NATIONAL REAL ESTATE Investor®

Hotels Might Be a Good Bet for HNW Investors, But Which Types Should They Focus On?

Full-service properties may offer higher yields, but select-service hotels are less expensive to operate.

John Egan | Dec 10, 2018

If the hotel sector was being reviewed on a website like TripAdvisor in terms of 2019 opportunities for high-net-worth (HNW) real estate investors, some segments of the industry might earn five-star status, while others might be a couple of notches lower. But just as with guests' opinions about hotel properties, real estate professionals don't see eye to eye when it comes to which types of hotels are white-glove picks for HNW investors and which ones have room for improvement.

Still, industry experts say the lodging industry could open the door to appealing yields for HNW investors in 2019 . In the past several years, hotels have become a "very attractive investment vehicle" for HNW individuals, many of whom are first-time players in the sector, says Lou Plasencia, chairman and CEO of The Plasencia Group, a Tampa, Fla.-based firm that specializes in hospitality sales, investment consulting and advisory services.

"High-net-worth investors are now getting stronger risk-adjusted yields out of hotels than apartment buildings, medical office buildings or the stock market," Plasencia says.

That being said, which segments of the hotel sector hold the most potential for strong risk-adjusted yields?

From Plasencia's perspective, HNW investors might be better off buying full-service hotels and resorts in 2019, as opposed to limited- or select-service properties, especially if they plan to hold the assets for at least 10 years.

"Select-service properties are generally less complicated operations, but they also do not offer the opportunity for enhanced asset appreciation over time," Plasencia says. "Consider that in any given market there may be at least 10 to 15 select-service properties for every one full-service hotel, and there are at least 10 to 15 full-service hotels for every one luxury resort. The law of supply and demand definitely kicks in."

Select-service hotels also deliver less opportunity for value-add improvements and long-term appreciation, he adds.

In the estimation of Rob Goldstein, assistant portfolio manager for real estate securities at Plymouth Meeting, Pa.-based CenterSquare Investment Management LLC, HNW investors might want to be careful about limited-service hotels in 2019.

"Given the elevated construction pipeline as a percentage of stock within the limited-service segment, we're cautious on the competitive landscape for existing limited-service hotels, particularly in suburban locations where demand may not be as robust as in urban environments," Goldstein says.

Meanwhile, Michael Ward, a commercial real estate attorney in the Atlanta office of law firm Culhane Meadows PLLC whose practice includes hotel transactions, suggests potentially shying away from older properties, as they're less able than newer properties to compete for travelers' dollars. Nonetheless, compelling prices and cap rates for an older hotel could swing that philosophy in the other direction, according to Ward.

HNW investors should be hunting next year for opportunistic turnarounds (assets that have been through bankruptcy or have been mismanaged, for instance) and distressed properties in the hotel sector, according to Peter Anadranistakis, co-founder and president of Phoenix-based hotel investment and management firm Oxygen Hospitality Group. On his radar are recently de-flagged hotels with 100 to 150 guest rooms.

“These situations offer the ability to reposition the asset through rebranding, renovation, redevelopment, new management and cost control,” Anadranistakis says.

For 2019, data suppliers STR and Tourism Economics anticipate the highest revenue per room (RevPAR) growth for the hotel sector will be in the luxury, midscale and independent segments.

As opposed to some of his industry counterparts, Daniel Marre, co-chairman of the hotels and leisure practice at Seattle-based law firm Perkins Coie LLP, says he prefers to zero in on hotels by market rather than by sub-type.

For instance, Marre says he’d steer clear of developing a full-service hotel in Chicago, as that property type has flooded the market in recent years. On the flip side, he says he’d be tempted to invest in secondary markets like Minneapolis and Charlotte, N.C., that are growing but aren’t over-saturated.

Along those lines, Plasencia says gateway markets like Chicago, New York City, San Francisco and Los Angeles could face headwinds in 2019 due to rising labor costs, as well as labor-union activity. In addition, Plasencia expects hotels in places such as Louisiana and Texas to see a spike in property insurance premiums next year. However, Texas, Florida and other states with sunny climates could enjoy a spike in traffic from big-spending international travelers, he adds.

STR and Tourism Economics predict 23 of the top 25 hotel markets in the U.S. will notch growth in RevPAR this year, with double-digit increases on tap for Chicago, Miami, Minneapolis, Philadelphia and San Francisco.

When looking at geography, Marre notes that one property type might perform well in a certain market, but not in another. For instance, a luxury hotel—while extremely expensive to operate —could be a good investment in the right market at the right time.

“On the other hand, limited-service hotels, while not as sexy, are more profitable to operate and probably, in the long run, a better bet to a steady return,” Marre says.

However HNW investors decide to capitalize on the hotel sector, they should proceed with caution, experts advise. Unlike an office building or a warehouse , a hotel is a business with employees, inventory and other concerns, notes Cliff Risman, chairman of the hotel and leisure practice at Dallas-based law firm Foley Gardere LLP.

“High-net-worth investors who jump into a hotel deal because they think it’s sexy, or because they like having dinner there, many times go away licking their wounds. It’s a complicated business,” Risman says.

Nonetheless, it’s a business where overall performance in 2019 promises to be somewhat on par with 2018.

STR and Tourism Economics forecast that all of the key indicators for the U.S. hotel sector are expected to dip slightly from this year to the next. For instance, the firms predict occupancy growth will decrease from 0.4 percent this year to 0.1 percent in 2019. Meanwhile, ADR growth is projected to decline from 2.6 percent to 2.3 percent, and RevPAR growth from 3.0 percent to 2.4 percent.

Marre warns that although ADRs and other hotel fundamentals remain sound, some markets are overbuilt and can't absorb any more properties.

"Because we seem to be in a mature part of the economic cycle and no one knows when it will enter a downturn, one should be realistic when it comes to hotel investments," he says. "Hotels … are the canary in a coalmine for the real estate industry because every room has to be repriced every night. When the economy turns down, the hotel sector will feel it first."

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