

NYU Conference Takeaways: Cautious Optimism Turns to Caution

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The 41st **NYU International Hospitality Industry Investment Conference** wrapped up on June 4, 2019, and the overall sentiment of the event was one of caution, a shift from a sentiment of cautious optimism at conferences earlier in the year. Most expect the next industry downturn to come soon, perhaps as soon as next year or early 2021. Absent a Black Swan event, the expectation is for a correction rather than a deep downturn. Main takeaways include the following:

Caution but Not Panic

There is substantial equity and debt available for the hotel sector. The long-term view for the sector is positive and it is seen as less risky, over the extended view, when compared to other investment sectors. Investors that may have previously sought IRRs at or above 20% in the sector may be settling for IRRs in the mid-teens, which remains more attractive than other asset classes. There is also a record number of people traveling, despite a decline in China visitation, which is affecting select U.S. destinations.

Waning RevPAR Growth Forcing Investors to Find New Value-Add Opportunities

The proliferation of new brands and continued additions to supply are keeping a lid on significant RevPAR growth. Buyers are turning their focus to opportunities within hotel assets that allow for bumps in RevPAR and revenue in other areas, above and beyond just riding the shallow wave of market average growth. Tactics such as renovating and rebranding, refocusing certain the food and beverage outlets or creating new ones (adding new “experience driven” aspects that add revenue and don’t rely on market-driven revenue lifts), and/or repurposing space as new retail outlets, as well as other similar changes to drive new revenues to the bottom line, are key in developing a pro forma with future upside that isn’t reliant on average rates advancing significantly higher. Unfortunately, these value-add opportunities are becoming harder and harder to find.

Costs Are on the Rise

Both labor costs and construction costs are on the rise, which are each taking their toll on expansion in the sector. It is harder and harder to find staff members to fill positions at virtually all levels of a hotel’s operation, particularly the line-level positions. This is driving hourly wages higher, as hotels compete for fewer and fewer available workers. The stricter immigration policies of the current administration are not helping an industry that has long benefited from immigrants as a primary source of employees. Labor costs are rising 5-6% in some cities, which is not balancing well with RevPARs increasing in the 1-2% range. Similar labor issues in the construction sector are not helping new development either, as costs rise and the lack of labor are extending timelines for construction considerably. With many construction and other materials sourced in China and Mexico, the recently imposed tariffs are contributing to the rising costs. Finally, there is uncertainty regarding potential future changes to the Affordable Care Act, and whether or not these changes will increase the employers’ staff benefit costs. Increases in insurance expense and property taxes were also noted as concerns.

PIP Requirements Are Becoming a Bigger Hot Button in the Current RevPAR Environment

As more and more brands advance weighty PIP requirements on owners, more and more owners are finding that reserves that have been set aside for four or five years are not significant enough to cover the improvements, especially in light of escalating project and construction costs. These dynamics are already driving more owners to sell assets, rather than manage through the cost and logistical burden of a substantial renovation that may not ultimately lead to a significant and immediate RevPAR bump, a trend that is likely to

Summary

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Many Owners Are Taking Advantage of a Competitive Debt Market and Choosing to Refinance Rather Than Sell

A wide array of lenders is active in the market, including traditional players such as banks, life companies, and CMBS, as well as numerous debt funds. The result is a highly competitive debt market, with interest rates even lower than in recent years. On the whole, lenders are still disciplined, with loan-to-value ratios remaining below the levels realized at the peak of the last cycle; however, many other loan provisions are increasingly subject to negotiation. It is now possible to pull some equity out of a deal, leading some owners to choose refinancing over a sale.

With all these factors being considered, buyers are being very careful to buy at the right basis. Knowing a downturn is headed our way, no matter how shallow, buyers need to buy at the right price now given the near-term trajectory of NOI (unless value-add strategies can be implemented) and where values may be positioned three years from now.

NYU remains the highlight of the summer hospitality conference season, and this year's event was highly attended. We remain laser focused on the hotel sector at **HVS**, and if you would like to connect with any of our consultants or brokers, please let me know. I can connect you with the person most knowledgeable about the challenges you may be facing.

Thank you to **Anne R. Lloyd-Jones, Suzanne Mellen, Stacey Nadolny, Drew Noecker, Eric Guerrero**, and **Chris Fernandes** for contributions to this article.

About **Rod Clough**



As President of HVS Americas, Rod oversees strategy execution for HVS throughout its 40 Americas locations. Rod's tenure with HVS spans over 25 years, during which time he has played an important role in growing the company from a few locations across the Americas to 40. In a typical year, Rod's group consults on over 2,500 existing or proposed hotels and resorts, and in 2021, he oversaw the 568-hotel Extended Stay America appraisal portfolio. In 2003, Rod founded the firm's sister appraisal division, U.S. Hotel Appraisals, which completes roughly 1,000 hotel appraisals annually. Rod is a founding owner/partner of HVS Mexico-Latin America, and he re-launched the firm's U.S. Brokerage and Capital Markets division in 2018. Rod is a Designated Member of the Appraisal Institute (MAI) and a licensed real estate broker. Furthermore, Rod is proudly Latino and gay, and his firm is welcoming of all races and colors, sexual orientations, ages, genders, and gender identities. Once associates join HVS, they tend to stay due to the extraordinary culture Rod has inspired, a culture defined by the ideals of balance, connectivity, efficiency, collaboration, honesty, integrity, kindness, and excellence, among others. Rod resides in northern Colorado where he and his husband Jeff are raising their daughter, Rory.