Growth and Development of the Hotel-Motel Industry

Origins of the Lodging Industry

The hotels and motels we know today evolved from small, one-room, private dwellings that served merchants as early as 500 B.C. From this modest beginning, the hotel industry has come to play a vital role in the development of trade, commerce, and travel throughout the world.

The first record of innkeeping law is found in the code of Hammurabi, who ruled Babylonia in approximately 2000 B.C. The code sets forth specific regulations for the operation of Babylonian taverns and inns, including corporal penalties for watering down the beer. In this period, taverns and inns were prevalent throughout Greece, Italy, Egypt, and Asia. Greek taverns were frequently located near a temple for easy preparation and transportation of sacrificial animals. These establishments provided travelers with food, drink,

and sometimes a bed. The Olympic Games, which were begun in Greece in 776 B.C., involved travel for both spectators and players, creating a demand for accommodations.

During the rise and fall of the Roman Empire, travel for pleasure became possible due to good roads, stable government, economic prosperity, and increased leisure time. Educated, affluent Romans vacationed in Greece and toured Egypt. An excellent network of consular roads and post houses was developed to handle this increased travel demand.

After the fall of the Roman Empire in A.D. 476, travel and trade decreased significantly. The Middle Ages was a time of unstable politics and danger on the roads. Religious travelers were common, however, as the church increased its dominance. Religious orders provided accommodations for travelers in monasteries and the hospices, or inns, they operated. Most trips during this period were pilgrimages to holy sites or journeys to fight in the Crusades, which began in A.D. 1095 and lasted approximately 200 years.

In the thirteenth century the innkeepers of Florence, Italy, formed the first hotel guild. Guild members interviewed visitors at the city gate, assigning foreigners to certain lodging facilities and local visitors to others. Most guild members did not own their hostelries; they rented them under three-year leases from the city.

A resurgence in the demand for lodgings started in England during the Industrial Revolution (1760) when the British government arranged for mail to be delivered by coach. A nationwide posting system was created and a network of posting inns was established to accommodate the young postboys and provide a change of horses. Travel by coach became fashionable and long coach trips gave rise to overnight lodging demand and the development of the English inn. These lodging facilities, forerunners of the modem motel, were located on coach trails to provide refuge for weary travelers and protection from highwaymen. Accommodations in these inns typically consisted of individual, unheated rooms with straw beds for the nobility and common

sleeping areas on stone floors for their servants. Travelers and local townspeople alike enjoyed hearty food and drink.

The American counterpart of the English inn was the colonial inn and tavern. Such inns sprang up in seaport towns and along stagecoach roads and canals. In addition to providing travelers with overnight accommodations, colonial inns were often public gathering places used for courts of law, town meetings, and school classes. Massachusetts recognized the importance of inns to statewide commerce and passed a law penalizing any town that did not provide this convenience.

The following description of a colonial inn illustrates how far American hostelries have come in 200 years:

> Accommodations often meant sleeping on the floor of the "long room," with one's feet turned toward the fireplace and one's head on a rolled-up coat, alongside a dozen or more other persons of

> both sexes. It meant a quick cold-water wash in an outdoor basin and gingerly use of a communal towel. A warning blast on the landlord's cow horn meant all hands to table, ready to tackle breakfast with fingers and knives. 1

Over time the accommodations provided by colonial inns gradually improved in response to the needs of a mobile, restless society and American innkeepers assumed their place as important community figures. Samuels Coles of Boston, who opened one of the first taverns in America, became a leading church member and a steward of Harvard University. Because inns functioned as centers of political and social activity, their owners and operators enjoyed a high profile in the community.

The First Hotels

[1] 1. Leslie Dorsey and Janice Devine, Fare Thee Well (New York: Grown Publishers, Inc. 1964), 4.

The first hotel constructed in the United States was the 73-room City Hotel, located at 115 Broadway in downtown New York City. Completed in 1794, the City Hotel was enormous compared to colonial inns and served as a model for similar establishments in Boston, Philadelphia, and Baltimore.

Boston's first hotel was the Exchange Coffee House (1806), which boasted seven stories and 200 rooms, many overlooking a five-story, domed interior courtyard (a fore- runner of the atrium concept). Philadelphia's first hotel, the Mansion House, was built in 1807. Baltimore followed, opening the Baltimore City Hotel in 1826. Each of these properties was larger and more lavish than its predecessor and became the focus of civic pride.

During the 1800s hotels moved westward and flourished in major American cities and towns. The Tremont House in Boston started a trend toward luxury accommodations by offering unheard-of services and amenities: private gues-trooms, doors with locks, a washbowl with a water pitcher and free soap, bellboys, French cuisine, and an annunciator system that allowed the front desk to contact guests in their rooms.

Spurred by the success of the Tremont House, hotels across the country attempted to outdo each other in size, luxury and inventiveness. In 1836 the Astor House in New York City installed steam-powered pumps to send water up above the first-floor level so that plumbing could be installed on upper floors. The New York Hotel, built in 1844, was the first hotel to provide private baths connected to some of its bedrooms. The Buffalo Statler, built in 1908, included private baths in all of its guestrooms. In 1835 the American Hotel in New York City was the first to have gaslight throughout the building. Edison's electric light was first installed in the public areas of the Hotel Everett in 1882 and the Sagamore Hotel, which opened in 1883 on Lake George, New York, was the first to have electric lights throughout. In 1894 the Hotel Netherlands in New York City installed the first hotel telephone system. The Fifth Avenue Hotel in New York City was the first to have elevators, an innovation that later enabled hotels to be constructed as high-rise structures. The first fully air-conditioned hotel was the Detroit Statler.

As the number of hotels increased, many properties faced the prospect of rapid obsolescence and a consequent loss in value. The City Hotel, for example, became obsolete in 15 years due to competition and was converted into an office building 38 years later. The trend-setting Tremont House was closed for major modernization after 20 years of operation and was considered a second-class property during the last two decades of its 65-year life. Today hostelries face similar problems because of constant changes in modes of transportation and customer preferences as well as competition from newer properties.

The hotels of the mid-1800s followed the railroads westward, and ornate, luxury properties were constructed at major rail centers: the Palmer House in Chicago (1882), Brown Palace in Denver (1893), and the Palace in San Francisco (1875). Hotels became status symbols, and cities tried to outdo each other by building larger and more expensive facilities. In many cases the hotels developed far exceeded existing or potential markets.

