

Understanding the Current State of the Hotel Transaction Market

May 14, 2024 / By Eric Guerrero , Josh Williams



The hotel transaction market continues to face significant headwinds. Investors are still concerned about the prohibitive cost of debt, and with the chances of a summer rate cut from the Fed becoming slimmer, expensive debt may remain for the foreseeable future. Additional challenges to getting deals done are the bid-ask spread, rising operational costs, and extensive change-of-ownership property improvement plans (PIPs). As ownership groups consider placing their hotel assets on the market, they should consider how these headwinds are affecting buyer underwriting so that they have realistic pricing expectations.

Based on the latest **RCA** data, Q1 2024 hotel transactions in the United States declined 42% compared to the same period last year. In terms of the actual number of trades, limited-service hotels experienced a 19% decline, compared to a 31% decline for full-service hotels. This supports what has been evident in the current pipeline and through investor conversations: there is more interest in the limited-service and extended-stay segments.

Below are some sample historical (within the past two years) and current deals from the HVS Brokerage & Advisory pipeline to illustrate the numbers from an inside perspective. It has been interesting to see the shift in buyer activity within this period.

Historical Trades

Hilton Garden Inn – Texas

- ◊ Sold in June 2022
- ◊ Days on Market (Initial Launch to Escrow): 29
- ◊ Number of Buyer Confidentiality Agreements (CAs) Executed: 93
- ◊ Number of Offers Received: 4
- ◊ Sales Price: \$14,600,000 (97% of the Pricing Guidance)



Comfort Inn – New York

- ◊ Sold in March 2023
- ◊ Days on Market (Initial Launch to Escrow): 68
- ◊ Number of Buyer CAs Executed: 211
- ◊ Number of Offers Received: 16
- ◊ Sales Price: \$11,125,000 (111% of the Pricing Guidance)



Holiday Inn – South Carolina

- ◊ Sold in May 2023
- ◊ Days on Market (Initial Launch to Escrow): 47
- ◊ Number of Buyer CAs Executed: 300+
- ◊ Number of Offers Received: 18 Fully Approved Auction Bidders
- ◊ Sales Price: \$9,600,000 (107% of Reserve Price)



Summary

The hotel transaction market continues to face significant headwinds. Nonetheless, there are still many good deals to be had, and with some patience and strategy, long-term returns may match or even exceed an investor's expectations. This article examines and compares current transaction data to historical activity.

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Holiday Inn Express & Suites – Texas

- Currently Under Contract
- Days on Market (Initial Launch to Escrow): 182
- Number of Buyer CAs Executed: 127
- Number of Offers Received: 2
- Sales Price: Confidential (88% of the Pricing Guidance)



Best Western – Texas

- Sold in May 2024
- Days on Market (Initial Launch to Escrow): 50
- Number of Buyer CAs Executed: 73
- Number of Offers Received: 2
- Sales Price: Confidential (91% of the Pricing Guidance)



The numbers show a tale of two cities. The stark contrast evident between the historical and current trades is in both the number of offers received and the sales price as a percentage of the pricing guidance. The hotel transaction market from 2021 to early 2023 saw competitive buyer activity, and it was common to trade an asset at or above the pricing guidance; there was not a lot of price negotiation taking place. During this period, cheap debt was available, and with valuations at depressed levels due to COVID, there was a dramatic increase in activity from those seeking to capitalize on the lowered prices. Today, strong buyer interest still exists, based on the number of CAs executed, but there is a disconnect in advancing those buyers to complete property tours and make offers. The disconnect is a result of two factors: 1) the bid-ask spread between the pricing guidance and what buyers are willing to pay, and 2) buyer unwillingness to come to terms with the current state of the debt market term with lower loan-to-value (LTV) ratios and higher rates.

Within the past few months, more ownership groups have begun to come to terms with valuations, and many are willing to meet the market if they need to sell. This has led to a **robust listing pipeline for HVS Brokerage & Advisory**, with more listing engagement agreements executed in Q1 2024 compared to the same period last year. When providing broker opinions of value (BOVs), we focus particularly on property taxes and insurance. Many times, the year-one pro-forma may have a lower net-operating-income flow-through due to the large rise in these fixed costs.

Regarding debt, buyers will need to understand the current reality and that the Fed's decisions are out of their control. A 0.25% rate reduction will not materially change the return on investment, so a short-term change in rates should not affect a long-term decision to acquire an asset. Sellers have come down in pricing, so it is now time for buyers to step up and bridge the gap. This will require buyers to become comfortable with the initially higher-priced debt, knowing that there are sunnier skies ahead.

In addition, the previous practice of benchmarking new construction costs in comparison with sales price has shifted, as lenders are using "in-place cash flow" as their lending basis, rather than appraisal estimates. The once-standard practice of obtaining debt based on a percentage of appraisal has changed to a basis of simple cash flow to debt-ratio minimum thresholds.

Market feedback from buyers indicate that PIP expenses (including mid-cycle and change of ownership) have increased significantly to anywhere from 25% to 45% above pre-pandemic levels. Brands have recently suggested that the reserve norm for renovation costs, previously 4% of revenue, is now closer to 8–9% of hotel revenue over a ten-year ownership cycle.

Many of the currently active buyer groups understand that the return is going to be back-end driven when acquiring an asset right now. The investment thesis is minimal cash-flow initially, while the PIP is implemented

and the business plan is executed, followed by strong cash-flow in the latter years of the investment, then a sizable valuation increase on exit when the hotel is resold.

Being a prudent investor in today's hospitality market is difficult, but not impossible. There are still many good deals to be had, and with some patience and strategy, your long-term returns may match or even exceed your expectations. As a seller, the **1031-exchange program** is still a viable tax alternative program that provides an interest-free loan from the U.S. government as you leverage their tax capital into a new investment. It is now more important than ever to seek an experienced transaction advisor to help you navigate the market. **Reach out to one of our HVS Brokerage & Advisory team members** to discuss your current needs.

About **Eric Guerrero**



Eric Guerrero is a Senior Managing Director and a Partner at HVS, leading the firm's Brokerage & Advisory division in the United States. With over a decade of investment sales experience, he has participated in hundreds of hotel transactions with an aggregate value of over \$800 million across the nation. Eric has advised both private investors and institutional clients and has managed hotel transactions of all classes and sizes, from independent, \$1-million, limited-service hotels to \$50-million, select-service portfolios across multiple states. Contact Eric at (713) 955-0012 or [\[email protected\]](#).

About **Josh Williams**



Josh Williams is a Senior Managing Director with the HVS Brokerage & Advisory division and is based in the southeastern United States. With nearly two decades of investment sales experience, Josh has participated in over 260 hotel transactions with an aggregate value of \$2.2 billion. He advises both private equity investors and institutional clients on hotel transactions of all classes and sizes, from independent limited-service hotels to full-service and select-service portfolios. Josh's extensive and long-term industry relationships, together with HVS's extensive market intelligence, help to maximize value for his clients. He is supported by a team of experienced HVS professionals for each transaction, which results in an exceptionally high level of execution quality and closing rate on transactions. Contact Josh at (843) 438-2502 or [\[email protected\]](#).