# 2013 Lodging Outlook: Developing Confidence

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Hotel Industry Poised for Another Strong Year

TMI Hospitality is developing two hotels down the road from its Fargo, ND headquarters: The Residence Inn, to the right, is scheduled to open in April and the Comfort Suites is scheduled to open in June).

Mitch Patel is betting big on 2013. His Chattanooga, TN-based Vision Hospitality Group has eight hotels currently under construction that should open this year, increasing his portfolio of 17 hotels by almost half. Patel isn't alone in his confidence.

Lauris Molbert, CEO of TMI Hospitality, has eight hotels under construction, six to open this year, and another eight will break ground. The Fargo, ND-based company formerly known as Tharaldson Motels has built more than 400 hotels through 30 years, but last year it celebrated a first: TMI bought a hotel and Molbert says more acquisitions will come this year.

Houston-based Boxer Property, known predominantly as a multi-tenant office buyer, made a splash in December when it entered the hospitality sector with the acquisition of the Pointe Hilton Tapatio Cliffs Resort in Phoenix. It was "not a one-off purchase, but rather a long-term commitment to hospitality," says Andrew Segal, Boxer's founder and president.

RockBridge Capital closed on more than $200 million in debt and equity placement in 2012 and Managing Director Bruce Lowrey says the Columbus, OH-based hotel investment firm is poised for more this year as the transaction market continues to improve.

There are plenty of reasons for the optimism. Industry-wide revenue per available room grew by 6.6% in 2012, according to preliminary numbers from STR, and PKF, PricewaterhouseCoopers and STR are forecasting growth in the 5% to 6% range this year. Supply growth remains muted at less than 1% and well below historical norms, while demand has continued to grow, according to those same firms. Jones Lang LaSalle Hotels projects global transaction volume will increase slightly to $32 billion as debt availability reaches its highest levels since 2007.

And with the presidential election in the rearview mirror and the Fiscal Cliff crisis averted, at least temporarily, two of the biggest unknowns are now known.

"I'm bullish on this business," says Vision Hospitality's Patel. "There has been a lot of uncertainty with what was going on in the world and through all that we had a pretty good year. So that gives us some confidence for 2013 and hopefully some of that uncertainty has been calmed down."

The Henry in Dearborn, MI saw a 35% increase in RevPAR last year, thanks to a rebranding and renovation from Greenwood Hospitality Group.

**Operating Success**

Tom Conran, a principal with Greenwood Hospitality Group, understands the renewed interest in lodging. His management company's portfolio of 10 hotels saw a 16.4% increase in RevPAR in 2012, led by The Henry's stunning 35% year-over-year growth after an aggressive renovation and rebranding in Dearborn, MI.

"The industry has experienced back-to-back years of record demand (up 2.8% in 2012), which coupled with limited supply growth (.5%), has fueled the increases in the other measurement categories," says Amanda Hite, STR's president. "It's been near ideal conditions for the industry to finally put the recession in the rearview mirror."

U.S. occupancy climbed 2.3% to 61.3% last year, while rate grew 4.3%. Occupancy will gain just .3% this year, according to STR's forecast, but rate will climb 4.6%. PwC projects RevPAR growth of 5.4% and PKF is slightly more bullish at 6.1%, both firms agreeing rate will be the driver.

In Dearborn, Conran says The Henry's success was a case of the stars aligning. Greenwood and its investment partner acquired the former Ritz-Carlton in 2010, a hotel originally developed by Ford Motor Company, and invested more than $7 million in a comprehensive renovation. The hotel was rebranded as the independent Henry, joining Marriott's Autograph Collection. The hotel's location was perfect, down the road from Ford's corporate headquarters in the heart of the Rust Belt, as was the timing of the reinvestment, just as the U.S. automotive industry shifted into high gear.

"There is absolutely as much opportunity in secondary space as gateway space," says Conran, whose company owns a stake in half the hotels it manages. "I think as the dynamics of the market have maintained pretty good progress in '11, '12 and now '13, investors today are a bit more optimistic and confident in hotel real estate."

Of Vision Hospitality's eight planned openings this year, only one is in a top 50 market (Nashville). All are select-service properties: five Hampton Inns (two are & Suites), two Fairfield Inn & Suites and one Residence Inn. Patel is quick to point out three of the Hamptons are replacing older Hamptons leaving the system.

"We're always concerned about overbuilding, but I don't think that's our case," Patel explains. He's buoyed by the success of his existing portfolio, primarily located in Tennessee and Indiana, which saw approximately 6% growth in RevPAR last year.

In Fargo, the story is similar for Molbert and TMI. They own and manage 179 hotels in the U.S., primarily select-service premium brands, and the majority are located in the middle of the country, from the upper Midwest down through Texas. Molbert says 2012 was a "very good year RevPAR wise" and that TMI bettered the industry mark. He expects the same for this year, driven by rate.