In addition to luxurious city hotels, resort hotels were introduced as new rail lines enabled affluent Americans to travel on vacation. Spas, which were considered the first American resorts, were opened in Saratoga Springs, New York (Grand Union Hotel) and White Sulphur Springs, West Virginia (the Greenbrier). Other grand resort hotels built during the 1800s were the Hotel Del Coronado outside San Diego, California, the Ponce de Leon in St. Augustine, Florida, and the Broadmoor in Colorado Springs, Colorado.

Travelers who could not afford luxury accommodations usually were forced to stay at rundown roominghouses, which offered only minimal services and cleanliness. As rail transportation became affordable and more middle-class people began to travel, a new type of hostelry was needed to fill the gap between luxury hotels and roominghouses.

E. M. Statler recognized this demand and built the nation's first modern, commercial hotel in Buffalo, New York. When the Buffalo Statler opened in 1908, it offered many revolutionary conveniences: private baths, circulating ice water, full-length mirrors, overnight laundry, and free morning newspa-

pers. Statler's slogan, "A room and a bath for a dollar and a half," put clean, comfortable transient accommodations within the reach of millions of Americans and increased the interest in travel among the middle class.

Prosperity, Decline, and Renewal

The economic prosperity of the 1920s produced one of the greatest hotel-building booms in America's history. Encouraged by rising occupancy rates, which exceeded 85% in 1920, hoteliers expanded existing properties and constructed hundreds of new and larger facilities. During this period the number of available hotel rooms in some cities doubled with the addition of large convention properties. Chicago's 3,000-room Hotel Stevens (now the Chicago Hilton) opened in 1927 and was the world's largest hotel for more than 35 years.

During the Roaring Twenties, hotel promoters set up shop in towns and cities throughout the United States and sold local residents on the idea that real

estate was a sound and safe investment vehicle. Their sales pitch was not based on economic feasibility, but on civic pride and a chance to raise neighborhood or personal prestige. In some cases local merchants were promised patronage from hotel guests if they invested in the project. Seldom did an independent expert prepare a market study and appraisal; instead, the class, size and design of the facilities to be built were frequently determined by the amount of money that promoters could raise. In these "community-financed" hotel projects, real estate bonds for first and second mortgages were sold to members of the community. In many cases the financing structure involved high leverage and an inordinate amount of risk. The financing fees and commissions charged by promoters tended to be very high and were usually paid as soon as the financing was in place, so that the promoters had no vested interest in the performance of the hotel.

Beginning in the mid-1920s, Hotel Management magazine, a trade publication now known as Hotel and Motel Management, published articles by several industry spokespersons warning against "over-hoteling." They urged professional hoteliers to tell the public the "real facts" about hotel occupancy

levels and financial condition to offset the exaggerated stories that had circulated earlier in the decade and contributed to overbuilding. To illustrate the extent of the problem, a nationwide survey was conducted in 1928-29 by an objective body, the Engineering-Economics Foundation. This postgraduate institution in Boston performed the research, quantifying hotel room supply, guest demand, occupancy levels, rates, and hotel failures from 1919 to 1928. They found that nationwide occupancy had dropped from 85.5% in 1920 to 67.6% in 1928. At the same time room rates appeared to be fairly constant, but the Foundation claimed that additional services had to be provided to guests, which effectively lowered the rate achieved. The number of hotel failures also illustrated a downward trend, with 64 reported in 1924 and 112 in 1928.

The Depression of the 1930s put an end to new construction and sent more than 80% of the nation's hostelries into foreclosure or receivership. By 1933 one-third of the country was out of work and the gross national product had dropped almost in half. Both commercial and leisure travel came to a virtual standstill, and the average national hotel occupancy fell to just over 50%.

Although the Depression forced many hoteliers out of business, it offered those with cash the opportunity to expand their holdings by purchasing distressed properties from receivers and lenders. Parties who had taken debt positions in the original financing structure found themselves owning a piece of the hotel after it was foreclosed. These parties included both institutional lenders and individual investors who had purchased mortgage bonds through public subscriptions in the 1920s. None of these investors were knowledgeable about hotel operations and all were eager to sell the properties or their shares to any willing buyer at greatly reduced prices. This created an exceptional opportunity for those who understood the hotel industry and had some available cash or credit.

Typical purchase terms for failed hotels required a small cash down payment from the buyer with the lender providing a restructured debt component for the balance of the purchase price. During the Depression prominent appraisers warned investors not to value hotels based on the assumption that the prevailing low levels of income would continue into perpetuity; they projected future earnings to turn around in three to five years. For the U.S. hotel in-

dustry, the Depression lasted longer than anticipated because of the severe overbuilding that had preceded it and the lack of commercial and pleasure travel during the 1930s.

During the Depression several hotel companies significantly expanded their holdings, which provided the impetus for the establishment of national hotel chains. Conrad Hilton began his lodging chain in 1919 with the acquisition of the 40-room Mobley Hotel in Cisco, Texas. During the 1920s he purchased and developed a total of eight hotels throughout the state of Texas. Because his hotels were highly leveraged, Hilton lost three of his properties during the Depression, but by 1935 profits from oil leases provided him with the cash to satisfy his creditors and to fund new purchases. Hilton took control of the Sir Francis Drake in San Francisco, the Town House and Rosslyn Hotels in Los Angeles, and the Roosevelt and Plaza in New York. In 1945 Hilton was able to acquire the Palmer House in Chicago for less than $20 million, although it cost more than $25 million to build in 1929. In that same year, Hilton acquired the Stevens Hotel in Chicago for about $8 million; that hotel was

built in 1925 for $30 million. In 1942 Hilton bought the Waldorf-Astoria bonds for 4.5% of their original value.

Ernest Henderson founded the Sheraton hotel chain in 1937 with the purchase of the Stonehaven Hotel in Springfield, Massachusetts. Although he was inexperienced in hotel operations, he understood real estate and the use of leverage and had some cash available. He took advantage of the depressed hotel prices of the 1930s and early 1940s and the readiness of sellers to negotiate. By 1941 his company had acquired four more hotels and was on its way to building one of the nation's largest lodging chains. Henderson believed in leveraging his cash position and acquiring hotels with a minimum amount of cash, sometimes negotiating with sellers to take back second mortgages in return for higher selling prices.

Leading hotel companies such as Hilton and Sheraton were able to overcome the fears of bankers and other lenders who were wary of independent developers and hotel investments in general. With fire sale prices and very favorable financing terms, strong hotel companies with prominent names and

proven track records were able to continue their expansion. In some cases the hotel chains guaranteed their mortgages by putting all their hotel properties up as collateral. This strategy enabled them to borrow 60% to 70% of fair market value of the property.

