HREC's Spring 2019
Hotel Capital Markets Update

Meet The Money®
National Hotel Finance & Investment Conference Recap

HREC recently co-sponsored JMBM's **29th Annual Meet the Money National Hotel Finance and Investment Conference** in LA. Below you will find "top of mind" insights from hotel industry investors, managers, lenders and brand representatives which provide a snapshot of where things stand in the world of hotel investment and finance. In summary, while the hotel industry continues to prosper with continued RevPAR growth, low mortgage rates, and new incentives such as Opportunity Zones spurring development, inhibitors such as supply concerns and rising labor and construction costs are keeping unfettered growth in check.

STATE OF THE HOTEL MARKET

Hotel transaction volume in Q1 2019 was down 36% from Q1 2018 but on pace with 2016 & 2017.

RevPAR is growing but at a more muted pace — up 2.1% in T-12 at end of Q1 2019.

39% of hotel markets experienced negative RevPAR growth YTD 2019 — that's a rising trend but not enough to signal recession.

Cap Rates — steady to drifting down — aided by lower interest rates and reflective of a healthy market.

Expenses — generally rising faster than RevPAR growth, with labor costs the main culprit.

New Supply — robust but flattening and at levels below peak years of 2018 and 1999.

The trendy economic consensus — expect a modest pullback in 2021, then a return to growth. No panelists predicted a significant recession, although 68% of Lodging Industry Investment Council (LIIC) members anticipate a recession hitting in 2020 or 2021.

HREC Investment Advisors®
HOSPITALITY REAL ESTATE COUNSELORS®

6400 S. Fiddler's Green Circle, Suite 1730
Greenwood Village, Colorado 80111
(303) 267-0057
Fax: (303) 267-0105
www.HREC.com

LENDING TRENDS

CMBS underwriting has been kept in check, although more Interest Only is being offered and more borrowers are negotiating future mez allowance into loan docs. CMBS volume is down and bond demand is robust, which has driven 10-year rates to multi-year lows (4.0%-4.5%).

Debt Funds are proliferating and competing with banks by offering higher leverage and non-recourse. Rates on value-add bridge deals priced at L+4.5% a year ago have compressed to L+3.5% today.

Banks are stingy with new borrowers unless they bring major deposits to the bank, but offering attractive terms for existing relationships.

Mezzanine & Pref Equity sources are very active behind bank construction loans — many are agnostic whether inserted as mez or pref, offering similar leverage and fine going pref to conform to banks' HVCRE requirements.

Construction Lenders Wish List — high barrier to entry markets, unbeatable locations, the ideal brand to suit demand, and a reasonable F&B underwrite (10-15% margin). "Not every rooftop bar will match The Dream."

CAPITAL STACK TOOL TRENDS

Opportunity Zone Investing is attracting massive attention — big players are raising OZ blind pool funds and individuals are developing Single Asset Single Investor funds. If your project is in an OZ, get informed!

PACE Financing is gaining acceptance among 1st mortgage lenders. PACE (property assessed clean energy financing) can fund 10-25% of the capital stack on new builds and rehabs at a 6-7% coupon, non-recourse with no intercreditor requirement and no ability to accelerate loan.

EB5 — Limits on EB5 visa issuance have constrained deployment of EB5 funds thereby extending the time it takes to raise capital for projects. "Visa relief is needed."

Regardless of which tool you use, "it is still about the quality of the deal".

TOP OPERATIONAL CHALLENGES AND HOW INVESTORS ARE NAVIGATING

Labor Costs — up significantly over 5 years - maids get bussed in +1 hour & willing to leave for a 50 cent raise. **Solutions:** $500-$1,000 year-end bonus is cheaper than re-hiring & re-training. Offer online training thru videos on phone. Today's employees want instant feedback, not annual reviews. "Robots" – really? Is that hospitality? It's the future.

Employee Retention — at a low given the tight labor market. **Solutions:** "Embrace talent" through culture building and profit sharing. "People don't leave a company, they leave their boss", so build loyalty between department heads and staff. GMs should focus on community ties; Jr. and regional colleges are the target for employee searches.

Development Costs — up as much as 15% in the last year! **Solutions:** stick to high barrier-to-entry markets. Build for-sale residential with your resort – the profit subsidizes the hotel.

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TOP OF HOTEL MINDS IN '19

What's hot? Select Service in secondary markets with population and job growth.

Why Select Service? Efficient — GOP margins driving up toward 50%; **flexible** — the more F&B in your neighborhood, the less you need to provide, and vice versa; **easier approval** w/ cities than limited service because of added amenities; **lower cost** to build and operate than full service.

Why Dual Brand? Economies of scale (labor, purchasing) and can attract a **wider range of unmet demand.**

Brand Proliferation — a net positive for developers and consumers — "that's capitalism."

Lower interest rates — "making deals pencil on the margin" and "allow you to pay more".

Why so expensive? Sellers of newer hotels are pricing according to today's construction costs = lower cap rate = driving up the bid/ask spread.

Compete with Airbnb? "Activate" the lobby / common area, where the Millennial / Gen Z target market wants to be "Alone Together".

It pays to have a hotel capital markets pro navigate this market to source the ideal lender and terms for your financing, so call any time to discuss your current needs. Feel free to share this article, and thanks for reading!

GREG PORTER
Senior Vice President | Mortgage Brokerage
HREC Investment Advisors
(**O**) 760.438.4401 | (**C**) 949.500.7314
gporter@hrec.com | www.hrec.com

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