Hotel Investment Today

Capture opportunities in primary urban markets

With some hotel owners running out of patience and cash, city center hotels could offer bargain pricing and ample upside over a five-to-10 year hold target.

NATIONAL REPORT from **ISHC** -- Hospitality industry headlines often boast about the high per-room values and exorbitant sale prices. On average, hotel asset values remain high despite the current **financing challenges**, particularly rising interest rates.

However, it's important to keep in mind that this high pricing level is being driven primarily by the allure of luxury resort properties which have led the post-pandemic recovery. Cases in point are the 260-room Montage Resort Hotel in Laguna Beach, California, which sold for $614 million last year, setting a statewide record for California, and Arizona's 210-room Four Seasons Scottsdale which posted a $267.8 million price tag in 2022.

Stephen Hennis

With downtown markets still lagging the recovery curve (2022 urban occupancy sat nearly 10 points below the 2019 metric: 63.3% vs. 72.8%), many urban hotel assets are selling at "rollback" pricing, providing an opening for opportunistic investors.

City center potential versus resort appeal

For years, even decades, many hotel investors exclusively targeted assets in primary urban markets. While city center locations typically have a high cost of entry, they generally have been considered safe investments. Though their performance is more volatile during economic swings, urban hotels historically not only retain most of their underlying value, but also appreciate faster than the general hotel inventory.

For these reasons, the portfolios of many REITs and institutional investors are still heavily weighted toward downtown lodging facilities. Nevertheless, such investors have decided to divest some urban properties as they shift their strategy. In the process, many of them have taken a calculated hit on returns due to sliding asset values.

A review of urban hotel transactions since the beginning of 2022 illustrates that value appreciation for investors averaged a mere 0.7% annually over the hold period (nine years on average). In sharp contrast, resort asset transactions demonstrated an astounding 7.4% annual appreciation.

Driven by strong leisure demand (aka revenge travel), resort properties are well ahead of the recovery curve in this cycle. The table below summarizing the key transaction stats illustrates the juxtaposition of the two sectors.

	Avg Annual Appreciation	Avg Hold Period (yrs)	Assets Sold at a Loss
Urban Centers	0.7%	9.1	52%
Resort Markets	7.4%	8.2	8%

Based on transactions from January 2022 to present

To put this in perspective, urban hotel transactions show a 6% total increase in value over the past nine years, while resorts are selling 79% above their initial investment. This obviously has a significant impact on returns as the bulk of a hotel owner's payout is usually garnered upon disposition. Long-term investors may have recovered some of their equity via refinancing during the hold period, but more recent buyers are taking a negative hit to returns.

Contrarian risks, rewards

More than half of the downtown properties transacted over the past 15 months were sold at a loss. And it's important to note that none of the sales analyzed was considered distressed. Despite the fact that corporate travel and conference attendance is expected to drive downtown occupancy recovery this year, many investors have lost their patience, opting to dispose of urban assets and reinvest their residual equity elsewhere.

There are certainly some downtown markets where asset pricing continues to rise. The development hotbeds of Austin, Nashville and Miami have seen strong value growth. Meanwhile, traditionally strong core markets like Chicago, New York City and Washington, D.C. have experienced slides in value.

	Avg Annual Appreciation	Avg Hold Period (yrs)
Chicago	-3.3%	11.6
New York	-2.8%	12.1
Washington DC	-0.7%	10.6
Austin	4.1%	11.5
Nashville	4.7%	7.4
Miami	4.9%	7.7

Based on data from January 2022 to present

Clearly the dynamics of downtown markets have changed following the pandemic. Hybrid office environments, fewer retail stores, high labor costs, rising crime rates and expanding homeless populations are just a few of the factors affecting real estate in the urban core. Potential buyers must be willing to manage through the near-term uncertainty to profit five to 10 years down the road.

We have seen similar storylines before. Remember in previous economic downturns when resort properties were viewed as having significant risk due to the high reliance on leisure travel, the segment dependent on a strong economy to drive higher wages and disposable income? Well, look at where resort asset pricing is now. As leisure business proved to be most resilient during the pandemic, resorts are the darling of investors.

As market trends have demonstrated consistently, everything is cyclical, from taste in fashion to the appeal of various investment sectors. Urban hotel assets are no different. They will return to their prominent position in the hierarchy of hotel investments over the course of the next economic expansion. Right now, some urban hotel trades exhibit sale prices 40% to 50% below peak market values. Without a doubt, those investors who take advantage of current pricing levels will reap the greatest rewards.

Stephen Hennis has over 29 years of experience in the analysis of lodging real estate investments. Prior to establishing Hotelogy, Hennis oversaw the successful launch and expansion of STR's consulting arm.

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