It was not until the early 1940s that the US. hotel industry started to recover. By this time the general economy had improved and the hotel room supply had been significantly reduced by closures. What really revived the hotel industry was the onset of World War II. The massive movement of defense industry workers, military personnel, and their families created an unprecedented demand for transient accommodations, and the national occupancy level soon exceeded 90%. Although most towns and cities needed more lodging facilities during this period, there was little new hotel construction because financing, materials, and labor were unavailable.

Financing for new hotels was unavailable because lenders and investors were still wary of risk after the downswing of the Depression. In some areas the hotel room supply was actually reduced because hotels were converted into

housing for the troops. Properties such as the Hotel Stevens in Chicago and the Greenbrier in West Virginia actually served as barracks during the 1940s.

Labor and material shortages during the war years made it difficult for hotels to maintain a high standard of service. It was common for guests to wait hours in hotel lobbies only to find that no rooms were available. At one point New York City hotels had to limit guests to a stay of three days.

The 1950s marked the beginning of a radical change in transportation. The railroad, which had served travelers for more than a century, began to lose customers to the more economical automobile and the faster airplane. The technology developed during the war helped produce a more affluent population that enjoyed shorter work weeks, more leisure time, and a new freedom to travel. The "mobile society" was born, and an increasing number of people took advantage of the convenience of highways and airlines.

Sites directly across from downtown railway stations, which were once considered prime hotel locations, quickly became less desirable and economically obsolete. A more informal lifestyle was developing, and the traveling public seemed willing to sacrifice luxuries such as doormen, bellhops, valet parking, and evening turndown service in exchange for less expensive rooms.

The Birth of the Motel

A new type of highway-oriented lodging facility offering inexpensive, "no-frill" accommodations was needed to meet the needs of travelers and, in 1950, the modern motel was born. Although the origins of the motel can be traced to the relatively primitive tourist cabins of the 1930s, the motels of the 1950s offered much better facilities.

Most early motels were one-story, wood-frame structures built on slabs with approximately 20 to 50 units. Their modest rooms had inexpensive furnishings, particle board walls and ceilings, tile floors, small baths and metal

shower stalls, and radios. Few motels at this time provided food and beverage service or meeting rooms.

Although motels were spartan compared to most hotels, they became competitive because of their convenient highway locations, ample free parking, and low rates. The motel market included vacation travelers (especially young families and senior citizens), salesmen, middle managers, and government employees. Operating statistics for the 1950s show steadily declining hotel occupancies, but stable occupancy levels for motels. Because the number of motel rooms was increasing at the time, motels obviously were beginning to capture a transient market previously monopolized by hotels.

The first motels were radically different from hotels with respect to size, construction costs, land values, operating ratios, and management requirements. The distinction between hotel and motel has lessened, however, due to a variety of factors:

- Motels began to increase in size with additions to existing properties and more total units constructed for new properties.

- Motels joined referral groups and franchises to obtain national images and greater exposure.

- Motels started offering more amenities: television, air-conditioning, shag carpeting, tile baths, telephones, swimming pools, restaurants, lounges, meeting and banquet rooms, and gift shops.

- Motels began providing more services: 24-hour telephone switchboard and front desk attendants, nationwide telephone reservation systems, acceptance of credit cards, direct-dial guestroom phones, and morning wake-up calls.

- Improved building techniques were introduced, including the use of concrete and steel, pre-assembled units, and high-rise construction.

By the mid-1960s, most new motels offered all the facilities and amenities typically available at hotels. At the same time, hotels were modifying their operations to compete with motels. The result was a gradual merging of the two types of properties into a new type of facility known as the motor hotel. Motor hotels combined the services and facilities of hotels with the convenience of motels.

Although independent motels and motor hotels flourished throughout the United States, their potential guests had little idea of what to expect when they pulled off the highway. Standards of service and quality varied and guests were frequently disappointed. Kemmons Wilson recognized this problem when traveling with his own family and saw it as an opportunity. In 1952 Wilson started a new era in the hospitality industry by founding Holiday Inns, one of the earliest motel chains. Holiday Inns offered guests a modern

motel with standardized service, a recognized name, and moderate prices. Starting with four motels near Memphis, Tennessee, in the early 1950s, the Holiday Inn chain grew to more than 100 motels nationally by 1960. This tremendous growth was accomplished by selling franchises to individuals who would operate the properties as their own businesses. The first Holiday Inn franchise was sold in Clarksdale, Mississippi for $500 and a flat fee of $.05 per occupied room. In return for these payments, the franchisee received the Holiday Inn name and logo, architectural plans, training and operation manuals, and national advertising. In 1964 Holiday Inns launched its Holidex I reservation system and a major benefit was added to the franchise package. Kemmons Wilson was overwhelmed with franchise applications.

During the 1950s the supply of motel rooms nationwide increased from 600,000 to 1,500,000. Several factors contributed to this large increase. The first was the passage of the Interstate Highway Act in 1956, which laid out a map for the growth of highways and thus roadside motel sites. Those traveling on interstate highways bypassed motels on state highways and these older lodging facilities rapidly succumbed to external obsolescence. A second

factor contributing to the increased motel supply was a change in the income tax laws in 1954, which permitted real property owners to use an accelerated method of depreciation. This led to a period of readily available cash from "tax-based" hotel deals. In such deals, syndicators offered investors participation in hotels and the benefits of large depreciation and interest expense deductions to offset income in the early years of the investment. Franchising was the third factor contributing to the growth in the supply of motel rooms during the 1950s. The ability of developers to benefit from the name recognition of motel franchises enticed many non-hoteliers into the business.

Lodging Chains

Several new lodging chains were established in the late 1950s and early 1960s. The Marriott Corporation, formerly known for its food service business, entered the lodging industry in 1957 with its Twin Bridges Marriott Motor Hotel in Arlington, Virginia, outside of Washington, D.C. Marriott is now the largest operator of hotels in the United States.

In 1957 the Pritzker family of Chicago diversified its holdings by entering the lodging industry with the purchase of the Hyatt House at the Los Angeles International Airport. Hyatt is now a leading operator of convention hotels. Hyatt hotels are best known for their spectacular atrium lobbies.

In 1954 the Howard Johnson Company, known for its restaurants, opened its first motor lodge. By 1959 the Howard Johnson name was already on 75 motor lodges, both company-owned and franchised. In the mid-1950s Marion Isbell and his associates began acquiring motor hotels in the Southwest. By 1962 they had formed the Ramada Inn chain.

In 1962 the Carlson Companies, founded by Curtis Carlson, acquired the Radisson Hotel in downtown Minneapolis to initiate that company's diversification into the hotel business. The company began purchasing and renovating inner-city hotels in the Midwest and operating them under the Radisson name.

