

Nov 21, 2005

By: Jeff Higley

Hotel & Motel Management



Angelo Stambules of GMAC Commercial Mortgage and Debi Ethridge of Lodgian discuss the popularity of different asset classes during a LIIC roundtable.

PHOENIX—Hotels are selling like hotcakes at a lumberjack camp, and members of the Lodging Industry Investment Council said during the group's September meeting that there is no apparent end to the deal making in sight.

But there is one dynamic in the transaction pipeline that worries some LIIC members: Few buyers are in line for the basic, middle-of-the-road hotels that are on the block. Meanwhile, much like the hungry tree-choppers at breakfast, hotel buyers are clamoring for the big, fluffy assets to fulfill their appetites.

Bob Alter, c.e.o. of San Clemente, Calif.-based Sunstone Hotel Investors, said that nearly every buyer wants to acquire an asset such as the 351-room Hilton Glendale (Calif.) like Eagle Hospitality Properties Trust did for \$79.8 million earlier this year.

"There's a huge disconnect in this market relative to the size of assets," Alter said. "Try to sell some Holiday Inns out there. Try to sell some secondary hotels. The cap rate is significant because there are not that many buyers. You get into that midsize, what I call a \$10-[million] to \$20-million deal, that's the wrong brand in the wrong market, and there's not many folks out there who want to buy it. We're focused on what Wall Street wants, both from a buying side as well as a lending side."

Since 2001, Sunstone has closed on 19 hotels representing more than \$618 million in aggregate purchase price. Its minimum price for an acquisition is \$15 million.

Larry Shupnick, senior v.p. of development and acquisitions for MeriStar Hospitality Corp., said his company has faced that scenario with some of the assets it has sold as part of a major disposition program the real-estate investment trust has undertaken during the last three years.

"We still have about 15 [hotels] or so that we're in various stages of selling right now, and some of them don't have a cap rate," he said. "We have two or three of them that don't have a bottom line. They're basically being sold by the pound. It's the goals of someone else, in their eyes, and what they could do with the asset."

Debi Ethridge, v.p. of finance and investor relations for Atlanta-based Lodgian, said just about the entire roster of hotels the company had on its disposition list fall into the flat-as-a-pancake category.

"That was almost my entire list of 20 assets—people would ask me what the cap rate is, and I said that's just laughable to me, because I'm selling hotels with negative cash flow," she said. "Everything I've sold is by the pound. I mean, it's a whole different ball game. You are talking two opposite ends of the spectrum. I'd love to get the kind of loans that Bob and Sunstone were able to get. I just know that if I were out there in the market, I've got a different asset class than these great Renaissance properties he's buying. And you have to understand your place in the food chain, if you will."



Bill Blackham, president and c.e.o. of Eagle Hospitality, said lenders feel pressure to lend capital to the lodging industry.

Changing paradigm

LIIC's mission
The Lodging Industry Investment Council is an industry think tank that meets three times annually to discuss hotel finance, development and operations issues. Its 70 members include consultants, lenders, operators, developers, educators and legal professionals.
Co-chairmen of LIIC are Mike Cahill of Denver-based Hospitality Real Estate Counselors and Sean Hennessey, president of Lodging Industry Advisors. Vice chairman is Jim Butler of Jaffer, Mangels, Butler & Marmore, a Los Angeles-based law firm. LIIC's Web site is www.liic.org.

LIIC's mission

The appetite for upper-end hotel assets has not wavered during the past two years because of the reputation the lodging industry has cultivated during this economic upturn.

"The rating agencies have turned a corner for someone in hospitality," said Angelo Stambules, v.p. with GMAC Commercial Mortgage Corp. "With the last cycle that we've been through, they have come to terms with the fact that lodging is not as ugly as they previously thought."

That new-found beauty comes from the idea that hotels are real-estate assets instead of only operating assets.

"Hotels are being treated a little more like real-estate by the rating agencies, and to that extent, some of those structural features that the rating agencies really held hard and firm on, have loosened," Stambules said.

Mike Cahill, LIIC co-chair and president of Hospitality Real Estate Counselors, said this is a major breakthrough for the hotel industry.

"I went to a real-estate summit last week that had an interesting panel where they had the chief investment officers of several major international funds, and they actually spoke of hotels, scarily, like real-estate," Cahill said. "I always looked at hotels as an operating business that happens to have a large real-estate piece. They see this as a shifting paradigm. If somebody ever told me they would loan me on a 5.5 [percent] interest rate [for a hotel], I would have probably told them never in my lifetime would I see that hotel transaction. It's almost too good to be true. Maybe this is the way the world is going to be now."

Bill Blackham, president and c.e.o. of Eagle Hospitality, said lenders feel pressure to lend capital into the lodging industry.

"Somebody was showing me some graphs and statistics that suggested that relative to other asset classes, the hospitality industry in relationship to recovery cycles and patterns and state of recovery, etc., was stronger on a fundamental basis," Blackham said. "The pricing, as cheap as it may seem, in the hospitality assets relative to some other asset classes, is still strong."

Marilyn Weitzman of consulting company The Weitzman Group said the long-term answer will come when it is determined if the shift is cyclical or a structural change in the real-estate industry.

"We've all seen a tremendous amount of [capitalization] rate compression without any real growth in bottom line in many types of real-estate," she said. "But there are many experts who are saying this is a real sea-change, and that real-estate as an asset class will continue to be a larger portion of investment by pension fund monies and by international capital. If it is correct, then we'll see some minor raises in cap rate, but are we going to see cap rates that are 400 or 500 basis points higher? Likely not, because there's too much capital chasing too little good real-estate."