

A PANEL OF
INDUSTRY LEADERS
DISCUSSES THE KEYS
TO THE INDUSTRY'S
CONTINUED RECOVERY
BY ED WATKINS

REAR REBO



2011 will be a pivotal year for the U.S. hotel industry as owners and operators **strive to keep last year's momentum** intact. While operational performance should continue to improve, questions remain on how robust the transactions market will be and when new hotel development will return. To get the answers to these and other questions, *Lodging Hospitality* convened a panel of industry leaders during the recent International Hotel/Motel & Restaurant Show in New York. The discussion ranged from finance to operations to marketing to development:



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WHAT IS THE OUTLOOK FOR HOTEL TRANSACTIONS IN 2011?

Kevin Mallory, CB Richard Ellis Hotels: Right now, things feel robust. In 2010, transaction volume was four to five times what it was in 2009, and the outlook for 2011 may be two to three times what we experienced last year.

Joe Epstein, First American Realty Associates: Good deals get done. They always got done, and they'll still get done. The terms may be different, the rates may be different, the ground rules may be different, but bankers still understand what good is.

David Gutstadt, Morgan Stanley: I don't think the dam has quite broken, but we're certainly well on our way. You don't see people twiddling their thumbs and focusing only on workout problems. They're buying paper and moving toward controlling assets.

Keith Pierce, Wyndham Hotel Group: There are still a large number of properties, particularly those that were acquired in the 2006-'07 timeframe, in trouble. They bought high and then the bottom dropped. Many franchisors pulled back on renovation and product improvement requirements to get them through this difficult cycle. But some of those deals were thin, so they're going back to the bank because they can't make it out of this very difficult time.

IN THE LAST SIX TO 12 MONTHS WE'VE HEARD EVERY CLICHÉ POSSIBLE WHY BANKS HAVEN'T BEEN TAKING BACK DISTRESSED PROPERTIES. WHY HAVEN'T MORE BANKS TAKEN ACTION?

Bjorn Hanson, New York University: There's an institutional memory from what happened in the early 1990s. Many real estate owned-departments [of lenders] wouldn't even use the word hotel because when they took back a hotel that was performing poorly they ended up inheriting things like liquidated damages clauses, CapEx deficiencies and all kinds of liabilities. It's better to work with a quality debtor than it is to end up being the owner of a hotel and bearing all of those economic and other resource requirements.

Epstein: It's a living, breathing nightmare and lenders remember how awful it was. Everything that can go wrong does go wrong when you're in the hotel business, and no one wants to do that if you have a choice.

Mallory: We've transitioned into a period where lenders are rather positive and believe time is their friend. If I own a high-quality asset and the fundamentals are coming back and the capital markets are coming back, I'd rather hold that asset than realize its value today.

WILL THAT CHANGE AS INDUSTRY PERFORMANCE IMPROVES AND MORE OPPORTUNITIES BECOME AVAILABLE?

Robert Habeeb, First Hospitality Group: There seems to be a push and pull. We just came out of a period in which lenders and the brands were looking the other way with troubled assets because there was no valor in being aggressive with them. In 2011, the brands will enforce quality standards and end the deferrals on capital improvements. On the flip side, as the government forces banks to deal with their troubled assets, it's going to have the net effect of moving the market.

Hanson: From a CapEx perspective, the peak was 2008, when the industry spent about \$5.5 billion. 2010 CapEx spending was about \$2.7 billion. We were probably spending too much in 2008, but to be less than half of that at \$2.7 billion isn't enough.

Gutstadt: We're finally at the point where banks' capital cushions are going to be less constrained and a lot of private investors have figured out where the loans are. The trickiest thing in the cycle was you had real estate investors who weren't natural buyers of debt, so non-traditional real estate investors— hedge funds and others—ended up taking large positions. Frankly, the people who made the best trades were the hedge fund guys who were able to figure it out. The real estate guys are finally starting to figure out how to understand where these loans are and how to talk to the banks and trade this type of paper. We'll see a lot more of that happening [this] year.