International activity by American hotel companies became prevalent in the 1960s. Inter-Continental Hotels Corporation, a Pan American Airways' subsidiary which was established in the late 1940s with the opening of the Inter-Continental in Belem, Brazil, continued to develop hotels in Latin America. Hilton Hotels, which had been operating the Caribe Hilton in Puerto Rico since the late 1940s, established their Hilton International division in the 1960s, expanding their operations into Europe and South America.

A move toward vertical integration within the airline and lodging industry occurred during the 1960s as several large airlines acquired or merged with hotel companies. Trans World Airlines purchased Hilton International Corporation. United Airlines purchased the Western International chain (now Westin Hotels). American Airlines started purchasing and developing their own hotels under the name of Americana Hotels. As of now, all these relationships have been terminated, showing that the ownership synergy between the travel and lodging industries is not as strong as was once believed.

Arrival of the Budgets

As the motel evolved into the motor hotel, it began to lose one of its primary competitive advantages--price. By providing more facilities and services, motels were forced to charge higher rates. This created a void at the low end of the room-rate scale and precipitated the creation of the "budget motel."

Budget motels were introduced in 'the late 1960s and flourished during the building boom of the early 1970s. These hostelries offered accommodations at prices substantially lower than the prevailing rates of first-class motor hotel chains. To offer this discount, budget motels take advantage of lower initial investment costs, operating efficiencies, and high volume.

Lower Initial Investment Costs

The initial investment costs for budget motels are lower because these facilities have smaller guestrooms, minimal public space, lower land costs, and a simple, no-frills design. The quality of construction, however, is not reduced.

Guestrooms in budget motels average 250 square feet, while rooms in conventional motor hotels typically contain 335 square feet. Smaller rooms reduce construction costs and interior decorating expenditures and less land is needed to build a budget motel. Budget motels eliminate low-revenue public areas such as meeting and banquet rooms, large lobbies, extensive food and beverage facilities, and executive offices.

Because the size of the facilities is reduced, budget motels require approximately 1.6 acres per 100 rooms, compared to 2.5 acres per 100 rooms for conventional motels. Additional savings can sometimes be realized by utilizing secondary locations such as land off an interchange or a short distance from the prime commercial/office area. Most people traveling on a budget are willing to drive a little farther for a better price.

Budget motels are planned for the efficient use of materials and space. Guestrooms are double loaded (back-to-back) and constructed on concrete stabs with cinderblock walls between rooms. Modular construction has been successfully used in some areas. Landscaping and decoration are kept to a minimum.

Many budget motels are built with construction specifications and standards similar to those of conventional motor hotels. Operators realize that inferior materials and building techniques may produce initial savings, but are a poor choice in the long run when repair and maintenance expenses are considered.

Operating Efficiencies

Compact facilities and fewer guest services contribute to operating efficiencies and result in lower expenses. With smaller guestrooms and reduced public space, budget motels require less cleaning and maintenance and can be

more efficiently heated and lighted. Some budget chains use maintenance teams that work at several properties, performing routine repairs and preventive maintenance.

The elimination of bellmen, elaborate food and beverage facilities, room service, entertainment, the acceptance of credit cards, and other services reduces payroll and operating expenses. Major savings are realized on food and beverage service; in budget motels cafeteria and coffee shop service is typical. Often a budget hotel will lease adjacent land to a restaurant chain to avoid any involvement in the food service business.

Price, location, and good value for the traveler's money tend to generate high volume for budget motels. The main reason travelers select a budget motel is price. As with any product that has an elastic demand curve, a reduction in price increases volume. Operating results substantiate this premise --i.e., budget motels typically operate at higher occupancy levels than surrounding conventional properties. Many budget motels are purposely located next to higher-priced hostelries to attract price-conscious travelers.

Although budget motels economize in many areas, they tend to provide clean, good-quality guestrooms. The rooms contain comfortable beds, full baths, color television, standard furnishings and fixtures, and cheerful drapes, bedspreads, and wall coverings.

From an investment or valuation perspective, budget motels are often vulnerable to the adverse effects of increased expenses and decreased occupancies. Because of its lower price structure and similar fixed costs, a budget property generally has a higher breakeven occupancy level than a standard motel. Appraisers must consider this greater risk when projecting income and expenses and determining a proper capitalization rate.

The 1970s Hotel Boom

As budget motels began to inundate the market in the 1970s, the entire lodging industry experienced the start of a construction boom reminiscent of the

1920s. Many factors contributed to this period of expansion and later led to its demise.

New construction was sparked by the enormous amount of financing made available by all lenders, particularly real estate investment trusts (REITS). These high-leverage finance companies were created to allow small investors to participate in real estate mortgages and equities. The concept was quickly accepted by Wall Street, and soon billions of dollars were available to finance real estate projects. Many lenders became so overwhelmed with new money that their underwriting procedures broke down and some marginal developments were approved.

During the late 1960s and early 1970s, hotel companies were actively expanding their chains through franchising. Franchising was a source of new capital for hotel franchise companies, allowing them to grow and achieve national recognition using the franchisee's financial investment in individual properties. Some franchisors, eager to demonstrate sustained growth and become national in scope, employed questionable marketing tactics to sell new fran-

chises. Many of those selling franchises were compensated based on the number of franchises sold, so there was little incentive to discourage developers from investing in poor locations and overbuilt markets. Many lenders and hostelry developers were led to believe that a national franchise would guarantee a successful operation.

The combination of readily available financing and aggressive hotel chains eager to sell franchises resulted in overbuilding and the development of many poorly located, undercapitalized hostelries managed by inexperienced owners. The bubble burst on the lodging industry when inflation caused construction costs and interest rates to escalate; the 1974 energy crisis drastically reduced travel, and the accompanying recession curtailed business trips, conferences, and conventions.

Operators of marginal properties quickly fell behind in their mortgage payments, and lenders were forced to foreclose. As lenders became hostelry owners, they either organized workout departments headed by experienced hoteliers or engaged professional motel management companies to assume

operational responsibilities. Sales data indicate that lenders who were looking for quick sales to remove non-performing hotel assets from their books had to lower their sales prices substantially to attract all-cash buyers. Lenders who were willing to hold on to foreclosed hotels and employ professional management to reposition and improve the properties' operation were generally able to recoup their original investments in three to five years as the hotel industry started to recover. However, even lenders who repositioned their properties had to take back favorable purchase-money financing to sell the properties because money from other sources was not available.

