Capital Markets Update

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The momentum that began to build in 2012 continues with accelerated activity by Wall Street-related debt and equity. Improved perceptions regarding the domestic economy, coupled with continued volatility in Europe and rock bottom interest rates, are driving investors to U.S. real estate since it is perceived to be less risky than stocks and yet generates better than bond yield returns.

Increased investor appetite has crowded the major markets and forced players to broaden their scope to secondary and in some cases, tertiary markets. The scarcity of product and expectations for premium returns on hotels outside the major CBDs are driving investors to expand their geographic and product preferences.

CMBS lending is leading the hotel debt markets' recovery providing borrowers attractive terms, including historically low interest rates, higher LTVs, and lower debt yield requirements than exhibited just six months ago.

Wall Street originated approximately $48 billion of CMBS all of last year, and approximately $5 billion in the 1Q12. Initial estimates of approximately $60 billion for 2013 now appear low considering 1Q13 production is approximated at a whopping $20 billion or four times higher than last year's first quarter. Wall Street volatility, coupled with increasing expectations of the Fed's reversal of low interest rate policies, has investors reviewing their portfolios for maturities into 2014 and beyond.

Wall Street's return provides balance sheet lenders the psychological comfort that an exit strategy exists for their loans, and more directly, creates a fiercer competitive landscape in which they must contend to maintain share. As such, we see banks and other balance sheet lenders sharpening their pencils on in-place cash flow deals, as well as broadening their sights on transitional, renovation and construction loans.

Developers with good bank relationships are already accessing their local lenders for select-service construction loans. At our recent Hunter Conference, 52% of the owners responded yes to a survey question that asked if they were planning to develop a hotel this year. The renewed ability to source capital for development is a reflection of the debt markets' recovery now extending to the smaller thrifts and commercial banks, which were arguably the worst hit by the 2008/09 credit crisis.

Despite blue skies, clouds remain that threaten the financial markets recovery. Each week it seems a negative news release can spin the markets into apparent free-fall. First, the domestic economic recovery remains fragile with stubborn unemployment rates and insufficient job creation. Sequestration, ObamaCare, Dodd-Frank and other government programs continue to weigh on the minds of business leaders, especially small businesses and entrepreneurs. Political and economic uncertainty abroad, in Europe, Korea, Afghanistan and the Middle East, continually present potential threats to growth.

Finally, a tremendous amount of debt remains outstanding. ULI estimates $300 billion of debt over the next three years needs to be retired. This will stretch current lending sources.

Given these competing pressures, we are actively assisting our clients in their review of their capital needs over the next three years. Those that address their situations proactively are ensured of benefiting from today's improved conditions.