Buy Now or Buy Later- Attempting to Time the Market is not the Best Strategy

The silver lining of an economic downturn is the great buying opportunity that is created for those with capital to invest. This down-cycle is developing into what will probably become one of best times to acquire hotels since 1991. For those with memories dating that far back will remember the collapse of the savings and loan industry, massive overbuilding, the Gulf War and a recession. Hotel values were often expressed as a percentage of replacement cost and it was not unusual to see acquisitions made at 30% to 40% of the hotel's cost new. Hotel experts at the time said that no one would every make a hotel loan again and hotel values would not recover for another decade. Those with a stomach for risk who deployed their money to acquire these distressed assets laughed their way to the bank because they often tripled their investment in 3 to 5 years.

Today, the environment is similar to the early 1990's. We are in a deep recessions. Banks have suspended most forms of lending. Unemployment is rising and the general population has cut back on travel and all types of expenditures. The only difference this time around is that the current recession was not preceded by overbuilding. The hotel industry is facing only a demand problem and not oversupply. This means that when the recession ends and travel resumes hotel occupancies will rebound quickly since there is not an oversupply of hotel rooms that first needs to be absorbed.

The question I am asked the most by hotel buyers is, "When is the best time to buy? When will I get the most for my money? Should I hold off until the prices really tank? How much will hotel values fall? How fast will they recover?" Let's try to answer these important questions.

Each year my company, HVS, tracks hotel values in 50 U.S. cities along with the United States as a whole. Our valuations go back to 1987 and are projected out to 2015. While many consultants publish data on hotel occupancy, room rate and revpar, this information is useless unless it can be related to net income and asset value. HVS provides this important link which is critical information for hotel buyers, sellers and lenders.

The following table shows our yearly valuations of a typical hotel in the United States. The yearly values represent the total value per room along with the annual percentage change and the dollar per room change.

Value Trend for a Typical U.S. Hotel HVS

	1987	1988	1989	1990	1991	1992
Value Per Room	$37,000	$37,000	$38,000	$32,000	$27,000	$30,000
Percent Change		0.0%	2.7%	-15.8%	-15.6%	11.1%
Per Room Change		$0	$1,000	-$6,000	-$5,000	$3,000
	1993	**1994**	**1995**	**1996**	**1997**	**1998**
Value Per Room	$33,000	$37,000	$45,000	$50,000	$59,000	$60,000
Percent Change	10.0%	12.1%	21.6%	11.1%	18.0%	1.7%
Per Room Change	$3,000	$4,000	$8,000	$5,000	$9,000	$1,000
	1999	**2000**	**2001**	**2002**	**2003**	**2004**
Value Per Room	$61,000	$69,000	$52,000	$52,000	$51,000	$65,000
Percent Change	1.7%	13.1%	-24.6%	0.0%	-1.9%	27.5%
Per Room Change	$1,000	$8,000	-$17,000	$0	-$1,000	$14,000
	2005	**2006**	**2007**	**2008**	**2009**	**2010**
Value Per Room	$82,000	$100,000	$95,000	$81,000	$61,000	$55,000
Percent Change	26.2%	22.0%	-5.0%	-14.7%	-24.7%	-9.8%
Per Room Change	$17,000	$18,000	-$5,000	-$14,000	-$20,000	-$6,000
	2011	**2012**	**2013**	**2014**	**2015**	
Value Per Room	$62,000	$79,000	$93,000	$103,000	$112,000	
Percent Change	13.4%	26.1%	18.6%	10.7%	8.6%	
Per Room Change	$7,000	$16,000	$15,000	$10,000	$9,000	

Source: HVS

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This data shows the recession of the early 1990’s where hotel values dropped about 30% in two years and slowly recovered through the mid 1990’s. The events of 9/11 and the recession sent hotel values crashing almost 25% in 2001. Because there was not significant overbuilding prior to this downturn, the recovery was rapid and strong with gains of more than 25% starting in 2004.

As of today, hotel values have already fallen about 20% with 2009 shaping up to a disaster year with a 25% decline expected. The outlook for 2010 looks like another down year with an almost 10% decline. All tolled, hotel values will probably decline 40% to 50% before the recovery starts. Like the 2004 recovery, hotel values will rise rapidly and by 2014, they will be back to pre-recession levels.

So when will be the best time to buy? The valuations contained in the table above represent “market value” which assumes a “willing buyer and willing seller, neither under pressure to buy or sell.” To get the best deal, hotel buyers need to find an unwilling seller who is under extreme pressure to sell. Under these circumstances the resulting transaction pricing usually represents “liquidation value” not market value. We are just starting to see liquidation pricing which can be as much as 20% to 40% below market value. We are recommending to our hotel buyer clients to ignore the herd mentality of staying on the sidelines until 2010 to acquire at the exact bottom of the market and instead focus on buying today at liquidation pricing. Since values have already dropped 20% to 30%, we believe great deals will be available during 2009 especially if you can find those sellers who need to get rid of their hotels immediately. Those buyers who wait until 2010 may get somewhat better pricing, but there will be many more other buyers competing for these acquisitions. We are forecasting the U.S. hotel market to start a recovery in 2011 with values rising rapidly thereafter.

Attempting to time the market in order to buy at the absolute lowest point will mean that you will most likely miss out on some very good deals that transact prior to the exact low point in the cycle. Furthermore, different markets have somewhat different cycles with some going lower and recovering slower. A thorough market analysis of individual micro markets is necessary to insure you are minimizing your risk while at the same time maximizing your opportunity. If you are interested in a complementary detailed valuation analysis for the top 25 U.S. hotel markets (from 2000-2015)- drop me an e-mail at srushmore@hvs.com