MARKET REPORT

Understanding the Current State of the Hotel Transaction Market

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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.

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)

Current Trades

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.