History has shown that, during economic downturns, hotel values generally do not fall in the same proportion as their declining incomes. Sellers, particularly lenders who take back hotels through foreclosure, are not always willing to sell at substantially lower prices. They are more likely to wait out the downward cycle and dispose of their assets when the market starts to rebound. Therefore, appraisers can best reflect market behavior by projecting out a facility's net income to a point of recovery and applying the proper discounted cash flow procedure over this time period.

The end of the 1970s was a period of relative calm for the lodging industry. Because most lenders were recovering from the financial wounds inflicted by the 1975 recession, they had little interest in making hotel/motel mortgages. New construction was restrained, consisting primarily of additions to existing properties and the development of some large, downtown, convention-commercial hotels. The rebirth of center city hostelries was a direct result of fuel shortages and the availability of government financing for inner-city redevelopment projects. Highway-oriented properties, on the other hand, were adversely affected by escalating gasoline prices and decreased automobile travel. These lodging facilities lost some of their appeal among investors and hotel companies.

Decreased building activity combined with the normal retirement of older hostelries from the lodging market and an improving economy created a favorable supply and demand relationship and record-high occupancy levels in 1978 and 1979. Average room rates increased rapidly as hotel operators took

advantage of the excess demand to recoup earlier losses and keep up with inflation.

The 1980s - A Decade of Change

During the 1980s the U.S. lodging industry experienced significant change. Another massive building boom took place, several new types of hotels were introduced, and hotel chains began to increase their product lines through segmentation. The industry started to focus on the global hotel market after foreign investors acquired several U.S. hotel chains and many individual properties. Use of the hotel management contract became the dominant means of operation for most publicly traded hotel companies.

After the decline in new hotel development during the late 1970s, the environment appeared suitable for a period of renewed hotel expansion. However, the Federal Reserve tightened the money supply in the 1980s, sending the

prime interest rate up to record levels. Most of the projects that were in the preliminary planning stages but lacked sensible financing were put on hold.

Eventually monetary and fiscal policies, along with declining energy prices, were successful at reducing the national rate of inflation. This produced a downtrend in hotel interest rates beginning in 1983 and suddenly massive amounts of capital were available for real estate investments. Hotel developers, effectively out of the market since the mid-1970s, rushed to create new projects. They were aided by several major real estate development incentives: favorable industry trends, readily available debt and equity financing, and unique income tax benefits designed to stimulate real estate growth.

Lodging industry trends during the early 1980s were favorable for new hotel development. Many markets showed relatively high occupancy levels, hotel room rates were generally able to keep up with inflationary price increases, and the travel industry was expected to boom as a result of a healthy economy. National demographics characterized by affluent baby boomers, two-income families, and more leisure time further fueled developers' optimism.

As in the past, sellers of franchises were aggressively signing up new prospects using product segmentation to justify the saturation of a market with a common brand.

This time financing was readily available from the savings and loan industry. After recent deregulation, these banks were permitted to lend on commercial real estate such as hotels. Although savings and loans had experience in making real estate loans on single-family homes, most had little expertise with commercial properties, particularly hotels and motels. The result was almost identical to the real estate investment trust fiasco the decade before. Loan underwriting and administration was inept and sometimes nonexistent; the quantity of loans made seemed more important than the quality of the real estate and the integrity of the borrower; and short-term monies were often being used to finance long-term mortgages.

On the equity side, the money raised for hotel developments and acquisitions generally came from syndicated limited partnerships. Most of these ownership structures were devised to take full advantage of the generous tax bene-

fits allowed for hotel real estate. Initially, the majority of hotel syndications were relatively small and the equity raised was less than $10 million dollars. Later, however, Wall Street investors saw the opportunity to make huge fees from selling these equities, and pools of hotels were packaged together and sold to investors in $100,000 units. Some of the larger packages attracted more than $100 million in equity. Everyone wanted to invest in hotels, particularly when the property was a prominent, trophy-type hotel or the sponsor organizing the partnership was a major hotel company. A number of the syndications sold out in minutes and some were even oversubscribed.

Another factor contributing to hotel development during the 1980s was the very favorable treatment provided by US. income tax regulations. By carefully structuring hotel syndications to take advantage of available tax benefits, investors could virtually recoup their total cash outlay in the first year and reap additional benefits in the future regardless of the economic success of the underlying asset. Because there was little incentive to justify a transaction's economics (i.e., cash flow and reversionary benefits), a number of syn-

dicators overpaid for premier trophy properties, took out excessive fees, and overloaded their hotels with debt.

Hotel franchisers also played an important role in this overbuilding through a new concept called segmentation. In order to show continuous growth, the hotel companies, which at the time catered to only one pricing segment, started to realize that they could create new products for other pricing segments and thereby offer two or more affiliations in the same market without directly competing against themselves. For example, Holiday Inns, a mid-price lodging chain, went upscale and established Crowne Plaza and then ventured downscale with Hampton Inns. Marriott, which was known as a first-class operator, went downscale with Courtyard and downscale further with Fairfield Inn. In addition to adding new pricing segments, hotel companies created entirely new products (e.g., the all-suite hotel, the extended-stay facility, and the microtel). Hotel developers soon went wild building new properties financed with plentiful amounts of available money and flagged with an assortment of franchises and new products.

A change in the tax law in 1986 eliminated many of the real estate tax benefits of hotels, but the overbuilding in most markets was either in progress or had already taken place. By the end of the 1980s, the abuses of the savings and loans became apparent, but it was too late to reverse the overbuilding.

Up until 1990, the lodging industry in most areas of the country was facing massive overbuilding which created a supply problem. Lodging demand was still strong and, although a recession seemed likely, most industry experts were hopeful that the economy would hold up. Given this favorable economic scenario and the fact that very little new development was anticipated for the first several years of the decade, some experts expected hotel occupancies to improve quickly and the lodging industry to fare better than it had during the 1970s. Unfortunately, the economy did go into a recession, which curtailed business, convention, and leisure travel and produced a downtrend in lodging demand.

The 1990s – Recession, Recovery, and Expansion

The national economy entered another recession in 1990 and this factor (coupled with overbuilding and the Persian Gulf War in 1991) caused the national hotel occupancy rate to bottom out in the low 60% range. In some markets, occupancy rates dropped as low as 35%. The supply and demand imbalance was almost identical to the situation in the 1970s that led to numerous failures. Trailing closely behind this downward occupancy spiral were hotel room rates. Full-scale rate wars broke out in many markets as managers, seeing their patronage erode, attempted to test the elasticity of hotel demand. Since lower room rates rarely create additional new hotel demand but rather redistributes the existing business among the area's facilities, this strategy produced only short-term revenue gains for some properties and eventually led to long-term profit declines for almost everyone.

