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Hotel REITs: Time To Check In

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The key operating metric for the hotel industry is RevPAR, which represents revenue per available room. RevPAR captures both occupancy levels and the average daily rate charged to customers ("ADR") to reflect the operating performance of a hotel.

In a recent release, Smith Travel Research, the leading research firm in the hospitality sector, projected RevPar growth of 4.3% in 2012 and 4.9% in 2013. It also projected that the main driver of this growth will be an increase in room rates over the next two years. With this level of projected growth, investors should take a look at the hotel sector and determine if now is a time to check into hotel REITs.

According to Marcus & Millichap and Smith Travel Research, the hotel sector is coming off a strong year in 2011 with RevPAR growth around 8%. These strong results in 2011 follow a 5.6% RevPAR growth in 2010. With the steady growth in occupancy and the accompanying rise in hotel rates over the past two years, the hotel sector has transitioned into a recovery phase of the property market cycle. Supported by an improving economy, the hotel sector should experience the 4%+ annual growth projected by Smith Travel for the next two years. This recovery period in the hotel sector provides investor with the operating to invest in strong hotel REITs that will be positioned for near-term earnings growth.

While an economic downturn could hurt the hotel recovery, real estate economists point to the strong growth in hotel demand from increases in both leisure and business travel as a positive sign. Hotel room demand increased by over 4% in 2011 and boosted the average occupancy close to 60%, according to Marcus & Millichap and Smith Travel Research. With limited new hotel construction in the pipeline, existing hotel owners will be positioned to continue the increase in room rates and generate greater profitability for the hotels. Three of the largest state hotel markets--, California, Texas, and Florida-- are among the strongest performing markets. And, investors in hotel REITs will be positioned to benefit.

From an investment standpoint, limited service hotels provide attractive investment opportunities. According to Real Capital Analytics, the cap rates, or yields, on limited service hotels are approaching 9.0%, which is among the highest yields of all commercial real estate sectors. The cap rates on full service hotels are currently around 7%. Full service hotels have attracted greater attention over the past year, as they represent nearly two-thirds of the transaction volume in 2011. With the high cap rates on limited service hotels, REITs with the underwriting expertise to invest in the strongest markets and highest performing hotel chains are positioned to take advantage of a favorable investment market.

Below are some hotel REIT options with moderate leverage and attractive yields to consider:

- **Ashford Hospitality Trust (AHT):** Listed REIT, 8.95 current share price, 5.0% current dividend yield. AHT invests primarily in full service and limited service hotels across the big four hotel brands -- Marriott (MAR), Hilton, Hyatt (H), & Starwood (HOT).
- **Hospitality Properties Trust (HPT)**: Listed REIT, 25.38 current share price, 7.8% current dividend yield. HPT has invested in 300 select and limited service hotels and 200 travel centers across several well-known brands. HPT has had increasing revenues over the past year.
- **Carey Watermark Investors**: Non-listed REIT, 4.0% current dividend. Carey Watermark invests in both full-service and limited-service hotels. It currently has invested in 2 hotels in Long Beach, CA - one full service and one limited service. The sponsor, W.P. Carey, has significant experience in commercial real estate with an investment portfolio over $12 billion.
- **Apple REIT Ten**: Non-Listed REIT, 7.5% current dividend. As of 9/30/11, Apple REIT Ten had investments in 19 limited service hotels with brands such as Hilton Garden, Hampton Inn, and several Marriott brands. Apple REIT Companies has a long and successful track record of investing in limited service hotels.

With the favorable pricing on hotels and the strong projected growth in RevPar over the next few years, these hotel REITs can provide good returns for investors who check in now.

Disclosure: I have no positions in any stocks mentioned, and no plans to initiate any positions within the next 72 hours.