth coming on-line). One released report projects that during 2011 & 2012, RevPAR will increase at an average annual basis of 9.2% and profits will rise at a 17.8% average annual pace. During my 30-year career in the hotel business, I have witnessed that participants and outside observers are always surprised by how quickly and sharply hotel sales and profits can decline or improve.

The opportunity to buy at the low end of the hotel investment cycle typically comes around only once every 10 years. If investors wait until the economy and RevPAR changes are clearly on the rise, they will find that hotel sale prices have also increased, and once again they will have to compete with many buyers for each available hotel.

Warren Buffett's adage that you should "buy when others are fearful and be fearful when others are greedy" applies to hotel real estate as well as the stock market. And this is indeed a fearful time in the hotel business.

My suggestion to hotel owners is to be proactive by taking a thorough look at properties on the market. If you are able to make a sensible buy in today's depressed climate, you are likely to realize substantial equity gains three or four years from now. Keep in mind that your deals will have to pass stricter underwriting standards than in the past and will require more equity (30-35% instead of 20-25%).

The current potential for outsized returns, based on buying low, should be considered by serious hotel investors.

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