Many hotels quickly fell behind with their highly leveraged debt service payments, and this immediately led to a rash of foreclosures and bankruptcies. During this same time, the savings and loan industry began to flounder under the burden of non-performing loans and the Resolution Trust Corpora-

tion (RTC) was created to handle the crisis. Since savings and loans were prominent hotel lenders at the time, the RTC soon started to take over hundreds of defaulted hotel loans and actual properties as they acquired insolvent banks. Instead of holding on to these assets and waiting for values to recover, the RTC held massive auctions and disposed of hundreds of hotel properties at bargain prices. Those investors that had the foresight to see a market turnaround made huge profits by buying low and selling high.

A number of lenders opted to restructure their non-performing hotel loans rather than force their borrowers into bankruptcy. Many combinations of principal reduction, interest rate adjustment and other types of forgiveness were structured to assist hotel owners in coping with excessive levels of debt service. Those borrowers who were able to survive and get through these crisis years generally preserved some of their equity and tax benefits.

By 1993, new hotel construction had declined significantly. Lenders, trying to get out from under problematic hotel portfolios, curtailed all real estate lending and would not even consider hotel financing opportunities. The tax ben-

efits associated with hotels had been reduced significantly, and passive investors left the hospitality market entirely. The slowdown in supply growth, coupled with an improving national economy emerging from recession, had a beneficial impact on occupancy levels, which began to recover in 1992. As increases in lodging demand outpaced the growth in supply, improved occupancy levels continued to move upward through 1994 and 1995. The occupancy improvement motivated the resumption of supply growth at this point, but only for smaller limited-service hotels, generally financed by local banks. However, higher-rated economy and mid-scale properties soon started to become economically feasible (i.e., economic value exceeded development cost), and these projects were more commonly financed with funds supplied by regional banks and Wall Street conduits who structured mortgage-backed securities to sell off pieces of the debt that were risk rated by the rating agencies. During this period, the replacement cost for first-class and luxury hotels still exceeded the value of similar existing properties, so little development took place in these two segments.

The re-emergence of Real Estate Investment Trusts (REITs) also influenced pricing trends and sales volume during the mid- to late 1990s. Given their structure, organizational purpose, and low cost of capital, REITs were driven by the need to grow by acquiring assets. According to information provided by the Lodging Research Network, the number of hotels owned by REITs increased from 39 in 1993 to 970 in 1998, while the number of hotel rooms controlled by REITs increased from 6,643 in 1993 to 183,784 in the first quarter of 1998. As the REITs and other public companies, including C-Corps, actively pursued high-quality hotels, the competition for these properties accelerated, placing upward pressure on hotel values. This rapid growth came to an abrupt end in mid-1998, when the stock market lurched downward from fears of a global recession, particularly in Asia. As the fears proved to be unfounded, stability returned to the capital markets, although the relationship between the stock prices of the larger hotel companies and the perceived health of the lodging industry continued to create a sense of uncertainty. As the decade ended, the budget and economy segments of the lodging industry were most at risk, whereas the luxury segment was the safest category for investment. New construction in the luxury sector continued to be difficult to cost-justify, so additions to supply have been minimal. Furthermore, the

barriers to entry and long development time required for hotels of this type is likely to delay overbuilding for a number of years.

Throughout the past decade, hotel values in the U.S. have fluctuated fairly dramatically. During the late 1980s and early 1990s, values declined in most parts of the country. The downturn, which began in most markets in 1988, was largely attributable to lower operating incomes caused by an oversupply of new hotel rooms that were constructed during the mid-1980s. Overbuilding resulted in flat or declining average rates and occupancies, which caused revenues to fall. A number of other factors exacerbated the situation. The national recession caused a drop in demand in many markets during the early 1990s, and the Persian Gulf War created a virtual freeze on travel in the beginning of 1991, further limiting hotel demand. Operating costs continued to rise despite poor market conditions, resulting in a decline in the net operating income of many hotels throughout the nation. Because operating costs have a large fixed component, some lodging facilities experienced precipitous drops in net income.

As bottom-line profits eroded, many hotels were unable to meet debt service, and hundreds of properties entered foreclosure or bankruptcy. Lenders and government agencies soon became hotel owners. Because most financial institutions were

preoccupied with their distressed real estate, very little mortgage capital was available and the nation suffered from a well-publicized credit crunch. The property owners, who, in most cases, were lenders, financed a majority of the hotel transactions that occurred during the early 1990s.

In the early 1990s, the primary market participants were owner-operators with the expertise to turn around under-performing properties. Hotels were out of favor with passive investors as a result of the industry's poor operating performance and the uncertainty of future appreciation. The wide disparity in buyer and seller expectations also limited the number of transactions. Many sellers were unwilling to accept the fact that the market value of their hotel investments had declined below the cost of the project or the original investment. Moreover, many owners were faced with a significant tax burden upon sale, further reducing their willingness to settle for a price that was below the original acquisition cost.

As a result of these market forces, there was very little sales activity involving large, high-quality hotels in the early 1990s. The primary difficulty was the lack of properties available for sale. Owners who were not forced to sell opted to wait for prices to recover. The few hotels that did enter the market during this period generally attracted 15 to 20 interested bidders, mostly consisting of owner-operators. As a result of the competition for these few assets, the prices of better-quality hotels began to escalate rapidly. In response, more sellers were encouraged

to place their products on the market, and the number of hotels available for sale (and the number actually sold) began to rise in 1994. This trend continued to accelerate through the first half of 1998.

An indicator of this market trend is the number of hotel sales that have occurred during the past few years. HVS International tracks major hotel transactions of more than $10,000,000 on an annual basis. In 1992, the number of major transactions was 70; a slightly lower level of 53 was registered in 1993. This total increased significantly, to 108 in 1994 and 147 in 1995. In 1996, the total number of major transactions soared to an estimated 227, then increasing again to 280 in 1997. The wider availability of mortgage capital was a material factor influencing the increase in both market activity and prices. Initially, the number of lenders returning to the market was extremely limited, and the underwriting criteria were fairly stringent: loan-to-value ratios were in the 60% to 70% range, and amortization periods were shortened to 20 or 25 years. The qualification of the borrower was also a crucial consideration for most lenders.

In the mid-1990s, an increasing number of lenders entered the hotel mortgage market. Although these institutions continued to adopt a cautious posture, the greater availability of funds fostered competition, particularly for high-quality assets and well-qualified buyers. As a result, loan-to-value ratios returned to historical levels of 70% to 75%, and interest rates decreased to the 8.0% to 9.5% range for

most deals. Amortization periods remained in the 20- to 25-year range. The lingering influence of the downturn in the early 1990s is evident in the widespread practice of underwriting based on net income after the deduction of management fees and a reserve for replacement; these line items typically total 7% to 8% of gross revenues.

