

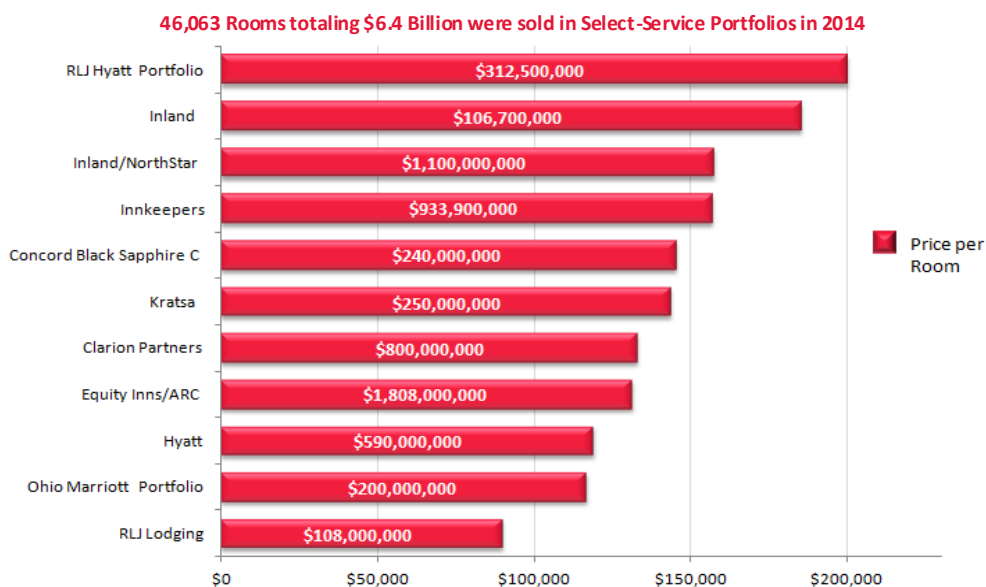
# Analyzing Select-Service Portfolio Transactions in 2014

Susan Furbay | January, 2015

HVS

Portfolio transactions rose in 2014, a reflection of improving investment and performance conditions for U.S. hotels. The following article looks at the major sales and how portfolio transactions can raise the value of individual hotel assets.

The U.S. hotel market experienced a growing number of select-service portfolio transactions in 2014, the result of extremely strong buyer demand and owners willing to sell to capitalize on rising hotel values. Nearly one dozen portfolios consisting of select-service hotels changed hands in 2014, with total sales soaring to \$6.4 billion and average price per key hitting \$140,000.<sup>1</sup> The table below details buyers, sellers, dates of sale, and key figures from these transactions.



Portfolio Name	Date	No. of Properties	No. of Rooms	Cap Rate	Buyer	Seller
Equity Inns/ ARC Hospitality	To close Feb-15	116	13,744	-	American Realty Capital Hospitality Trust, Inc	Whitehall Real Estate Funds
Inland Hotel Portfolio	Nov-14	4	575	-	Chatham Lodging Trust	Inland American Real Estate Trust
Kratsa Hotel Portfolio	Nov-14	15	1,739	-	Aimbridge Hospitality	Kratsa Properties
Inland/NorthStar Hotel Portfolio	Nov-14	52	6,976	-	NorthStar Realty Finance/Chatham	Inland American Real Estate Trust
Hyatt Hotel Portfolio	Sep-14	38	4,950	-	Lone Star Funds	Hyatt Hotels
Ohio Marriott Select-Service Portfolio	Sep-14	16	1,711	-	Aimbridge Hospitality	CrossHarbor Capital Partners, LLC
Clarion Partners Hotel Portfolio	Aug-14	47	6,013	8.0%	Blackstone Group	Clarion Partners
Innkeepers Hotel Portfolio	Jun-14	47	5,945	7.5%	NorthStar Realty Finance	Cerberus
Concord Hospitality Black Sapphire C Portfolio	Apr-14	13	1,650	8.2%	Abu Dhabi Investment Authority	Concord Hospitality
RLJ Hyatt Portfolio	Mar-14	10	1,560	6.8%	RLJ Lodging Trust	Hyatt Hotels
Blackstone Upscale Select-Service Portfolio	Mar-14	15	1,856	-	The Blackstone Group	OTO Development, LLC
RLJ Lodging Hotel Portfolio	Feb-14	11	1,200	7.9%	Sage Hospitality	RLJ Lodging Trust

Overall, transaction prices ranged from just over \$106 million for the four-hotel Inland Hotel Portfolio to more than \$1.8 billion for the 116-hotel portfolio to be acquired by American Realty Capital Hospitality Trust in February of 2015. A good number of the hotels comprising the past year's select-service portfolio transactions are slightly older properties affiliated with nationally recognized brands, such as Courtyard by Marriott, Residence Inn by Marriott, Hilton Garden Inn, and Hyatt Place. Most of these properties are located in secondary markets, though some are in gateway or urban markets such as San Francisco, Los Angeles, and Chicago.

Buyers included Blackstone, RLJ, and Aimbridge, as well as newer players such as NorthStar and Lone Star Funds. It is notable that such firms have begun to enter the hotel market to deploy idle capital and take advantage of the attractive yields hotel investments provide compared with other real estate classes. A wide range of industry participants played the role of sellers, including private owners/operators, public and private REITs, and publicly traded real estate companies aiming to capitalize on today's robust pricing environments.

