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Hotels Lure Investors as Lodging Surpasses U.S. Offices, Retail

By Nadja Brandt - Sep 9, 2010

Hotel purchases are increasing faster than deals for office buildings, shopping centers or any other type of U.S. commercial property as rising occupancies and room rates boost the lodging industry.

Sales of hotels jumped 136 percent in the first half of 2010 from a year earlier, the biggest gain among five commercial real estate categories tracked by New York-based Real Capital Analytics Inc. Those deals were based on transactions of at least $5 million and exclude hotels attached to casinos.

A rebound in business and leisure travel is helping the U.S. lodging industry recover after last year's recession sent occupancies to a 30-year low. Hotels can boost rates quickly to take advantage of economic growth, while tenants at offices and retail properties tend to sign multiyear leases.

"Hotels have already absorbed the downturn," said Richard Jones, executive vice president of acquisitions and operations at Atlanta-based developer Portman Holdings LLC. "It's not as evident what exactly the impact of this downturn is going to be for other commercial real estate."

Owners of offices, shopping centers and other buildings with pre-recession leases are now signing agreements that will result in "significant cuts in rental income" said Jones, whose company develops lodging, office and retail properties.

Income for hotels, meanwhile, is rising. Revenue per available room, or revpar, in the top 25 U.S. markets rose to $73.87 during the first half from $71.08 a year earlier, according to Smith Travel Research Inc. of Hendersonville, Tennessee. Occupancies climbed to 63 percent from 59 percent during the period, while remaining below 2008's 66 percent.

Host Hotels, Pebblebrook

Host Hotels & Resorts Inc., the owner of Ritz-Carltons in San Francisco and Phoenix, in July agreed to buy the W New York Union Square with partners including Istithmar World PJSC, and said it will purchase the Westin Chicago River North for about $165 million. The same month, Pebblebrook Hotel

Trust bought the InterContinental Buckhead Atlanta hotel for $105 million in cash from InterContinental Hotels Group Plc.

Pebblebrook today said it purchased the 183-room Hotel Monaco Washington D.C. for $74 million. The property will continue to be managed by Kimpton Hotel & Restaurant Group LLC.

Hotels are inherently different from apartment buildings or other types of commercial real estate, said Lewis Wolff, co- chairman of Sunstone Hotel Investors Inc., an Aliso Viejo, California-based real estate investment trust. Because their space is rented by the night, not the month or year, hotels are a better investment than other properties during a boom and worse during a bust, he said.

'Operating Business'

"It's not really real estate," Wolff said. "It's an operating business that's immediately affected by any economic change. Apartments are not daily operations. They are much closer to being actual real estate than hotels are."

The vacancy rate at U.S. shopping centers rose to 10.9 percent in the second quarter from 10 percent a year earlier and near a record 11.1 percent set in 1990, Reis Inc. said in July. Office vacancies increased to 17.4 percent during the period, the highest level since 1993, according to the New York-based real estate research firm.

Hotel occupancies and rates still have a long way go before recovering to their peak levels, said James Tisch, president and chief executive officer of New York-based Loews Corp., which operated 19 high-end hotels as of June.

"Now we're obviously in a recovery, but in terms of revpar, we're still at 75 or 85 percent of the revpar of '07," Tisch said during an interview at Bloomberg's New York offices last month. "While the business has improved, it still has a long way to go before it gets back to where it was."

Rising Profits

Lodging companies have reported higher earnings, buoyed by rising demand in cities. Starwood Hotels & Resorts Worldwide Inc., the White Plains, New York-based owner of luxury brands including the St. Regis and W hotels, in July reported earnings that beat analysts' estimates and raised its revpar forecast. Marriott International Inc. of Bethesda, Maryland, the largest U.S. hotel chain, said second-quarter profit more than tripled and increased its full-year earnings forecast.

In the meantime, profits are still falling for some retail and office landlords. General Growth Properties Inc., the Chicago-based U.S. mall owner planning to exit bankruptcy in October, said last month that second-quarter core funds from operations declined 17 percent after store rents dropped.

Boston Properties

Boston Properties Inc., the biggest U.S. office landlord by market value, said in July that second-quarter FFO slid 5.9 percent as rental revenue fell. The same month, SL Green Realty Corp., Manhattan's largest office owner, reported a slump in second-quarter FFO after New York tenants signed leases for an average of 4.4 percent less than previous rents.

FFO is a measure of cash flow used by REITs and excludes interest, depreciation and other gains and losses.

Sales of hotels totaled $3.19 billion in the first six months of 2010, up from $1.36 billion a year earlier, according to Real Capital Analytics. The 136 percent increase compares with an 82 percent gain in office transactions, a 51 percent advance in apartment deals, a 37 percent climb for retail properties and a 22 percent rise in industrial property sales.

By dollar volume, hotel sales trailed other property types because they are a smaller portion of the market. Office transactions, totaling $11.9 billion, led deals by value, Real Capital data show.

The volume of lodging transactions remains below the record reached in 2007. A total of $78.6 billion of hotels sold that year, Real Capital said.

REIT Demand

REITs may be the primary buyers of hotels as they come on the market because "they are fairly well capitalized and have access to attractively priced capital," said John Arabia, managing director at Green Street Advisors, a Newport Beach, California-based real estate research company.

Sunstone last month acquired Miami Beach's Royal Palm hotel in a foreclosure auction for about $117 million. LaSalle Hotel Properties, a REIT that focuses on upscale lodging, last week said it bought its first hotel in San Francisco as well as two in Philadelphia for a total of $292.5 million. DiamondRock Hospitality Co. in May agreed to buy the 821-room Hilton Minneapolis for about $155.5 million, and Host Hotels said in July it's seeking deals in the U.S., Europe and Asia.

"Publicly traded REITs will be a significant buyer of hotels over the next few years," Arabia said. "It's now REITs that will have their day in sun."

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