The market for hotel investments slowed in the third quarter of 1998 due to a reduction in both equity and debt capital available for real estate acquisitions. At that time, many hotel buyers and conduit lenders withdrew from the market due to a downturn in lodging REIT and C-Corp stock prices and the uncertainty of capital markets. The number of major hotel transactions slowed to 241 in 1998 and declined further in 1999 to 118. The market improved somewhat in the first quarter of 1999 as the international capital market stabilized. Transaction activity in the first half of 1999 was significantly below that of the first half of 1998 due to the virtual withdrawal of REITs from the market. By the third quarter of 1999, hotel transaction activity increased once again as buyers and sellers adjusted to new pricing levels and took advantage of the relatively low cost of capital. Private equity capital and traditional debt from commercial banks and credit companies are expected to continue to fuel hotel transactions over the near term. Activity by conduit lenders and public lodging companies also resumed, albeit at a more moderate pace than that witnessed in 1997 and early 1998.

In 1998, moderate to high supply growth in the economy and mid-priced segments caused the U.S. hotel occupancy level to decline. The decline of occupancy in several major U.S. markets, coupled with the instability of the global economy, has caused several major lenders to halt hotel financing in fear of another economic slowdown. Furthermore, as the number of high-quality, available assets and the amount of available financing diminishes, sales activity is expected to slow. This will, in turn, likely result in the stabilization and decline of sale prices.

New Products and Concepts

In recent decades, several new lodging products were introduced including the all-suite hotel, the extended-stay hotel, and the hard budget hotel. These facilities have gained wide acceptance among the traveling public. While the all-suite hotel and the hard budget hotel essentially absorbed existing demand from traditional hotel products, extended-stay properties actually cre-

ated new transient lodging demand by attracting long-term travelers who had previously used apartments and residential hotels.

The all-suite hotel concept is based on the theory that certain types of commercial and leisure travelers do not use the meeting, banquet, restaurant and lounge facilities found in most full-service hotels. Taking the space allotted to these facilities and relocating it into guestrooms could create individual suites with separate living and sleeping areas. The key to the all-suite concept is to reallocate space in a manner that keeps the room rates charged for a suite similar to the room rates of comparable, full-facility hotels. This creates a favorable price-value relationship for the guest who does not need all the facilities found in a full-service property. Most all-suite hotels also offer a free breakfast and an evening cocktail hour to attract patrons.

The all-suite hotel has been well received by individual commercial travelers and by some leisure travelers. In many markets such hotels are currently the occupancy leader with room rates on par with similar, full-facility hotels.

Since they generally have limited food and beverage facilities, all-suite hotels are usually easier to operate and their profit margins are higher.

The extended-stay hotel is designed for the traveler who must stay in an area for five or more consecutive days. It differs from a standard hotel in that the rooms and amenities are oriented toward someone who wants a more residential atmosphere. The guestrooms in an extended-stay hotel have large living areas and full, eat-in kitchens; some have two separate sleeping areas, individual dining rooms, and separate baths. The exterior of such a hotel generally has a residential feel similar to a garden apartment complex, complete with recreational facilities and even barbecue grills.

The high occupancy levels realized by the initial wave of extended-stay hotel development dramatically heightened interest in this segment, and the number of extended-stay hotel products continues to expand, fragmenting into sub-segments ranging from economy to first-class. The true depth of the extended-stay demand segment remains difficult to gauge, although managers of the lower-rated extended-stay products often find themselves competing

with operators of conventional limited-service hotels, while higher-rated extended-stay products often compete as the equivalent of a first-class, all-suite hotels. Generally, the hotels succeed, as the strong investment in the guestroom offerings presents a strong price-value perception for guests of all stripes. Nevertheless, the operating efficiencies inherent in the design and operating concept are diminished as the length of guests' stays shrinks.

The hard budget is the 1990s version of the budget hotel. Over the years the budget hotel concept has gone through what has been termed "amenity creep." In an effort to increase room revenue and thus franchise fees, hotel franchise companies encourage franchisees to upgrade their properties by adding more amenities. This process generally starts with simple additions such as a free morning newspaper and continental breakfast; later it may spread to such extras as coffeemakers in guestrooms, free shampoo and other beauty supplies, fitness centers, turndown service, and so forth. Each of these amenities creates an expense that must be offset by an increase in revenue. In the end amenity creep can turn a budget hotel into a mid-rate property or a mid-rate hotel into a first-class property.

Hard budget has taken the budget concept back to basics. Its guestrooms have been downsized to only 192 square feet. It offers none of the normal hotel amenities such as a restaurant, lounge, meeting space, or swimming pool. A hard budget is 10% to 20% less expensive to construct, requires less land, is easier to operate and maintain, and can undercut the room rates of comparable budget hotels by as much as 25%. The hard budget concept, which had its genesis with Statler's "room and a bath for a dollar and a half," illustrates the recurring cycles in the lodging industry.

Market Segmentation

Market segmentation, as a hotel industry phenomenon, originated in the 1980s and continued through the 1990s. Market segmentation essentially represents an expansion strategy for hotel companies. When hotel chains such as Holiday Inn, Marriott, Hilton, and Sheraton were founded, they developed a standardized form of operation that was oriented toward a single

class of traveler. For example, Holiday Inns were designed, operated, and priced to appeal to the mid-rate commercial and leisure traveler. Marriott went after more affluent, first-class guests by offering higher-quality facilities and services. Over the years these chains developed strong brand loyalty among these specific classes and types of travelers. As it became apparent that markets for the "core" brand of these hotel chains were essentially satisfied (e.g., most of the available hotel markets within the United States had a sufficient number of Holiday Inns to satisfy their mid-priced travelers), the hotel chains had to find a vehicle for expansion that would allow them to develop or franchise additional properties within their established market areas. The answer to this dilemma was to develop a new product and brand name to capture a different class of traveler.

Market segmentation allows hotel chains to expand without simply drawing a portion of the demand away from their core properties. For example, Holiday Inns implemented market segmentation by developing an upscale hotel product with higher-quality finishes and decor, a higher level of service, and more amenities to attract first-class travelers. This brand of hotel was called

the Holiday Inn Crowne Plaza (now known only as Crowne Plaza). Going in the opposite direction, Holiday Inns also developed a downscale, budget-type product known as the Hampton Inn, which was designed to capture the more price-sensitive traveler. The Hampton Inn brand (which is now controlled by Hilton Hotel Corporation) offers a lower level of service than the standard Holiday Inn. It has no restaurant, lounges, or function room and the size of its guestrooms and the quality of its decor and amenities are less than one would expect at the typical Holiday Inn. By offering three types of products, Holiday Inns significantly increased the size of its potential market. This allowed the chain to develop or franchise hundreds of additional hotels within its established market areas throughout the United States.

