Hotel Investment Strategies

Using Cycle Analysis To Increase Your Investment Returns

A profitable hotel today may be tomorrow's foreclosure causality. What makes hotel investment so complicated is the number of cycle patterns occurring simultaneously. But when investors effectively time their hotel acquisitions, new developments and dispositions to coincide with a relevant cycle, they often accentuate the return on their investments.

HVS International and many investors look at hotel cycles from a valuation point of view. For 13 years we have tracked hotel valuation cycles in several rate categories. Our findings are set forth in these graphs showing the actual cycles from 1986 to today with projections to 2002. While this cycle analysis illustrates trends in the U.S. hotel industry, its concept applies worldwide.

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—Steve Rushmore

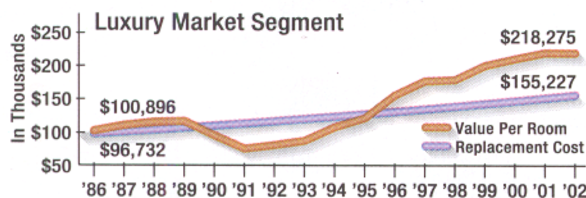
The graphs comparing market value to replacement cost illustrate points in time when project feasibility is either positive or negative. As the market value line moves upward and passes through the replacement cost line, new hotel projects display positive feasibility, lenders and investors gain interest and development begins. Savvy hotel developers anticipate this trend and start their projects before the two lines actually cross. Negative feasibility occurs and development slows when the market value line falls below the replacement cost line. Historically, new hotel development usually does not slow until the market value line crosses the replacement cost line.

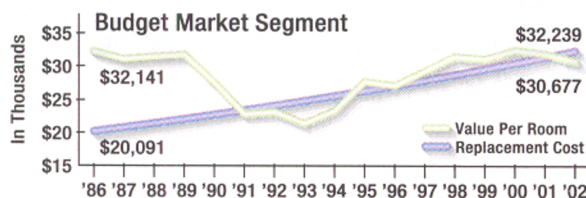
Luxury Hotels include chains such as Hilton, Hyatt, Marriott and Sheraton. Between 1986 and 1989 the market values of luxury hotels exceeded their replacement costs. This period marked the tail end of the building boom that characterized the mid- to late-1980s, which was a contributing factor to the steep drop in hotel values during the early 1990s. Between 1990 and 1995 new development of luxury hotels was non-existent because market value was far below replacement cost. When the market value and replacement cost lines crossed in 1995, developers were ready to build, but it took several years to convince lenders to make the huge capital commitment necessary for these projects. Looking into the future, expect market value starts to flatten in 2001 as values for luxury hotels peak. These hotels represent good development and investment potential for the next four to eight years.

Although upscale hotels such as Doubletree, Crowne Plaza and Radisson exhibited similar market value and replacement cost trends as luxury hotels, owners of these types of properties might want to consider selling sometime in the next two to three years. The value of upscale hotels is projected to fall commencing in 2000 as a result of overbuilding.

Budget Hotels include products such as Motel 6, Super 8 and Sleep Inn. Their market value and replacement cost graph shows a trend starting in 1995 where market value tracked just above replacement cost, indicating a minimal amount of developer's profit from these types of properties. In 2001 we project market value will fall below replacement cost, indicating this segment is heading toward an overbuilt situation. Owners of budget hotels should exercise caution in markets where new competition is likely because values are likely to decline over the next several years. ♦

Replacement Costs vs. Value per Room





HVS International

By Stephen Rushmore, *MAI, CHA, CRE, president and founder of HVS International, a global hotel consulting firm with offices in New York, Miami, Denver, San Francisco, Vancouver, Mexico City, London, New Delhi and Singapore. Mr. Rushmore can be contacted at 1.516.248.8828 Ext. 204.*