ALIS Conference Perspectives

July 30, 2021 / By Rod Clough, MAI

The **ALIS Conference** came and went this week, bringing **Downtown L.A.** hotels to life with optimism and hope that normal for the hotel industry is coming in the not-too-distant future. Here are some collective takeaways from our team that was in attendance.

Market Performance

- The recovery remains a submarket story, with no overall trend driving the nation's performance as a whole and little consistency in the recovery from market to market. Some markets are seeing strong recovery and are operating at or even above 2019 levels, while others are lagging. The recovery is not only underway in leisure-oriented markets; markets with heavy industrial/warehouse/logistics demand sources have also experienced improvement. Secondary/tertiary markets are recovering faster. Once the lagging submarkets gain momentum, these will layer on top of already-recovered segments, and the overall recovery should keep its momentum.
  - While many believe the latest growth in RevPAR is temporary and caused by summer leisure travel, ultimately, the recovery is following different patterns in different submarkets.
  - Booking windows are short, so there is little visibility on future bookings at the moment in markets that rely heavily on group demand. Accordingly, there is a lack of clarity as to when group/business travel will return in earnest in some markets. The big-box hotels in CBDs are still struggling, and many may become distressed.

Capital Markets and Transactions

- There is much more capital than product currently available. Buyers are focused on premium select-service and extended-stay hotels, and capital is generally focused on more opportunistic and higher-return strategies.
- The market is getting more efficient at placing buyers and sellers (a shorter list of investors are being offered assets).
  - There have been more off-market deals happening than fully on-market deals. Brokers have been doing quiet/targeted marketing processes, so buyers are really having to dig for deals.
- Finding assets to purchase at a reasonable price continues to be challenging, as asset prices remain elevated and the transaction market is extremely competitive. The extensive amount of capital raised to acquire hotels is placing upward pressure on prices, and the risk of hotel performance recovery does not appear to be factored into the purchase price of some deals. Buyers expect to see more opportunities to come online in the fall/winter of 2021, as lenders are becoming less accommodating to borrowers and as the need for capital for renovations and property improvements is increasing.
  - Cap rates continue to be pushed downward.
  - Some still believe we have not yet seen "the movie play out fully" and that additional distressed assets may start to enter the market as lenders lose patience and understand that the recovery may be longer for some assets/submarkets.
  - There is an expectation for more "market clearing" through special-servicer forbearance offerings and federal subsidies from CARES I & II burning off, leading to additional restructures or sales.

Summary

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Comments

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    - Premium select-service and extended-stay hotels in certain markets driving high RevPAR penetrations are leading to valuations above 2019 levels and, in certain instances, above current development costs given liquidity in the market. Moreover, there is a high level of interest in Hilton or Marriott select-service or extended-stay hotels in good markets. Most are not expecting a "COVID discount" for these products.
- Borrowers are willing to take today's high cost of short-term debt with the anticipation that the imminent inflation will push revenues and asset values upward. For some, this comes with the assumption that the cost of long-term, permanent debt will remain low in the foreseeable future. However, others expect that with rising inflation, interest rates will also have to rise, and many are wondering what impact that will have on the market, valuations, and transactions.
    - We continue to see more alternative forms of debt from sources that have traditionally been active in the equity space.
    - Hotels have become more attractive than other asset classes, like office/retail, particularly for their ability to hedge against inflation due to daily adjustments in ADR (as opposed to long-term leases).

COVID Delta Variant

- While a concern, most believe it will not be as significant as may be expected. The belief is that the current wave will soon subside and become a non-issue, and the recovery will continue.
    - Buyers that we met with are still being aggressive with underwriting and trying to win deals; they are not really underwriting a downturn again.

Labor, Construction Cost, and Inflation Challenges

- Operation and labor issues are the biggest challenges. Some hotels are limiting midweek reservations so that there is enough staff on hand to service the hotel during the weekend, when premium rates are reached. Another strategy is to price single-night stays at rates that essentially convert business to multi-night bookings.
- Labor issues are affecting hotels in every segment and every market and are the primary concern of owners and operators. Some employees are available but unwilling to work prior to the expiration of the federal unemployment benefits. Nevertheless, operators are beginning to see the light at the end of the tunnel, with federally provided unemployment benefits expiring in September. Wage rates are rising 10% to 25% in many markets, as hotel operators compete with other employers providing higher pay and better benefits. Labor cost increases are expected to continue even when the workforce has fully returned. A sizable portion of hotel-industry employees have left the industry and will need to be replaced by new recruits.
- New technologies driven by artificial intelligence combined with mobile apps are expected to enable hotels to operate more efficiently and with a smaller labor force.
- Construction costs have increased 10–15% between cost of materials and labor.
- Inflation is creating cost pressures for wages and supplies.

Final Takeaways

- There was more discussion throughout the panels on sustainability, corporate responsibility, and community focus. More groups in panels are examining the importance of looking at investments in a holistic way, rather than all about revenue/profits.
- Most attendees were cautiously optimistic. While fewer deals were getting done at ALIS this year, everyone was certainly happy to be able to connect again in person.

Many thanks to **Suzanne Mellen**, **Luigi Major**, **Eric Guerrero**, **Emil Iskandar**, **Dan MacDonnell**, **Kirsten Smiley**, and **John Berean** for their contributions to this overview.

About Rod Clough, MAI

Rod Clough is the President of HVS Americas. He is responsible for the overall direction, management, and ongoing success of 40+ offices across North and Latin America. Under his leadership, HVS Americas conducts over 3,500 valuation and consulting engagements annually. During his 30-year tenure, Rod has been instrumental in leading the growth of the firm; this includes significantly expanding the number of offices across the United States, as well as launching multiple divisions, including U.S. Hotel Appraisals, HVS Latin America, HVS Brokerage & Advisory, and HVS Asset Management & Advisory. A frequent speaker at the nation's largest hotel conferences, Rod is a designated member of the Appraisal Institute (MAI) and a state-certified appraiser. He earned his BS from Cornell University's School of Hotel Administration and also holds a Colorado real estate broker's license. 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. Contact Rod at (214) 629-1136 or .