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THE US LODGING INDUSTRY Q1 2011:

## The Up Cycle Has Clearly Begun

*By Dan Lesser***Lesser**

NEW YORK CITY-As the United States approaches the second anniversary of the official end of the recent recession, the severity of the downturn coupled with prevailing economic headwinds is resulting in a sluggish recovery. While corporate profits have recovered to pre-recession historic highs, overall US job growth remains weak and the national unemployment rate relatively high. A recent dramatic spike in oil prices along with a hint of a rise in interest rates and overall inflation, create challenges to the development of a self sustaining economic expansion, and away from a stimulus driven recovery. While trending upward, interest rates and inflation still remain relatively low when compared with long term historical trends. Coupled with strong domestic and international capital flows and investor perception of long term appreciation, US commercial real estate offers strong yield opportunities when compared with other asset classes. Due to the constant re-pricing of guestrooms, US hotels in particular are highly sought after for superior risk adjusted returns.

Lodging was among the most battered sectors during the recent downturn. As businesses once again invest in research, development, and new plants and equipment, US lodging industry fundamentals are now dramatically rebounding. Furthermore, while the housing market continues to be challenged, consumers continue to deleverage through pay downs of debt, bankruptcies and foreclosures. Simultaneously, Americans are spending once again as evidenced by rising levels of personal consumption and retail sales including travel and leisure.

US hotel transaction volume and pricing particularly for institutional grade assets continues to dramatically rise. Hotel focused REITS, private equity funds, and foreign investors are all actively seeking to deploy raised capital aimed at the lodging sector. With an up market firmly in place, lenders are now foreclosing on troubled legacy assets and the phenomenon of "extend and pretend" is quickly coming to a close. As the hotel industry continues to recover and quality assets bounce back more rapidly than their trailing peers, the notion of sector "haves and have-nots" is becoming apparent. Struggling, functionally obsolete hotels that are approaching the end of their economic lives will sustain the brunt of changing consumer demand which will manifest itself through low occupancy levels, declining room rates, and conversions to alternative uses or property improvement demolition.

LW Hospitality Advisors (LWHA) continuously monitors the major US hotel sale transaction market. The LWHA Q1 2011 Major US Hotel Sales Survey (Table 1) includes 29 single asset sale transactions over \$10 million each that are not part of a portfolio allocation. These transactions totaled more than \$2.5 billion, and include over 11,000 hotel rooms with an average sale price per room of approximately \$240,000. By comparison, the Q1 2010 survey identified 14 transactions totaling a mere \$710 million including 5,000 hotel rooms with an average sale price per room of \$140,000.

Notable observations from the LWHA Q1 2011 Major US Hotel survey include:

- By all measures major US hotel sale transaction, activity and pricing are rising dramatically, and intensifying movement of the market appears to continue to gain momentum;
- Six major US hotel sale transactions greater than \$100 million occurred during Q1 2011, almost half of the total of such large transactions that occurred during all of 2010;
- Public hotel ownership companies and private equity groups dominate the acquisition landscape;
- Hotel investment opportunities in high barrier to entry product located in high barrier to entry markets are extremely sought after;

- The majority of major US hotel sale transactions trade at a discount to replacement cost.
- The recent dramatic rise of major US hotel sale prices is evident in two recent transactions:
  - The Q1 2011 acquisition of the 494 room JW Marriott in New Orleans for \$93.8 million by Sunstone Hotel Investors. The asset was purchased from a JV between Clearview Hotel Capital and Starr International USA Investments who previously acquired the hotel in Q1 2008 for \$67.5 million from Ashford Hospitality Trust; and
  - The Q1 2011 acquisition of the 221 room Best Western Tuscan Inn at Fisherman's Wharf in San Francisco for \$52.5 million by Walnut Hill Group. The asset was purchased from Abacus Lodging Investors who previously acquired the asset less than one year ago for \$34 million.
- Available capitalization rate data in connection with several recent major US hotel trades are illustrative of the low cost of REIT capital and/or perceived upside of urban hotel assets in top US markets:
  - Thayer Lodging Group acquired a 70-year ground leasehold interest in the 337 room JW Marriott in San Francisco from Ashford Hospitality Trust for \$96 million or a 3.7% cap rate based upon trailing 12 month net operating income;
  - Pebblebrook Hotel Trust acquired the 252 room Argonaut Hotel in San Francisco for \$84 million or a forward 12 month cap rate of under 5.5%; and
  - Hersha Hospitality Trust acquired the 152 unit Capitol Hill Suites in Washington, DC from AEW Capital Management for \$47.5 million or a forward 12 month cap rate of 7.3%.

