Appetite for investment: the current capital climate

Real estate fundamentals continue to improve, and debt and equity capital are abundant, providing a solid foundation for an uptick in transaction volume and overall competition. Global hotel investment continues to steadily increase, with 2014's totals expected to exceed US$54.5 billion compared to US$52 billion in 2013. Global hospitality and leisure transactions increased 8% year-over-year through Q3 2014, showing that the industry continues to gain momentum even in the face of accelerating geopolitical instability, health and terrorism concerns.[2] A wave of new hotels will open in 2015, and a robust global development pipeline of approximately 1.3 million guestrooms is in place.[3]

Throughout the Americas, strong performance continued in 2014, with real estate transaction volumes in some markets reaching pre-recession peaks.[4] Specifically in the US, economic and employment numbers have grown increasingly positive, and hotel performance has followed suit amid a rise in business and leisure travel.

Cross-border investment into the US increased approximately 137% from 2013 to 2014, with foreign buyers continuing to look beyond traditional gateway markets to secondary markets, such as Phoenix, Atlanta, Houston and Orlando. Investors from Canada, China, Malaysia, Japan, Singapore and the Middle East have chosen to deploy a large amount of capital in US hotels.[5] Greater competition among these investors and subsequently lenders is allowing for more aggressive loan-to-value ratios, averaging 73% through Q3 2014, compared to 66% in 2013. Investment in the US hotel sector was expected to continue accelerating throughout the end of 2014, with both the full-service and limited-service sectors demonstrating large pipelines of deals under contract.[6]

As a result of strong fundamentals and an increasing array of capital sources, capitalization rates in the US are anticipated to trend lower, with the rates in six major metropolitan markets, including New York City, San Francisco and Boston, averaging 5.5%, compared to 6.9% in 2013. The low rates are highly influenced by the country's low interest rates, which are anticipated to rise in 2015.[7] Nevertheless, with current capitalization rates close to the previous market lows of 2007, potential speculation about a bubble is countered by the fact that risk has been priced into the deals seen throughout 2014.[8]

In Latin America, many countries, including Brazil, Argentina and Venezuela, currently face economic challenges, such as high inflation rates, worsening unemployment and currency devaluation. These issues, coupled with their political instability, translated into weaker fundamentals in the first half of 2014. Hotel occupancy in Central and South America through July was down approximately 1.6% over the previous year, despite the boost from the

2. "Global Market Perspective Q4 2014: Hotel investment maintains momentum despite downside risks," Jones Lang LaSalle, www.jll.com/gmp/market-perspective/hotels, accessed November 2014.
3. "New Hotel Construction Pipeline in Global Shift," Hotel Interactive, www.hotelinteractive.com/article.aspx?articleid=32644, 17 April 2014.
4. "Hotel Investor Sentiment Survey," Jones Lang LaSalle, www.joneslanglasalle.com/hotels/EN-GB/Pages/HISS-June-2014-Americas.aspx, June 2014.
5. "US Capital Trends – Hotels," Real Capital Analytics, August 2014.
6. "US Capital Trends – Hotels," Real Capital Analytics, third quarter 2014.
7. "Fed's Dudley: expectations for mid-2015 rate lift-off reasonable," Reuters, www.reuters.com/article/2014/11/13/us-usa-fed-dudley-idUSKCN0IX0ZS20141113, 13 November 2014.
8. "US Capital Trends – Hotels," Real Capital Analytics, third quarter 2014.

World Cup in Brazil. The declining operating fundamentals could also be tied to the fact that the region was the only area globally where additions to supply outpaced demand.[9]

Even so, development and acquisition activity has been prevalent. South America now has 400 hotels in the pipeline, totaling 65,479 rooms, of which 40,000 are in Brazil thanks to its surge in corporate and leisure travel, as well as steady increases in its hotel operating metrics.[10] By comparison, the region had 305 hotels in development in December 2013, totaling 49,054 rooms.[11]

In Europe, the Middle East and Africa (EMEA), investor sentiment is high regarding future growth and transaction volumes, which through H1 2014 climbed 70% from a year-ago. Of the 31 major hospitality destinations in the region, including Barcelona, Casablanca and Munich, all except for Moscow are expected to show strong trading performance over the next six months.[12]

