



2021 NYC hotel market dynamics: Opening up - by Anudeep Gosal

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Arguably the greatest need at present for the hospitality industry in New York City is for patient capital. The traditional capital stack is not geared for a very long horizon. The 3 to 5-year yield driven model is now obsolete. Even the most creative of hoteliers aren't seeing a stabilized positive IRR until years 6, 7, or even 8 on most Manhattan assets. Most funds which have the level of dry powder hotels now require just aren't geared for the kind of volatility the hotel business is built on. The average daily rate (ADR) & occupancy change daily, every room unsold at midnight is revenue simply lost. The city's hotel occupancy reached 47% for the week that ended March 13th. This same week prior to the pandemic was 87.1% with an ADR of \$291.

Even then, New York City is now seeing this gap starting to bridge, and this fine balancing act taking shape. An increasing number of funds from across the country that were invested in more stable asset classes are realigning with a new model as they form partnerships with leading management companies to weather the storm. Third party management companies are no longer being mere managers and stepping up with equity stakes, and more performance-based deliverables. Their skin in the game is helping to attract capital from other industries. We are now seeing the management companies actively sourcing, negotiating and driving the deals.

As Manhattan predominantly had top tier hotels filled year-round with corporate travel (13.3 million travelers) and everyone else benefiting from the spillover, this is no longer the case. The spillover is now inverted. With room rates at record lows, the eagerly anticipated post vaccination pent up "summer surge" is going straight towards the experiential or luxury boutique properties, either with iconic locations and unparalleled views. Those seen in a travel magazine typically are now within reach for a much larger percentage of young travelers (the first to set foot on a plane). This makes the recovery slower for the cookie cutter flags, stereotypical limited service segment or hotels in the boroughs lacking the gentrifying neighborhood, nightlife, or cultural relevance. Some pockets of Brooklyn are still hot on the acquisition radar, with areas like Williamsburg being tagged as potential "Bleisure" markets by top tier hotel groups.

At the end of the day, it all boils down to skilled operators that are the key to making deals work. On the flip side to institutional capital, older generational/family-owned hotels with very low leverage are finding value by offering their properties on a net lease basis to middle market hotel owners with strong management experience. The net lease model allows such owners to retain the full value of their asset while still solving for the negative cash flow challenge. And it alleviates them from day-to-day responsibility for operational and financial management.

Deals are starting to materialize at the very top or bottom of the market, and slowly moving towards the middle market. Default on larger (1,000+ key) properties have forced lenders' hands to make the hard decisions to either foreclose, sell off the note, or restructure. Smaller "Mom & Pop" owners have been forced to do the same on the equity side by taking on partners, preferred equity or other instruments leveraging their equity.

In 2019, NYC travelers hit a record high spending of \$47.4 billion generated from 66.6 million trips to

the city, according to the 2019 NYC & Company annual report. That number today is closer to 20% of the 2019 record and is not expected to reach pre-pandemic numbers until 2025. The expectation is that as the city comes back, it will come back in a big way and the current valuations on hospitality assets will represent attractive pricing when weighed against future value.

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