

LODGING

INVESTMENT

ROADMAP

SPRING 2024

WHAT INNING ARE WE IN?

By Lou Plasencia

There was a time not too long ago where it was commonplace to relate where the hospitality investment sector stood in the economic cycle to a baseball game. What may have once been a clever way to relate a murky, academic concept became such an overused cliché that if it were a drinking game at the NYU Conference, we'd all end up stumbling around the Marriott Marquis by lunchtime.

We at The Plasencia Group would bet that most of us in the commercial real estate investment space miss that simpler way of marking our industry's position. Indeed, it's been several years since we, as a lodging investment community, could all feel relatively comfortable that we were on the same page about where we'd been and where we were headed. We haven't had that degree of clarity for what seems like ages.

To carry the baseball analogy forward, the lodging investment industry remains in what has been a fairly prolonged and unpredictable rain delay, marked by sporadic transactions occurring between unprecedented periods of inactivity.



HOW WE GOT HERE

The reasons for our collective doldrums are well documented. A massive runup in interest rates has made it much more expensive to finance a hotel, creating a pricing gap between what an owner paid at a time when debt was much cheaper and today's price expectations. Then, instead of rates coming down in early 2024 as was widely anticipated, the Federal Reserve has held them high to combat pervasive inflation. This capital markets turmoil, paired with operational ups and downs – leisure demand surging and normalizing, corporate business slowly yet steadily returning post-pandemic, a resurgence of group business, all countered by increasing labor and insurance expenses – has made price discovery very inconsistent, so much so that the transactional market is highly inefficient today. Hotel sale processes in the current environment are characterized by broad spreads between the top and the bottom bid, and going from letter of intent to purchase and sale agreement to closing feels more tenuous than ever.

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In our view however, the biggest contributor to the lodging investment sector's current predicament is what we define as investor inertia. The foregoing factors have slowed transactional volume to the point that making the decision to sell or buy feels truly radical today. Innumerable assets need to be sold, and a veritable tsunami of capital needs to be deployed, but because the market is so dislocated at present, both voluntary sellers and would-be buyers remain inactive. There is the perception of safety through inaction today.

WHERE WE ARE GOING

Thankfully, the current capital markets environment will continue to evolve, as will the psychology of investors in the hospitality real estate space.

Ultimately, the industry will return to normalcy. The Fed will cut interest rates. Whether those rate step-downs return our economy to near 0% rates, or whether those cuts are largely symbolic and “higher-for-longer” is here to stay is yet to be seen, but in our view, the Fed's impending activity is as clear-cut a catalyst for increased transactional volume as there is. A number of assets were earmarked for disposition in 2024 and set to launch on the heels of the first expected rate cut. Although this first step-down in rates may materialize six to nine months later than originally contemplated, many prospective sellers will use such an event as the impetus to sell.

Loan maturities will also provide fertile ground for transactions. Many loans that are collateralized by hotels cannot be refinanced without a capital infusion due to the heightened cost of debt and its implications for debt yields and debt service coverage covenants. As such, there will be situations where



a sale is the best path to paying off the existing debt and recouping at least some equity. Hotels that are under water will be subject to short sales, where borrower and lender work in tandem to facilitate a transaction. This is an efficient way to keep lenders out of the chain of title, which is often their goal.

Transactions could also be triggered by the buildup of CapEx needs at hotels across the country. CapEx-intensive to begin with, many hotels have been starved of capital as brand obligations were waived during the pandemic and capital reserve accounts were drained to service debt. There's also no certainty that owners will receive a return of or on the capital invested in many of these projects, creating a real incentive to pass along deferred capital needs to the next owner. All of this occurs against a backdrop where labor and materials cost more than ever.

End-of-life challenges for many equity funds will also drive increased sales activity. For many hotels in varied and vast pockets of the country, the recovery over the last three-plus years has not played out evenly or adequately. Investors who have extended their investment horizons waiting for a brighter day are reckoning with today's new RevPAR, operating, and CapEx paradigms. Many owners and investors will elect to allocate the dollars in their coffers to fresh opportunities.

We are most convinced of an expeditious return to a normal market propelled by the unprecedented amount of dry powder sitting on the sidelines today. At some point in the near future, the pressure to deploy capital will overcome the inertia we're currently experiencing. We expect the floodgates to open at that point, as ample capital is matched with the ample opportunities waiting in the wings. We've recently seen several large industry players get off the sidelines; their example should help the industry build the momentum it needs.

IN CONCLUSION...

We at The Plasencia Group believe the lodging sector has yet to turn the corner, but the end of our current lethargy is in sight. When compared to other asset classes, hotels and resorts present very attractive investments. We are bullish about the next 24 to 36 months. We look forward to working with you to capitalize on what is expected to be a very active period for the hospitality investment community just around the bend. In the meantime, we encourage would-be buyers and sellers to be trailblazers. There is a real advantage to being among the first to move, and given the interconnectedness of our industry, you won't be leading the charge alone for long. This could be the first inning of a very long nine-inning period of prosperous growth!

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WE'RE EAGER TO PARTNER WITH YOU

Our team stands ready to assist you not only with investment advisory services but also with loan workouts, note sales, refinancing, owner representation, and development management consulting. Our experience through several economic cycles can add value to forthcoming decisions regarding your current and future hotel and resort portfolio.

For more information on how we're assisting our clients through this cycle, don't hesitate to reach out and contact any member of our team by calling us at (813) 932-1234 or learn more about us on the web at tpghotels.com. There, you can find details on the services we're providing to owners, investors, lenders, servicers, and others with hotel interests. Until then, we hope you and your families remain happy, healthy, and safe. We look forward to speaking with you soon!



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About The Plasencia Group

In 1993, The Plasencia Group was formed to provide hotel and resort owners investment advisory services at a personal level. Thirty-one years and hundreds of engagements later, we still have the privilege of making our clients successful with the passion, access, and certainty they've come to expect. Our firm offers investment sales, owner representation, asset management, development and renovation management, debt and equity sourcing, and advisory services to hotel and resort owners throughout North America.

Contact us today if our experienced advisory team can assist you in evaluating your current portfolio and strategizing for the weeks and months ahead. We look forward to the opportunity to serve you.

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