Mallory: At CBRE, we're one of two contractors for the FDIC for REO property. Of the banks we've taken over through the second quarter of [last] year, only one hotel property was categorized REO in any of the banks we took over. We encountered a tremendous number of loans that were performing, but hadn't seen payments in 12, 18 months. That speaks to the capital constraints the banks were feeling as opposed to what was really happening in the underlying business.

REPORTEDLY HUNDREDS OF MILLIONS OF DOLLARS OF CASH IS SITTING ON THE SIDELINE WAITING TO BE UNLEASHED ON REAL ESTATE AND OTHER MARKETS. WHEN ARE WE GOING TO SEE THAT CASH DEPLOYED IN THE HOTEL MARKETPLACE?

Mallory: A buyer finding capital for an asset is not the problem. Finding an asset for investors is the challenge. We saw 38 transactions above \$10 million in Q3 of [last] year. There are a lot of deals occurring, and 50 percent of the \$20-million-and-lower transactions appear to be distress-oriented. That's the not the case as we go up market, where

THE ALL-STAR TEAM



PETER STREBEL
area managing director,
Omni Hotels & Resorts



ROGER BLOSS
founder, president & CEO,
Vantage Hospitality Group



JOE EPSTEIN
president & founder, First
American Realty Associates

they tend to be market transactions as opposed to distress transactions.

Roger Bloss, Vantage Hospitality Group: We're seeing a lot of bidding on hotels in the limited-service and economy segments. In cases of barrier markets like California, we're seeing properties on the market that are 20 or 30 years old that attract 10, 15 or 20 bidders on them.

Gutstadt: The debt market is the last hole to be filled, and you're seeing the CMBS machine start spooling up again. At Morgan Stanley, we were on pace to originate about \$2 billion in CMBS debt [in 2010], and some percentage of that was in hotels. We're not going to be back to \$80 billion in CMBS in 2011, but could be \$20 billion.



DAVID GUTSTADT
executive director,
Morgan Stanley



ROBERT HABEEB
president & CEO, First
Hospitality Group



KEITH PIERCE president
of brand operations in
The Americas, Wyndham
Hotel Group



BJORN HANSON dean of
the Preston Tisch Center
for Hospitality, Tourism
and Sports Management,
New York University

WHY HASN'T CORPORATE AMERICA STARTED HIRING AGAIN?

Bloss: There's a great amount of fear in consumers. Their homes are worth less; there's still high unemployment. The stock market is just pieces of paper to them, whereas their homes are something they can touch and feel and see every day. They see their fellow workers, their friends and their neighbors still out of work, and until the confidence in the housing and job markets comes back, value is still going to be a big piece of what people are looking for.

WHAT'S IT GOING TO TAKE FOR NEW HOTEL DEVELOPMENT TO RETURN?

Hanson: Occupancy will be below 60 per-



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cent for four consecutive years, and it's not about to rocket past 60 percent to some great number. Occupancy has only been below 60 percent in four cycles, including the 1930s.

So with 40 percent or more rooms available, it's kind of hard for an outsider to develop an investment scenario to allocate additional capital [for development]. And if you can buy for 20-30 percent less than replacement cost, a smart investor would buy, not build new.

Pierce: You'll need several quarters of RevPAR improvements before you'll get to the point where the RevPAR strength will be overwhelming enough to spur more development in both the mid-market and upper [segments].

Peter Strebel, Omni Hotels: Omni's a small company, but we've been successful with private/public partnerships. We have two [of these] mega-hotels under construction, one in Dallas and one in Nashville. There are a lot of development opportunities in cities that are trying to reinvent themselves and bring in development.

Epstein: You've got to find a demand and a need and a segment and a market, whether it's secondary or tertiary. You've got to have a feasibility study that shows a lender somebody other than the franchisor and the broker think it's a good deal. You've got to have cash to guarantee, and you're going to be dealing with banks instead of funds. It's not going to be non-recourse money. Near universities, military bases, hospitals, on a one-off basis, you can prove there are a demand and a need, but nationally we've got a long, long way to go.