The data on Table 2 illustrates that as of the end of April 2011 10 additional major US hotel sale transactions are in contract or have closed. Pebblebrook Hotel Trust is clearly the most acquisitive organization for large single asset trades.

US hotel industry fundamentals indicate strong corporate demand momentum and benign supply growth which will drive healthy average rate and RevPAR increases during the foreseeable future. Furthermore, group segment led average rate gains will drive the next stage of the US lodging industry recovery. Rising revenues will increase profit margins and generate robust operating returns. Improving industry operating metrics coupled with greater amounts of available debt will continue to increase US hotel sale transaction activity and prolong the rise of lodging property prices.

Furthermore, relatively low cost hotel REIT capital and the ease with which these entities have been raising new funds through multiple add-on public share offerings will continue to fuel the velocity of hotel sale transactions. Additionally, required capital improvement programs for scores of assets that delayed such expenditures during the recent downturn create value enhancement opportunities that are highly sought after by hotel investment sponsors.

Finally, sophisticated lodging investors always consider that the lodging industry is extremely sensitive to uncontrollable events such as terrorism, war, natural disasters and economic shocks. The beauty of repricing hotel average room rates in an up market can suddenly become a curse during a down draft caused by myriad negative events. While the hotel business is risky, the rewards clearly exist for those that know, understand, and are focused on the sector.

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## LW Hospitality Advisors: Select Major Q1 2011 U.S. Hotel Sales Survey

PROPERTY	LOCATION	NO. OF ROOMS	ESTIMATED SALES PRICE	ESTIMATED PRICE/ROOM	BUYER	SELLER
Manchester Grand Hyatt San Diego	San Diego, CA	1625	\$ 570,000,000	\$ 350,769	Host Hotels & Resorts	Manchester Financial Group
Doubletree Metropolitan Hotel	New York, NY	755	\$ 335,000,000	\$ 443,709	RLJ Development LLC	JV Highgate Holdings/Whitehall Goldman Sachs/Rockwood Capital LLC
New York Helmsley Hotel	New York, NY	775	\$ 313,300,000	\$ 404,258	Host Hotels & Resorts	Helmsley Enterprises, Inc.
San Juan Marriott Resort & Stellaris Casino	San Juan, Puerto Rico	525	\$ 133,000,000	\$ 253,333	Rockwood Capital	American International Group
Royal Palm Hotel	Miami Beach, FL	407	\$ 130,000,000	\$ 319,410	Sunstone Hotel Investors	KSL Capital Partners
Hilton Alexandria Mark Center	Alexandria, VA	496	\$ 121,000,000	\$ 243,952	Crow Holdings Realty Partners V LP	Amstar
JW Marriott San Francisco Union Square	San Francisco, CA	337	\$ 96,000,000	\$ 284,866	Thayer Lodging Group	Ashford Hospitality Trust
JW Marriott New Orleans	New Orleans, LA	494	\$ 93,800,000	\$ 189,879	Sunstone Hotel Investors	JV Clearview Hotel Capital/Starr International USA Investments LLC
Sheraton Universal Hotel	Universal City, CA	451	\$ 90,000,000	\$ 199,557	Shenzhen New World Group	Lowe Enterprises
Argonaut Hotel	San Francisco, CA	252	\$ 84,000,000	\$ 333,333	Pebblebrook Hotel Trust	N/A
Viceroy Santa Monica	Santa Monica, CA	162	\$ 80,100,000	\$ 494,444	LaSalle Hotel Properties	Kor Group
Hilton Garden Inn Courthouse Plaza	Arlington, VA	189	\$ 60,000,000	\$ 317,460	CP-IPERS Arlington Hotel LLC	Courthouse Hotel Properties
Hilton Garden Inn Denver Downtown	Denver, CO	221	\$ 58,500,000	\$ 264,706	Apple REIT Ten	Stonebridge Companies
Best Western Tuscan Inn at Fishman's Wharf	San Francisco, CA	221	\$ 52,500,000	\$ 237,557	Walnut Hill Group	Abacus Lodging Investors LLC
Capitol Hill Suites	Washington DC	152	\$ 47,500,000	\$ 312,500	Hersha Hospitality Trust	AEW Capital Management
Renaissance Hotel Downtown	Pittsburgh, PA	291	\$ 45,400,000	\$ 156,014	RLJ Development LLC	Sage Hospitality Resources
Holiday Inn Express Fifth Avenue	New York, NY	125	\$ 43,870,000	\$ 350,960	Walnut Hill Group	Magna Hospitality Group
Ocean House Hotel	Westerly, RI	49	\$ 36,600,000	\$ 746,939	Ocean House Hotel Partners LLC	Bluff Ave LLC
Hilton Rye Town	Rye Brook, NY	447	\$ 35,500,000	\$ 79,418	Lodging Capital Partners LLC	Ashford Hospitality Trust
Xona Resort Suites Scottsdale	Scottsdale, AZ	431	\$ 34,000,000	\$ 78,886	Sunstone U.S. Opportunity (No. 3) Realty Trust	N/A
Hotel Monaco Baltimore	Baltimore, MD	202	\$ 33,000,000	\$ 163,366	Kimpton Hotels & Restaurants	Baltimore & Charles Associates
Sheraton Keauhou Bay Resort and Spa	Kailua-Kona, HI	521	\$ 26,200,000	\$ 50,288	Kona Surf Partners LLC (Avenue Capital Management II L.P.)	JV Arlen Capital LLC & Brickman Associates
Charleston Marriott Town Center	Charleston, WV	352	\$ 25,500,000	\$ 72,443	Inland American Lodging Group, Inc	Forest City Enterprises Inc.
Wyndham Hotel Pittsburgh-University Place	Pittsburgh, PA	198	\$ 20,750,000	\$ 104,798	RLJ Development LLC	
Sheraton Bloomington Hotel	Minneapolis, MN	564	\$ 20,000,000	\$ 35,461	Platinum Equity	LaSalle Hotel Properties
Hotel Theodore	Scottsdale, AZ	189	\$ 16,250,000	\$ 85,979	Sydell Scottsdale LLC (Yucaipa Companies, LLC)	Wells Fargo Bank NA
Golden Gate Inn <sup>1</sup>	Brooklyn, NY	150	\$ 15,500,000	\$ 103,333	Brooklyn Amity School	Krishna Management
Delaware Park Hotel & Suites <sup>2</sup>	New Castle, DE	191	\$ 15,000,000	\$ 78,534	Hersha Hospitality Trust	N/A
Crowne Plaza Boston North Shore & CoCo Key Water Resort	Danvers, MA	366	\$ 10,100,000	\$ 27,596	Lightstone Group	JV Sage Hospitality Resources/Wave Development/Hexagon Investments

