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M&A Activity Heats Up Lodging

By Daniel H. Lesser

The US lodging industry has experienced an unprecedented level of merger and acquisition activity during the first half of 2007. Healthy industry operating metrics, along with an abundant amount of institutional and private debt and equity capital, has resulted in significant numbers of corporate entity and property level deals. Several recent M&A deals have been record setting, including the recently announced \$26 billion acquisition of Hilton Hotels Corp. by the Blackstone Group.

On the heels of the recent highly publicized delinquencies in the subprime residential mortgage market, the US commercial real estate credit markets are currently experiencing a dramatic tightening. Commercial real estate loan to value ratios have declined from recent peaks, and interest rates have ticked upward as CMBS issuers have had a relatively difficult time selling bonds to hedge funds (the most significant acquirers of AAA rated CMBS) who were already negatively impacted by the subprime "meltdown". Many believe that the current volatility in the credit markets should settle down shortly with the resultant velocity of commercial real estate transactions, including hotels, slowing to a more normal level relative to the recent frenzied pace. At this point in the cycle, the premise of US hotel investors is anticipated to be more heavily dependent upon the sector's operating fundamentals and less so on hyperactive capital markets.

The CB Richard Ellis Valuation & Advisory Services Hospitality & Gaming Group continuously monitors the major US hotel sale transaction market (above \$10 million single asset, not part of a portfolio allocation). Of the more than 50 such trades that occurred through the first half of 2007, the two largest single asset US hotel sales this year were the \$675-million

(\$2.3-million-per-room) acquisition of the Resorts East Chicago Hotel & Casino in East Chicago, Indiana by Ameristar Casinos Inc., followed by the \$575-million acquisition of the Makena Resort which includes the 310-room Maui Prince Hotel in Makena, HI by a joint venture between Morgan Stanley Real Estate Fund V US, Trinity Investments LLC & Dowling Co. On a per room basis the Maui Prince transaction equates to \$1.85 million; however, it is extremely important to note that in addition to the hotel, the sale transaction included two 18-hole Robert Trent Jones Jr. golf courses, 1317 acres of vacant land, and the stock of the Makena Wastewater Corp.

Interesting observations relative to the Mid Year 2007 Major US Hotel Sales survey include:

- The majority of single asset hotel trades of \$10 million or more occurred along both US coasts;
- Major urban 24/7 markets such as Atlanta, Boston, Chicago, Los Angeles, New York, San Francisco, and Washington, DC continue to be of interest to hotel investors due in part to high land and construction costs which create high barriers to entry for new hotel product;
- 14 (more than 25%) of the major single asset US hotel sale transactions of \$10 million or more traded in excess of \$100 million each;
- three "supertanker" (greater than 1,000 rooms) U.S. convention-oriented hotel trades occurred, namely the: Anaheim Hilton, Anaheim, CA (1,572 rooms), the Hilton Atlanta & Towers, Atlanta (1,226 rooms), and the Hilton Washington, Washington, DC (1,119 rooms);
- The most active acquirers of major US single hotel assets include sophisticated, hotel savvy investment groups who know and understand the unique aspects of the sector (aka "smart money").

Overseas hotel companies continue to expand their global footprint and distribution channels by selectively acquiring major hotel assets in US gateway cities; i.e. Taj Hotels Resorts & Palaces recent \$58-million (\$527,000-per-room) purchase of Campton Place in San Francisco, and Barcelona-based Hotusa Group and Losan Hotels World \$78-million (\$729,000-per-room) acquisition of the Dylan Hotel in New York City.

In addition to being the most recent prolific acquirer of hotel corporate enterprises, the Blackstone Group is also the most active seller of major single US hotel assets with seven such dispositions during the first half of 2007.

The outlook for the US lodging industry remains positive with profits anticipated to continue growing to record levels. Rising cash flows through both market factors (ADR's increasing above underlying inflation levels) and ever more sophisticated asset management techniques should more than offset the anticipated modest increases in capitalization rates as the credit markets tighten. Pricing for US hotel assets is anticipated to continue to rise, albeit at a slower rate than the recent past.

Sophisticated investors in US lodging assets continuously focus on potential threats/weaknesses to the market. Rapidly increasing property taxes, energy costs, and insurance premiums will continue to challenge hotel owners and operators. Depending upon how significant the current softening in the US housing market ends up could have an impact on discretionary spending on leisure activities by Americans, including staying in hotels. US lodging industry fundamentals are highly dependent on GDP growth, and any semblance of a slowing economy will have a swift impact on demand and the pricing of the nation's hotel rooms. Finally, geopolitical issues and the continued threat of terrorism on domestic soil will clearly remain high on the risk spectrum of the US lodging industry for the foreseeable future.

For a copy of the Mid Year 2007 Major US Hotel Sales, contact [Daniel Lesser](#). Lesser is senior managing director-industry leader, valuation & advisory services-hospitality & gaming group of CB Richard Ellis in New York City. The views expressed in this article are the author's own.

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