These transactions illustrate how certain factors shift in favor of a portfolio sale versus if the individual hotel assets that make up the portfolio were sold by themselves. If transacted as single assets, for example, it is most likely these hotels would have sold at a higher cap rate due to their age and a significant amount of deferred capital expenditures. The select-service portfolios detailed above transacted in the 6.0% to 8.0% cap-rate range, which is roughly 75 to 100 basis points below a single-asset transaction for a comparable hotel.

## CMBS Lenders Loom Large in Recent Portfolio Transactions

As investors seek higher yields and advance along the risk curve, more capital is flowing into the lodging sector. This has created an extremely competitive deal-making environment, thereby driving asset prices skyward. Non-traditional hotel investors, as well as active hotel investors that were up to this point not looking for select-service hotels, negotiated vigorously for these portfolios in a campaign to recycle idle capital.

Strong debt markets, particularly in the form of CMBS loans, have figured prominently in the rising number of select-service hotel portfolio transactions. While some owners had difficulty in modifying and working out their CMBS loans during the economic downturn of 2008 through 2010, the low cost of debt continues to attract investors to CMBS financing. For CMBS loans, loan-to-value remains at around 65% to 75%, though for some transactions supported by mezzanine financing, loan-to-value can be closer to 80%. Spreads for floating-rate loans ranged from 350 to 450 basis points over LIBOR and fixed-rate loans have been locked at around high 100 to mid-200 basis points over the ten-year Swap Rate. The strong resurgence of CMBS issuances factors heavily in larger deals with multiple tranches, with more single-borrower deals and hotels becoming a larger percentage of the pool, up from 3% to 5% two years ago to the high teens and even 20% today.<sup>2</sup>

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<sup>1</sup> This does not include the Blackstone Upscale Select-Service Portfolio, for which the transaction price and price per room figures were unavailable.

<sup>2</sup> Per CoStar and Trepp

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## Robust Hotel Market Performance

The rising number of select-service portfolio transactions in 2014 demonstrates the belief among investors that hotel performance metrics will continue to improve in the coming years. As of October of 2014, the U.S. hotel industry had experienced an 8.4% RevPAR increase; RevPAR had risen 8.8% for upscale chains, a tier populated mostly by select-service hotels.<sup>3</sup> Occupancy for upscale chain hotels is forecast to finish the year in the 76% to 77% range, while average rate is expected to realize a more than 5% increase over the same period of 2013.<sup>4</sup>

Many of the assets belonging to select-service portfolios sold in 2014 are located in primary markets such as Nashville, Augusta, Denver, Sarasota, and Oakland, which all experienced RevPAR growth in the mid-to-high teens through October of 2014. Most of the same markets are projected to realize double-digit RevPAR growth in 2015. As demand continues to strengthen, and with supply expected to grow only 1.3% to 1.4% in the coming year, circumstances seem strong for RevPAR to move even higher in 2015. According to HVS analysis based on data from various sources, RevPAR is projected to increase by 6.2% to 7.4%, which should lend even greater incentive to the investment community to continue deploying their capital in hotels.

## How HVS Values Portfolio Transactions

As alluded to above, there are some considerations critical to the accurate valuation of hotel assets belonging to a portfolio. Most importantly, once the individual appraisals are completed for each asset in the portfolio, a slight premium is applied to factor in the advantages associated with a portfolio versus multiple single-asset transactions. Such advantages, which influence the market value of the portfolio under the assumed conditions of sale, include the following:



### Geographic Diversification

An investor may see reduced risk for an investment based on cross-collateralization of multiple properties spread across multiple markets, a benefit referred to as "geographic diversification." Essentially, while one market may be suffering from negative economic conditions (as well as lack of demand or too much supply), other assets may be located in markets with positive economic circumstances. When the well-performing assets or markets outweigh the less successful, the assets in a portfolio rise, overall, in value.



### Physical Condition Diversification

An investor may also find reduced risk for an investment based on the diverse range of properties in a portfolio. This includes hotels of different ages, brands, designs, and physical conditions. Any given hotel is subject to negative impacts from changing guest preferences, dated aspects of design, branding, or physical condition. The balance of other properties in a portfolio, however, diminishes these effects. As with geographic diversification, the various stages of physical or functional obsolescence among portfolio properties can make each asset a less risky investment.



### Lower Closing Cost and Cost of Capital

For portfolio transactions, closing costs tend to be lower due to economies of scale on relevant fees, such as reduced third-party studies and brokerage commissions. In addition, portfolio buyers often incur a slightly lower cost of capital because they offer cross-collateralization to lenders, as described above, which allows for a less strict set of loan underwriting parameters. This justifies a downward adjustment of discount rates and termination capitalization rates to reflect a slightly higher value for each individual asset, adding a premium to the portfolio as a whole.

## Conclusion

Aided by a strong debt market, investors put an enormous amount of equity into select-service hotel portfolios in 2014. Along with the economy, the performance of the U.S. hotel industry looks to stand strong in 2015, which should produce even more motivated sellers looking to cash-out under the right conditions, as well as buyers motivated to park their cash in hotel real estate with the potential for upward growth. Questions remain about the extent to which the economy will continue to grow and the potential rise in interest rates this year, conditions that will factor into the transactions market for single-asset and portfolio hotel sales. Nevertheless, much of what made 2014 such a stellar year for portfolio transactions remains true thus far into 2015, setting the stage for attractive multi-property hotel investments.

<sup>3</sup> Smith Travel Research

<sup>4</sup> Ibid.

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