Source: LW Hospitality Advisors (LWHA) has compiled the above information from sources deemed reliable, and the information is thought to be correct, however LWHA cannot warrant absolute accuracy of all the data. Use of this information without verification from original sources is at your own risk.

Notes:

1 Hotel Was Never Opened

2 Hotel Was Purchased For Conversion To A School

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## LW Hospitality Advisors: Select Major Q2 2011 U.S. Hotel Sales (Or Contract) Survey

PROPERTY	LOCATION	NO. OF	ESTIMATED SALES PRICE	ESTIMATED PRICE/ROOM	BUYER	SELLER
Mondrian Los Angeles	West Hollywood, CA	237	\$137,000,000	\$ 578,059	Pebblebrook Hotel Trust	Morgans Hotel Group Co
Westin Gaslamp Quarter	San Diego, CA	450	\$110,000,000	\$ 244,444	Pebblebrook Hotel Trust	Starwood CMBSI LLC
W Boston Hotel	Boston, MA	235	\$ 89,500,000	\$ 380,851	Pebblebrook Hotel Trust	Sawyer Enterprises
Hotel Chelsea	New York, NY	250	\$ 80,000,000	\$ 320,000	N/A	N/A
Courtyard Washington Capitol Hill/Navy Yard	Washington DC	204	\$ 68,000,000	\$ 333,333	Chesapeake Lodging Trust	N/A
Continental Oceanfront South Beach Hotel,	Miami Beach, FL	251	\$ 61,000,000	\$ 243,028	JV Cube Capital & InSite Group	N/A
Hotel Monaco Seattle	Seattle, WA	189	\$ 51,200,000	\$ 270,899	Pebblebrook Hotel Trust	N/A
Trump Marina Casino & Hotel	Atlantic City, NJ	728	\$ 38,000,000	\$ 52,198	Landry's Inc.	Trump Entertainment Resorts Inc.
Holiday Inn Express Hotel New York City - Wall Street	New York, NY	112	\$ 36,700,000	\$ 327,679	Hersha Hospitality	Metro Six LLC (McSam Hotel Group)
Fairfield Inn & Suites	South Bend, IN	119	\$ 17,500,000	\$ 147,059	Apple REIT Ten	KRG/White LS Hotel

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