In December, Boxer Property bought the Pointe Hilton Tapatio Cliffs Resort in Phoenix, its first lodging property.

**Dealing Confidence**

David Kayle, Boxer Property's director of acquisitions, has become quite popular since the commercial real estate investment firm bought the Pointe Hilton Tapatio Cliffs Resort in Phoenix. "We're seeing a tremendous number of opportunities," he says. "People see us buy an office, they almost expect it. We buy a resort, and you get a little more attention."

The Hilton was bought in an all-cash transaction from special servicer C-III Capital Partners for an undisclosed amount, although Kayle says it was at a significant discount to replacement cost. The acquisition signals a new avenue of growth for Boxer.

"We'll grow it as fast as the opportunities come," Kayle says. "We're making a concerted effort to make it a real discipline within the company and on a long-term basis."

The improving economy and upswing in hotel operating fundamentals makes now the perfect time, says Kayle. "The other piece," he adds, "is the opportunities are out there from a value standpoint to acquire these irreplaceable properties on a great basis … That's exactly where we want to be: Those very unique resorts, luxury hospitality locations that are irreplaceable where the barrier to entry is extremely high or nearly impossible."

Although U.S. transaction volume may fall short of Jones Lang LaSalle Hotels' forecast of $15 billion in 2012 — it was at $13.7 billion and 5% off pace through November — the market seems poised for growth in 2013.

JLLH is calling for a slight increase from last year in global transaction volume ($32 billion), but the most promising conclusion the real estate services firm makes is the "global availability if debt is expected to be at the highest level in 2013 since 2007."

Hotel AG, a brokerage firm based in Atlanta, closed 75 transactions in 2012 and currently has 272 hotels on the market for $2.7 billion in value. It's more than double anything principal H. Keith Thompson has seen before.

"We believe the gap between asking price/sale price has closed and we are at transaction levels beyond the best years of the previous cycle," he says. Hotel AG focuses on mostly secondary-type markets and Thompson believes upper-tier select-service assets in the $15 million to $20 million range will be the most transacted segment this year.

It's the target for both Vision Hospitality's Patel and TMI's Molbert, both long-time developers now looking to buy in addition to building. The biggest sellers will likely be bank induced.

"Inadvertent hotel owners, like banks and receivers, will continue to drive a significant share of hotel product to market," says Mark Wynne-Smith, Global CEO of Jones Lang LaSalle Hotels. "We also expect institutional investors to liquidate select non-core assets that will create opportunities for value-add investors."

RockBridge Capital's Lowrey says the hold philosophy or strategy is finally ending. "Whether an owner or lender, you've been waiting for the market to come back," he explains. "Well, it's come back."

The Hampton Inn & Suites – Chattanooga Downtown is one of 17 hotels owned by Vision Hospitality Group. With eight hotels under construction and scheduled to open this year, that number will grow by almost half.

**Building Confidence**

Another strong sign for the industry going forward is developers are actually developing again. Supply growth is still projected to be less than 1% this year, but the confidence and credit are there for companies like TMI and Vision Hospitality. Both have been able to get projects off the ground through strong relationships with mostly local and regional banks.

The biggest challenge now is finding the right opportunities, not the financing, says Patel. "In the current supply-constrained environment," he adds, "developers who have access to capital and established relationships with brands are able to introduce new, high-quality inventory at favorable financing terms and realize a significant premium on past returns."

Molbert, whose company has multiple projects under construction or soon to be in North Dakota, Texas, Ohio, believes there are as many or more opportunities in secondary markets. "Everyone wants to be in a top 25 MSA, and there's nothing wrong with that, but we think there are many opportunities under that, in the top 50 or top 100," he says. "Demand has come back, supply is minimal — there are quite a few opportunities for those that have the resources and know-how."

Another reason for the increased confidence to both build and buy is some of the uncertainty that plagued 2012 has also passed. The election is over, and the Fiscal Cliff was avoided with a last minute deal on Jan. 1.

“We think there’s opportunity to get more certainty now; everybody needs to know what the rules are and then you can make your forecasts and have convictions,” says Molbert. “Our pipeline is based on that … There are some real good things going in those markets and they can get better with more certainty.”

According to PKF Hospitality Research, the years beyond 2013 will be even better. It is forecasting U.S. RevPAR to grow at a compound annual average rate of 7.2% for the next four years, twice the historical average.

“It may take a few months into 2013 before we see the data that will get hotel owners and operators excited,” says Mark Woodworth, president of PKF Hospitality Research. “Still, from our vantage, when we look beyond [this] year, we see one of the best times in history to invest in the U.S. lodging industry.”

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