Despite concerns over slow economic growth, Europe has witnessed a rejuvenated hospitality market. Investors have displayed great confidence in the continuing strength of London as the pre-eminent European hospitality center, which continues to attract large inflows of foreign capital. In addition, hospitality investment in Germany rose to US$1.9 billion through July 2014, representing a 100% increase in transaction volume as compared to July 2013 figures. Germany's low interest rates and high levels of debt liquidity have fueled high levels of investment.[13] While hotels in primary markets, such as Munich, are given the highest valuations across Germany, mirroring the wider commercial real estate market, investors have looked toward secondary markets, such as Frankfurt and Dusseldorf, for higher-yielding opportunities.[14]

In the Middle East and Africa, the development pipeline continues to grow and now includes 637 hotels, with 151,205 rooms, an increase of 139 hotels since December 2013.[15] Countries such as Nigeria, South Africa and Egypt have experienced continued economic growth, creating demand from institutional investors as well as major hotel brands that see expansion into the region as a source of future growth.

Despite rising construction investment and growing occupancy rates among African hotels, foreign capital inflows may soon diminish given investor concerns about tourism in the wake of the recent Ebola outbreak and political instability. While security and health concerns have not yet deterred investment, travelers do appear to be exercising caution. In Nigeria, which was declared free of the virus in October 2014, Lagos' revenue per available room (RevPAR) declined significantly year-over-year, primarily caused by a drop in average daily rate (ADR) from US$279 to US$248 (down 11%).[16]

9. "Latin American Hotels Have a Supply and Demand Problem," Skift, skift.com/2014/09/26/latin-american-hotels-have-a-supply-and-demand-problem, 26 September 2014.
10. "Latin America Hotel Market Has 400 Properties Under Development," World Property Journal, www.worldpropertyjournal.com/latin-america-vacation-news/new-hotels-in-latin-str-global-june-2014-str-global-construction-pipeline-report-luxury-hotels-in-brazil-new-hotels-in-mexico-new-hotels-in-colombia-8362.php, 16 July 2014.
11. "Central And South America Hotel Development Pipeline For December 2013 Increases to 305 Hotels," Hotel News Resource, www.hotelnewsresource.com/article75877.html, 15 January 2014.
12. "STR Global: MEA pipeline for July," Hotel News Now, www.hotelnewsnow.com/Article/14329/STR-Global-MEA-pipeline-for-July, 28 August 2014.

13. "Germany still the darling of the hotel investment sector with transaction levels heading for €2bn," 4 Hoteliers, www.4hoteliers.com/news/story/13221, 2 October 2014.
14. Ibid.
15. "Global hotel pulse: Middle East/Africa news," Hotel News Now, www.hotelnewsnow.com/Article/13850/Global-hotel-pulse-Middle-EastAfrica-news, 10 June 2014.
16. "Global Capital Trends," Real Capital Analytics, midyear review 2014.

Investment volume in the Asia-Pacific region decreased from US$6.4 billion in the first half of 2013 to US$3.3 billion in the same period in 2014[17] amid investor concerns over political unrest in markets such as Hong Kong and Thailand and economic uncertainty about the stability of China. But Asian investors dominated hotel transaction activity in the first six months of 2014, with North Asian and Southeast Asian investors completing 58% and 38%, respectively, of all deals in Asia. Hotel sales in Japan accounted for 47% of transaction volume across the region. Capital flows into India climbed, with noticeable volume gains recorded in the first two quarters as tourism continues to drive economic growth. India's half-year total of US$1.8 billion represents a 37% increase year-over-year, which is largely a result of a number of institutional players re-entering the market. Much like India, Australia's strong fundamentals, maturity and transparency have led to steady buying activity from Asian investors, who see potential yields in the booming market.[18]

Certain key themes seen globally are anticipated to continue into 2015. The rising availability of hotel development financing in mature markets will allow for more robust pipelines; assets in secondary markets will attract further interest from hotel developers; and Asian investors, private equity funds and REITs are anticipated to remain motivated buyers. However, these upward trends may be deterred if political instability and Ebola outbreaks continue. Barring any of these shocks to the system, the climate for hospitality capital markets activity should remain favorable.

17. "Global Capital Trends," Real Capital Analytics, midyear review 2014.
18. "Asia Pacific Hotels MarketView (H1 2014)," CBRE, accessed November 2014.