

Should You Buy, Sell or Hold?

HOTEL REAL ESTATE IN A SLOWING ECONOMY

BY JERRY DALY

With the sub-prime meltdown that began last summer, the overall U.S. economy has been slowing. In Florida, the building binge of the past three years, due to hurricane repair and the condo boom have abated, resulting in a noticeable drop-off in occupancy in hotels that serve the transient building trades. This decline has been somewhat offset by an influx of international travelers who are taking advantage of the low U.S. dollar.

Few industries are as closely tied to the economy as the hotel industry. And, hotel brokers nationwide are receiving a substantial number of questions from owners across the state and country: "Is this a good time to buy, sell, or hold?"

Two Florida brokers, Edward Xanders, CHA, president of Tallahassee-based Lodging Realty Services and Tony DeGeorge, CHB, president of Clearwater-headquartered Greene Canfield DeGeorge LTD say the answer for Florida hotel real estate is an unequivocal: "It depends."

National Trends

The two brokers pointed out recent pricing trends and outlined various strategies for the current Florida hotel real estate market based on their experience and a comprehensive database maintained by their organization, Hotel Brokers International (HBI), the nation's largest hotel brokerage group with more than 30 offices nationwide.

HBI's database tracks all public hotel real estate transactions and publishes the information annually in its TransActions Recap. In 2007, researchers recorded 736 hotel sales nationwide, totaling \$22 billion. This is up from 583 transactions in 2003 and down slightly from the high of 756 in 2005. The average size of the hotel sold has remained consistent over the past three years, with the norm in 2007 at 196 rooms. The average selling price per room last year was \$117,000.

This data covers all hotel segments from budget to luxury. The accompanying chart (2007 Hotel Sales by Segment) breaks down the number of transactions by segment, average number of rooms and average selling price per room.

The South Atlantic region, which includes Florida, remained the most active with 217 transactions at an average size of 186 rooms and average selling price of \$103,000 per key. HBI recorded 70 Florida transactions in 2007. The largest Florida sale last year was the 385-room Sanibel Harbour Resort & Spa, Fort Meyers for \$135 million, or \$351,000 per key.

Nationwide, suburban and highway locations were the most frequent transactions, with 300 suburban sales at an average of \$96,000 per key, and 130 highway sales at an average of \$45,000 per room.

National cap rates averaged 9.21 in 2007, essentially flat from 9.19 percent in 2006. Cap rates for the 2008 first quarter were 8.84, compared to 9.08 percent in the same period a year ago.

Industry-wide, hotel transactions have dropped off sharply in the 2008 first quarter, with 115 sales compared to 195 transactions in last year's first quarter. Transaction size also has declined from 215 rooms to 122 rooms and \$131,000 per room to \$82,000 per room, versus the 2007 first quarter.

Hotel Sales by Property Segment

Property Segment	Number of Transactions	Average # of Rooms	Average Selling Price per Room
Economy	135	106	\$31,000
Midscale w/o F&B	130	112	\$72,000
Midscale w/ F&B	92	166	\$55,000
Upscale	193	194	\$133,000
Upper Upscale	163	356	\$186,000
Luxury	23	221	\$479,000
Grand Total	736	196	\$117,000

Source: TransActions Data Services (2007)

"The credit crunch and concerns about the economy are the root causes of the slowdown," said H. Brandt Niehaus, CHB, president of HBI and Louisville-based Huff, Niehaus & Associates, Inc. "Because of tighter bank lending practices, there is a scarcity of debt to do larger deals. The publicly held companies have for the most part stepped to the sidelines, and there are only a handful of large private funds that still have capital. As a result, the mega-transactions involving upper upscale and luxury properties have declined sharply."



Only nine transactions in those two segments were completed in the first quarter, compared to 66 in the economy and midscale without food and beverage, the two most active segments. Smaller transactions, \$8 million and lower, are still getting done, largely because there are adequate sources for loans, primarily local banks and SBA lenders.

