



# NEWS

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## **Pent-up Demand Foreshadows Upbeat Year for Hotel Real Estate Sales**

According to an informal survey conducted by Hotel Brokers International, hotel real estate sales were brisk in the first quarter of 2003 and are expected to remain active throughout the year.

The survey of HBI members reveals that behind the accelerating pace is pent-up demand by buyers who have been sidelined by an unstable economy for the past 18 months. Concurrently, a number of owners are ready to dispense with properties for personal or economic reasons. Brokers say they do not expect to see the tidal wave of properties rushing onto the market such as that following the Gulf War recession, but they are witnessing a swell in activity for the first time since September 11, 2001.

Brokers surveyed report relatively few foreclosures and agree that the much-anticipated torrent of troubled CMBS loans, which was predicted to increase the number of properties on the market, has failed to materialize.

“Lenders are much more reluctant to take back a property than they were a decade ago,” said Ron McCord, CHB, CHA, HBI president and president of Milmark Hotel/Motel Investments. “Banks learned in the last recession that hotels are a special class of real estate that requires expertise not normally found at a lending institution. They generally concur that it is better to have a non-performing loan than an asset that is going to eat up equity.”

As a result, banks are granting more flexible payment terms to delinquent owners and are much more willing to restructure loans. Nonetheless, lenders are pressuring owners either to stay current with loan payments or sell. And, as economic recovery continues to stall, pressure to sell continues to mount for these troubled property owners.

Brokers also report a narrowing gap between buyers and sellers. Sellers are becoming increasingly motivated, while buyers are more willing to adjust for the current economy. As a result, the majority of new transactions are compromises reflecting both the reality of today’s trailing economy and the bull market of just a few ago.

Brokers say that capitalization rates have declined slightly but continue to be property-specific. While the majority of cap rates hover between 10 percent and 12 percent, some are as low as 7 percent, others as high as 19 percent.

Interest rates remain low, but lenders are cautious and continue to require between 25 percent and 35 percent down.

### **Best-selling Properties**

Survey results indicate that branded, mid-market properties without food and beverage continue to be the most sought after. Secondary and tertiary markets, particularly “drive-to,” are the most popular. Urban and airport markets, which are heavily influenced by travel rates, face the greatest challenges. In smaller communities, hotels with between 50 and 75 rooms are highly favored.

Although real estate inventory remains low, listing activity is increasing. Buyer interest is high, boasting a variety of potential investors, and a substantial number of private equity funds are seeking upscale properties. Wall Street and most real estate investment trusts (REIT) are on the sidelines, although some, like Winston Hotels, have formed joint-venture partnerships with private equity groups to acquire hotel real estate.

Buyers of mid-market hotels tend to be small companies and individuals. The survey reveals that the Asian-American community has been active for both buyers and sellers, accounting for about 50 percent of all transactions in the segment. Asian-American interests are increasingly directed toward larger, brand name hotels.

Still, lenders are accessible, especially for transactions valued at less than \$6 million, but equity requirements remain high. The Small Business Association and regional banks are the primary market makers.

### **Regional Outlook**

New England/Middle Atlantic—Brokers are optimistic that 2003 will be a strong year. The scarcity of full-service properties, lower land prices and less competition for loans may make this an ideal time to build for buyers with enough equity and patience.

South Atlantic – The “drive-to” market is returning throughout the region, especially at popular tourist and destination stops. As business travel continues to increase in major metropolitan areas, brokers are encouraged by first-quarter sales results and are optimistic about the promise of a fourth-quarter increase in sales activity.

North Central —Brokers report high interest from regional companies as well as a noticeable increase in the number of East and West Coast buyers. Coastal investors regard properties in the Midwest as better values for the money, compared with those in other markets.

South Central —Some major markets, including tech-oriented cities, are experiencing difficult times. However, waning real estate transactions are on the upswing. Look for transactions to increase during the next six to 12 months. Secondary and tertiary markets already are seeing an increase in activity.

Mountain/Pacific Coast— Valuations based on traditional formulas have dropped appreciably. Only must-sell properties remain on the market. However, because the barriers to new competition are so high in markets such as San Francisco, the underlying value of real estate also remains quite high. In non-urban markets, limited-service properties in “drive-to” locations are most popular. Properties available for sale are hard to find, but an influx of hotels appears to be looming on the horizon.

### **Looking Ahead**

Overall, said HBI president McCord, 2003 is predicted to be a successful year for both buyers and sellers.

“In the long run, real estate is a safe harbor,” he said. “The industry currently is in a difficult economic environment. Geopolitical events still cloud the short-term outlook, but the industry will rebound. Development is at a cyclical low, and interest rates remain quite attractive. As the economy gains strength, hotel profitability will improve.”

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