By Rick Swig

How Investors Handle Issues Today Will Impact Next Year's Results

A LOOK BACK AT WHAT HAPPENED IN THE HOTEL industry in 2008 can give one a case of whiplash. Conditions are mixed in terms of both asset productivity and transaction activity. Investors are either in a deep depression or mildly exhilarated, depending upon a property's location.

For example, high fuel costs are having varying impacts on different markets. Hotel owners in Orlando, Las Vegas, the Caribbean and Hawaii have already experienced the effect of higher fuel expenses through the shuttering of low-cost airlines and fare increases by traditional commercial carriers. As the surviving airlines fulfill their promises of reduced capacity to "unprofitable" destinations, hotels in these locales will be further harmed.

Conversely, gas prices have increased the instances of "stay-cations" or visits close to home. National parks and their surrounding destinations were packed this summer as families jumped in the car instead of getting on an airplane. Major destination cities that are surrounded by dense population bases, like San Francisco and New York City, also enjoyed solid regional demand and related revenues.

While currency devaluation made offshore destinations unattractive for US citizens, favorable exchange rates for international travelers provided a windfall for hotel owners. European channels, such as bookings.com or venere.com, moved buying habits away from traditional travel packages and opened up even more destinations to those wishing to visit non-traditional US locations.

The currency windfall may collapse, however, as the United Kingdom and other European countries are beginning to feel the impact of their own withering economies. Though this is no prediction for currency parity, vacationers, primarily Europeans, who enjoyed the super-sale in the US may not have the financial capacity to sustain their purchasing power in 2009. And if hoteliers are looking east for the Chinese and Indian traveler invasion, do not expect it next year. The infrastructures for providing mass travel services to the emerging markets are simply not in place yet.

Meanwhile, owners in primarily corporate destinations are probably feeling crushed this year. Corporate travel managers and meeting planners have mandated reductions to conserve profitability. This comes at a particularly bad time for operators because travel managers will take the mood and emotion of the moment to negotiate their full-year 2009 room rates. It is critical for owners and operators to remember that the annual contract signed today will impact their profitability for at least the immediate future, if not well beyond. There are still hoteliers who rue the days they made deals with radically discounted room rates during the 2002 and 2003 downturns.

Transaction activity has been reduced to a virtual crawl. There is no lack of equity capital to generate sales, but the bid/ask gap and the lack of financing are clouding the path. The bid/ask spread will only grow hazier due to some of the differences between markets. Buyers will have to figure out why and how they should purchase assets due to broad cap rate spreads. Markets with the most diversified demand feeders will command a premium. Secondly, potential buyers may be forced to predict market rebounds based on comparable historical trends, as well as fundamental market strengths and weaknesses.

As cap rates increase in conjunction with lower NOI performance, the valuation multiples may lead to pricing that seems insanely below replacement cost. As brokers or owners entice buyers with thoughts of underperforming environments with great upside potential and critically below-replacement cost valuations, buyers will either be lured into a questionable deal or actually make a reasonable and profitable purchase.

Confusion and lack of clarity define 2008, and no further rescue or annual performance enhancement is possible at this point.

Confusion and lack of clarity define 2008, and no further rescue or annual performance enhancement is possible at this point. The focus must be on decisions made today that will have a direct impact on 2009 results. It is important to recognize cyclical behavior to understand that tomorrow will not resemble current conditions. ◆

The views expressed in this article are those of the author and not Real Estate Forum.

Rick Swig *is president of RSBA & Associates, a hospitality industry consulting firm based in San Francisco. He may be contacted at rickswig@rsbaswig.com.*

Reprint Orders: www.remreprints.com
Enter Code 110810