HBI offices have run counter to the national trends, selling 28 hotels in the 2008 first quarter, compared to 22 in the prior year same period. This pace continues in the second quarter.

Florida Trends

"The overall Florida hotel real estate market remains attractive," Xanders of Lodging Realty Services said. "There are a few markets that have some overbuilding issues, most notably Tampa and Miami, but this is still a good time to be in the hotel business in Florida. Limited-service properties remain the most sought-after property type. Cap rates for this segment currently range from 9 percent to 12 percent, depending on location and age of the hotel. Luxury properties are trading in the 6 cap rate range."



Tony DeGeorge



Ed Xanders

An important subset of hotel real estate are bed and breakfast properties, with more than 400 such facilities throughout the state. "Our office does a lot of transaction in this segment and the market for bed and breakfast properties remains quite strong," Xanders noted. "B&B transactions are as much a lifestyle decision as a real estate acquisition decision and are treated as a residential real estate transaction by lenders. Currently equity requirements are in the 20 percent and higher range."

Prices for a typical bed and breakfast begin at around \$100,000 a room, which includes furniture, fixtures and equipment, good will, historical

name and the URL address. "We are seeing a lot of activity, and don't expect the current economy to have much impact on this segment."

Sell Now?

In the current changing economy, the decision to sell, buy or hold is based on a number of different conditions specific to each property. "There currently is about a 75 to 100 basis point difference between the buyer and seller, which is normal when the economy slows," DeGeorge of Greene Canfield DeGeorge said. "We expect that gap to narrow at the expense of the seller if the economy continues to soften."

Transactions are taking longer to complete, due to a more difficult financing climate. Sellers can expect a transaction to take 30 to 90 days longer than the norm of approximately six months to sell a hotel from listing to closing. "If an owner has a compelling reason, such as a major product improvement plan coming up, refinancing issues or the threat of major new competition, this is likely the best time to sell, in the next 12 to 18 months," he said.

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Buy Now?

The credit crunch meltdown has impacted the financing market. Higher equity requirements, now in the 25 to 30 percent range, are common. However, experienced owners with a proven operating track record still have little difficulty obtaining mortgages. Local banks, especially if they have an established relationship with the owner, currently are the best source. SBA loans also are available for deals under \$10 million to \$12 million. Interest rates remain at very attractive rates from a historical perspective. However, lenders are seeking more documentation. Personal guarantees are becoming more common.

"The financing markets have driven a lot of buyers to the sidelines," DeGeorge commented. "As a result, there is less competition for properties. Buyers with cash or good lines of credit should seize the opportunity to buy during this window of opportunity. If the deal you are considering makes sense in today's market, then you should think about buying one or more hotels per year. Five years from now, you will own an additional five to 10 hotels with much higher values and be in a position to never look back."

Hold Now?

"Owners who do not have a compelling reason to sell should consider all the factors involved," DeGeorge said. "Interest rates are at near historic lows, making transactions easier to pencil out and create lower cap rates. In a sluggish economy, buyers should determine if there are other higher return investment opportunities. If you're on the fence, contact a broker who specializes in hotels and get an opinion of value, as well as insights into your local market conditions. It will help you make a more informed decision and probably help you sleep more soundly.

"Regardless of market conditions, every owner should review his or her hotel portfolio at least once a year, just like you should with your stock portfolio," he added. "You may find you are too heavily weighted in one particular market, you may have a major product improvement plan review in several years, or you may be facing considerable new competition. All of these factors should be taken into account during the review."

Both Xanders and DeGeorge agree that the climate for Florida hotels remains sunny. Current market conditions offer something for the buyer, the seller and the owner who wants to continue to profit from the positive, long-term outlook for the hotel industry.

Jerry Daly is a contributor to FR&L Magazine and is president of Daly Gray, a Herndon, VA public relations firm specializing in hospitality issues.

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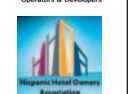
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