Habeeb: We have to recognize we're all development junkies. It's what developers do. The raw basics aren't out there to do it right now, but if there was a little bit of loosening in credit you'd see developers get active again.

Mallory: Generally, the issue is capital. If I were running a bank or an insurance company, I'd shoot anybody who came to investment committee with a hotel development deal.

WILL THE RAISING OF THE SBA LOAN LIMITS HAVE AN IMPACT ON DEVELOPMENT?

Bloss: It's going to help. In particular, Asian-American hoteliers have a lot of resources. They have a lot of synergies amongst each other, so they're going to build some hotels. A lot of them have relationships with their local bankers who they've been doing business with for 20 years, and through the good times and bad times they haven't

Cautious Optimism for 2011

Members of the *Lodging Hospitality* roundtable believe 2011 will be better than '10 and certainly '09, but they're not completely sold.

"We saw RevPAR improvements in 2010, so we're cautiously optimistic 2011 will be a stronger year, driven primarily by gains in occupancy," said Keith Pierce of Wyndham Hotel Group. "But it's still a fragile environment."

Robert Habeeb of First Hospitality Group, was a little more bullish, forecasting RevPAR growth of six percent or better this year. "And it's not illogical to believe we'll see some real significant rate appreciation as we get into a more normal supply and demand cycle," he said, citing particularly strong growth in urban markets. "We're finally getting some traction in downtown Chicago, which is a market that has lagged in rate for the past year and a half."

Bjorn Hanson of New York University, applied a statistical analysis to his outlook for the year. According to Dr. Hanson, in the last six hotel industry cycles, the second year of recovery (in this case, 2011), hotel demand grew between 5.5 and six percent, versus the long-term growth rate of 2.2 percent. The consensus outlook for demand growth in 2011 is three percent, he said.

There is no shortage of analysts with predictions for hotel performance in 2011. Here's a sample of what other experts say:

- STR says all three key industry metrics will rise in 2011: occupancy will increase 1.6 percent to 58.3 percent, ADR will climb 3.9 percent and RevPAR will be up 5.5 percent. Also, the supply/demand equation favors the industry with demand projected to rise 2.5 percent, while the net number of new hotel rooms will increase by 0.9 percent.

- Colliers PKF Hospitality Research is a little more bullish, calling for a 3.3-percent increase in demand and a 6.3-percent rise in RevPAR. And in 2012, RevPAR growth should hit 10.4 percent, the first double-digit climb in this metric since the statistic has been measured.

- HVS is even more optimistic, forecasting solid increases in occupancy (up 2.5 percent), ADR (4.5 percent) and RevPAR (7.1 percent).

defaulted on their loans.

Pierce: When you're in the economy segment, you can do a Microtel for \$4.5-\$5 million. Particularly those in the Asian community can come up with equity and walk in and get deals done. As a result, we'll do more Microtels than we will Wingates.

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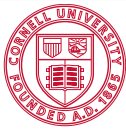
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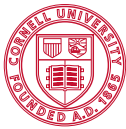
2011 Highlights

- **Fortune's Most Admired Companies: What Sets Them Apart** — Learn about the programs that earned these premier hospitality companies a spot on this prestigious list.
- **Unlocking the Future for HR in Hospitality: The Marriott Perspective** — Marriott International's EVP of Global HR explains how their people initiatives continue to deliver best-in-class employee experiences and strong business results.
- **HR and the C-Suite: Driving Business Results Through People Strategy** — An executive panel shares how they made their people strategy a key component of their business strategy.
- **Cornell University HR Executive Summit** — Hear a candid dialogue among the nation's preeminent HR leaders and employment and labor law experts focusing on HR strategies and legal issues.
- **Labor and Employment Law "Unconference" Session** — You take charge of the agenda and drive the discussion in this innovative session that integrates the experiences and talents of our diverse attendees.

