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Flurry of hotel transactions seems to have ended

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The hotel feeding frenzy by REITs is over.

After 12-plus months of gorging themselves on trophy properties in gateway cities like San Francisco, New York, Chicago and Washington, D.C., real estate investment trusts with an appetite for hostelries are taking a break.

An uncertain economy and jittery stock market get the blame.

Since August, many REIT stock prices have plunged. REIT stocks on average have fallen more than 10 percent since late July, a sharper drop than the market as a whole, making fundraising for acquisitions a dicier proposition.

Pebblebrook probably won't buy more hotels in 2011, says Jon Bortz.

"There's obviously significant concern about the global economy, and that translates into both poor performance in the overall stock market, and even poorer performance in companies perceived to be economically cyclical," said Jon Bortz, CEO of Pebblebrook Hotel Trust, which sparked the buying frenzy and premium prices for San Francisco hotels when it bought the Sir Francis Drake for $90 million in May 2010.

"With the latest downturn so fresh in people's minds, 2008 and 2009 and the impact it had on travel," Bortz said, "it's not surprising that people would be looking around the corner and seeing trouble if they believe the economy is going to turn down."

Hotel fundamentals remain strong, especially in San Francisco, where revenue per available room has increased over 20 percent this past year. Bookings and room rates remain unaffected by the economic turmoil, and San Francisco looks poised to regain the record-high revenue levels of 2008 by the end of this year.

Even consumer behaviors at hotels are unchanged. Group travel is on the rise and revenue per available room is projected to increase again in 2012, thanks in part to a bumper convention year and America's Cup activities. But that doesn't matter in the public markets, where sentiment rules, said Anwar Elgonemy, director of acquisitions for Equinox Hospitality Group.

"The REITs are getting hammered unjustifiably, and that's affecting their acquisition firepower," Elgonemy said. "They were smart. They started raising capital in the third quarter of 2009, so they were kind of ahead of the game ... and on a buying spree from the beginning of 2010 until August 2011. Since then, the psychology of the market has been spooked."

Because REITs favor cash deals, continuing to buy hotels would require raising capital, which no REIT wants to do at today's stock price.

"While we have cash, we in all likelihood prefer not to part with it, and would prefer to raise additional equity capital. We're not keen to do that with our stock down 35 percent from where it was 90 days ago," Bortz told the Business Times on Oct. 4. "There's a greater lack of clarity about the economy, so it gets harder to underwrite future performance, which is really necessary for making an acquisition and investing our capital."

Bortz said it is unlikely that Pebblebrook will buy any more hotels in 2011.

LaSalle Hotel Properties did make a San Francisco buy in early October, buying Larkspur's Villa Florence for $67.2 million.

The REIT pullback may open the door to more foreign buyers, such as the Singaporean firm that recently bought the Huntington Hotel, and private equity players who also have cash and have been wanting to get into the hotel buying game.

"This is what the folks in the industry are looking at: What exactly is going to happen now? Have things gotten too expensive? Or if prices are reasonable, who is going to come up with the cash or financing to make that trade?" said hotel consultant Rick Swig. "Financing of hotels has still not come back with a vengeance."

What this means for trophy properties like the Fairmont San Francisco and Hyatt Regency sitting on the block is anyone's guess. While both could go for over $200 million, Swig said, financing is anything but certain.

What seems likely is that the buyer won't be a REIT, at least not in the near term. Nor does Swig expect smaller investors to enter the game; too many large players on the sidelines still have lots of cash.

"We still like the market; we love the city. It is obviously a very high barrier to entry market; it's very difficult to build and to do it affordably in San Francisco," Bortz said.

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