Marriott has demonstrated the benefits of market segmentation as well as any hotel chain, leveraging the substantial goodwill and marketing power it has established through decades of consistent quality into nearly every possible hotel demand segment. Marriott has expanded by both segmenting and acquiring the rights to a variety of brands, including Residence Inn in the 1980s,

and, in the 1990s, Ritz-Carlton and Renaissance. These strategic acquisitions have emerged as another common means for sustaining growth.

Strategic Acquisitions and Mergers

Earnings growth is critical to public companies and hotel ownership increasingly became the province of publicly held companies in the 1990s. Whereas market segmentation continued to represent a viable approach to achieving earnings growth (along with property-by-property acquisition), a far more efficient means to this end was commonly practiced in the mid- to late 1990s in the form of strategic acquisitions and mergers. Starwood Hotels and Resorts and Patriot American Hospitality (now known as Wyndham International) were the most conspicuous companies. Starwood acquired the assets of hotel companies such as Sheraton, Westin, and HEI Hotels, while Patriot American amassed the assets of the Wyndham Hotel Corporation, Carnival Hotels & Resorts, Interstate Hotels, and Grand Heritage Hotels, among others. At the decade's end, the Promus Hotel Corporation, which controlled the Hampton Inn, Doubletree, Homewood Suites, Embassy Suites, and Red Lion

brands merged with Hilton Hotel Corporation. A few key multi-brand hotel companies, marketed cooperatively for greater efficiency and economies of scale, now control most of the industry's most recognized brands in similar groups.

The outcome of this shift in the nature of hotel ownership is difficult to discern at this stage; however, hotel companies are now scrutinized and evaluated based on their ability to increase shareholder value, a shift away from the traditional primacy placed on day-to-day operations and basic property level performance. Through future years, the most successful hotel companies will likely maintain a property level perspective and prioritize on-site management while still increasing their earnings through brand leverage, greater economies of scale, and an increasingly global perspective.

Globalization of the hotel industry should intensify during the next decade. More U.S. hotel companies may actively expand throughout the world and more foreign hotel chains will probably seek opportunities in the United

States. From an appraisal point of view, a global knowledge of hotel trends and valuation techniques will be essential.

Management Contracts

A final factor that has had a major impact on the U.S. hotel industry is the use of hotel management contracts, which emerged during the 1980s. Under this type of agreement a hotel company takes over the day-to-day operation of a hotel and is paid a fee for this service. If the hotel company is a well-known chain, the management fee also includes the right to use the trade name. The hotel management company generally has little or no ownership interest in the hotel and is not responsible for funding any operating losses.

Management contracts are particularly attractive for public hotel companies, which find it undesirable to keep real estate assets such as hotels on their balance sheets for accounting purposes. Progressive chains such as Marriott have created a strategy in which they develop or acquire a hotel, implement

their management, and then sell the property to either an individual investor or a partnership but retain operational control through a long-term management contract. Due to the widespread use of the hotel management contracts and franchises, very few hotels operating as part of a national chain are actually owned by that chain.

Learning from History

Many of the changes and trends that developed during the 1990s will continue to affect the U.S. lodging industry in the next decade. In the short- and long-term future, the lodging industry will have to adapt continuously to meet inevitable changes. Some of the factors that will impact the hotels and motels of the future are discussed below.

Faster Transportation

The jet airplane revolutionized long-distance travel by allowing people to cover more miles in shorter trips. As the speed of transportation increases,

supersonic or orbital aircraft will make it possible to fly round trip between New York to Tokyo and attend a business meeting all in one day. This would eliminate the need for any hotel accommodations.

Better Communications

Before long every home and office will be linked by a computer and video communication system. The need for face-to-face meetings will be greatly reduced when this technology becomes commonplace. Many business meetings, small conferences, training seminars, and conventions could be accomplished without incurring travel and hotel expenses.

Globalization

Faster transportation and communications could have negative effects on the lodging industry, but the inevitable globalization of businesses will create a need for business travel when face-to-face interaction is essential. The major business centers throughout the world will benefit from this trend.

Increased Pleasure Travel

As the number of affluent, two-income families increases and transportation becomes quicker, easier, and less expensive, the travel industry has seen an increase in pleasure travel. This trend is likely to continue with resort areas receiving the greatest benefit.

In addition, the preceding description of the hotel-motel industry in the United States identifies several important points that could affect the market value of lodging facilities.

1. The typical hostelry experiences a relatively high degree of functional and economic obsolescence. These factors tend to reduce a property's economic life; thereby decreasing the period during which an owner can fully recapture invested capital.

2. The growth of the lodging industry is influenced by developments in transportation. The first hostelries were located on coach trails; when the railroad came, hotels moved closer to passenger

terminals. Later the automobile led to the creation of the motel, and the airplane generated demand for rooms at airport locations. A decline in a particular form of transportation can lead to the failure of associated lodging facilities.

3. The budget motel is the result of a cyclical phenomenon. The rooming house was America's first economical lodging facility. After its popularity declined, Statler introduced the first full-facility hotel at an affordable price. In the 1950s the highway motel brought rates down for the mass travel market, and 20 years later the "revolutionary" budget motel was introduced. In the 1990s amenity creep made it possible to recreate the budget motel, this time called the hard budget.

4. Enormous amounts of financing were available in the late 1920s, the early 1970s, and the mid-1980s. Ready capital coupled with factors such as income tax advantages, other government incentives, and an overheated economy led to excessive overbuilding and many properties were forced into bankruptcy or foreclosed soon after they opened. In these boom periods, hotel own-

ers soon discovered what usually happens when a property is poorly conceived, undercapitalized, and mismanaged.

5. Distressed hotels have traditionally been valued by looking ahead to a time when recovery is expected and then projecting income and expense out until a stabilized level of occupancy is achieved. Discounted cash flow analysis is then applied to convert the projected income before debt service into an estimate of value. Using the actual net income of a distressed property would probably understate its market value because most sellers would wait for a recovery to occur unless they were forced to make an immediate sale.

6. The lodging industry has been characterized by change. Appraisers must stay abreast of current industry trends and developments to understand and correctly reflect investors' motivations and behavior in this dynamic market.