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WHAT ARE THE KEYS TO GETTING RATES BACK TO WHERE THEY NEED TO BE?

Strebel: It goes back to supply and demand. When demand goes up you can start charging more. New York really didn't see a drop in occupancy in the worst days. We just lowered the price and were able to fill the market with people who couldn't afford it before. People are starting to come back, so we can start raising our rates.

Hanson: There is a kind of a lag effect because the corporate rates for 2010 were negotiated in the fall of 2009, and the corporate national rate increase was about 1.5 percent. The convention rates for cities like New York negotiated in 2009 are going to haunt New York for 2011, 2012 and even for a few, 2013. Also, consumers now can do research so easily that a dollar [in rate] will shift demand, especially in the mid-priced segment.

ONLINE TRAVEL AGENCIES: ARE THEY YOUR FRIENDS OR FOES?

Habeeb: I recognize the contribution they make to the industry, but at one time, the smartest GM in the market drove the rate environment and the other properties would position themselves against him or her. Now with the OTAs, it's like Jack Nicholson in *One Flew Over the Cuckoo's Nest*. The craziest person in the market is driving the bus and everyone else is behind them following suit. Until we can learn to use those channels correctly the OTAs are going to be foes of ours.

Pierce: When you run at 65-percent occupancy every night you're 35-percent unoccupied, so give [the OTAs] the inventory, give them as much as you want, then pull back on it and close it out.

Strebel: From a marketing standpoint, the OTAs help encourage travel. They have massive marketing budgets and that puts the world of travel in people's minds. A lot of people shop on Expedia, but if you're a good brand and they believe in your brand, they'll come back to you to make the reservation.

Bloss: Yes, but the money they've obtained to spend on advertising came from the real estate assets of hoteliers.

WHAT KIND OF ADJUSTMENTS TO THE COST SIDE OF THE BUSINESS ARE YOU GOING TO HAVE TO MAKE AS DEMAND RISES BUT NOT NECESSARILY RATE?

Habeeb: 2011 is going to be a year of givebacks. The brands are going to look for a return to the normal capital cycle, and many of the brand standards that were relaxed over

READY TO REBOUND

the last year are going to be put back into force. Team members who accepted small or no pay increases are going to see things are starting to improve and look for [pay increases].

Hanson: If we look at what happened following other periods of unfavorable performance—1973, 1979, 1990 and 2001—margins increased and remained more favorable after every one of those cycles. The industry learned to do as much or sometimes more with less, and margins and profits increased. It's almost unbelievable to look at 1990, when the industry lost \$5.7 billion at 63-percent occupancy. In 2010, we had about 58-percent occupancy and made a \$13-billion profit.

IS THE RISE OF THE SO-CALLED SOFT BRANDS A FAD OR A LONG-TERM TREND?

Strebel: I see it as a long-term trend. Since there's no new development, you're left with a lot of hotels that are somewhat unique. They need distribution, but they don't fit into the Marriott system, or the Sheraton system or the

Wyndham system. Also, consumers will drive the trend because they like unique experiences.

Bloss: The Millennials are coming of age. They're going to be the biggest consumers in the history of America, but they're not brand-conscious. So where to you and me, it was apple pie and Chevrolet, to the Millennials, brands don't mean much.

WHAT KIND OF EFFECT WILL FINANCIAL REFORM HAVE ON THE INDUSTRY?

Gutstadt: One of the hot topics of the moment is what CMBS 2.0 will look like. Getting that right is going to be crucial to the reentry of not only lenders, but also investors in the market because what you've seen through this last cycle is absolutely chaos with respect to situations like the controlling class holder in a CMBS deal. Cleaning up that structure is going to be crucial and that's one of the major financial reforms that is underway.

For a more complete transcript of the Roundtable and a video presentation of the event, go to the Lodging Hospitality website: www.LHonline.com.

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