HotelNewsNow.com

Buy, sell or hold ... What's your strategy?

25 October 2011 9:47 AM
By Lee Hunter
HotelNewsNow.com columnist

Story Highlights

- Expect more midscale, upper-midscale and upscale assets coming to market.
- Depending on your asset level, you might have missed the peak of the market if you're looking to sell.
- If you intend to hold, have a plan. I am constantly amazed by all the owners of assets who do not have an exit strategy for their assets.

OK. Let's all take a deep breath. The last several weeks have been a whirlwind: The Dow has been on a rollercoaster (the Baird/STR Hotel Stock Index was down 15% for the month of August; it was down as much as 25% at one point in the month). High-profile transactions have been paired down (Hyatt only buying 20 assets from LodgeWorks instead of 24) or canceled all together. And there is the threat of a double-dip recession.

So, given all that is going on, what are you doing in today's hotel investment market?

Buy
The first half of 2011 has seen an increase in transactions (up more than 80%, according to STR Analytics). The dominant players in the market have been hotel real-estate investment trusts. Their access to low-cost capital has allowed them to acquire assets at price points that other investors are not able to justify. At the STR Hotel Data Conference in early August, Evan Weiss of LW Hospitality Advisors said, "REITs are buying assets at prices that don't make sense."

Assets in primary markets closed at US$200,000, US$300,000 and even US$400,000 per room at cap rates ranging from 5% to 7%. Other investors would submit bids (in the 8% to 10% cap rate range) but would consistently lose out due to their higher return thresholds/higher cost of capital.

Lee Hunter

However, the balance of power may be shifting now that stock prices are falling and REITs are perhaps seeing some of their capital bases eroding. Assets once only thought of as REIT buys might now be opportunities for other investors.

Please do not misunderstand: REITs will still remain active buyers of assets, but they will be more selective in the assets they acquire. Also please do not misunderstand: Pricing is not going to change for the other investors. It will remain in the 8% to 10% cap-rate range. Just because the REITs are being more selective does not mean there aren't multiple other investors looking at the same asset. The competition is strong, and these competitors still have cash to invest.

So what has been trading? Think of it as an inverted bell curve: There is a lot of activity on either end of the spectrum and not much going on in the middle. To think of it in STR chain-scale terms, the economy and upper-upscale segments have been where most of the activity has taken place.

Up until now, not much has traded in the midscale, upper-midscale and upscale segments, but I believe that is about to change (see Hersha Hospitality Trust's recent sale of 18 assets). Just as there was a flood of economy-level assets to the market during the last few months as lenders foreclosed and sold assets (or simply sold notes on assets), I believe we are going to see more midscale, upper-midscale and upscale assets come to market. Lenders will finally throw in the towel and foreclose. Borrowers who are tired of carrying the asset will negotiate a short sale with their lender. Borrowers who have seen the value of their asset increase to acceptable loss levels or, dare we say, are actually above water will decide to put their properties on the market. Will you be ready to acquire them when they do?

As REITs have focused on the primary markets, other investors have had to look to secondary and tertiary markets for opportunities. While they might not come with the prestige of primary markets, there are opportunities to make money here. All too often investors forego a good

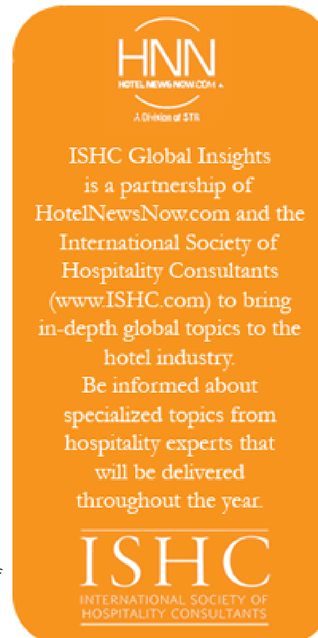
opportunity in a secondary or tertiary market because the city the property is located in does not carry the cache that New York or Washington, D.C., does. Do not be afraid of secondary and tertiary markets. There are opportunities there.

Hotels are good investments today. How confident are you in the Dow? Have you thought about inflation (experts are anticipating 3% this year)? As of this writing (1 September), PKF and STR are still projecting positive RevPAR growth for the remainder of 2011 and through 2012 (PKF: 7.3% and 8%, and STR: 7.8% and 7%, respectively).

ISHCGlobalInsights Ad Will Appear Here

Sell
Have you reached your "point of capitulation?" Are you one of the lenders or owners I referred to above that are now looking to sell? Well, depending on your asset level, you might have missed the peak of the market.

As I have indicated, most trades have comprised assets in the economy and upper-upscale chain scales. The economy-level assets continue to trade (thanks in part to SBA financing), but their pricing is softening (the amount of assets on the market is driving pricing down). The buyers of the upper-upscale properties, as mentioned previously, are seeing their cash levels erode as their stock prices decreases and are not as active in the market today. Do not worry. They will come back. I agree with David Loeb of Baird Equity Research that hotel stocks are undervalued. When investors realize this and return to the lodging segment, REITs will see their cash base increase and their deal flow will too.



Are you the owner (or lender) of a midscale, upper-midscale or upscale property and are thinking about selling (or foreclosing on and selling) your property? If the answer is "yes," I encourage you to put the property on the market sooner rather than later. Again, it is my opinion that during the next 12-18 months we will see a lot of properties in these segments come to market. You want to be the first to market and take advantage of the demand that still exists for that level of asset and not be a latecomer when investors will have multiple options and pricing will be forced down (read: that Econ 101 thing of supply and demand).

Hold
If you are not a buyer or seller of assets you are, by default, a holder of assets. What should you be doing in this market?

First of all, have a plan. I am constantly amazed by all the owners of assets who do not have a plan or exit strategy for their assets.

Second, be aware of a property-improvement plan coming from your brand. They have been patient during the last few years, but they are now requiring (even forcing) you to conduct a PIP. Also be aware of capital expense items. They are not covered in PIPs but can still be an issue (for you as the owner of the asset or for a new owner when you go to sell the asset—you do have an exit strategy, right?).

Third, drive your rate. STR said that July 2011 showed the highest demand of any month in history (or at least since they have been tracking it). Given this high demand, are you raising your rates? You should be. This increase in ADR flows through to the bottom line, which ultimately increases the value of the asset. This value increase is what you are trying to achieve so when you enact your plan and sell the asset (remember your exit strategy) you are able to achieve a higher sales price given your higher revenues and net operating income.

All in all, the world is not coming to an end. There are issues to be concerned with, but if you plan accordingly and act prudently, you should be in a position to take advantage of the opportunities that lie ahead.

Lee Hunter, CHB, ISHC, is COO of Hunter Realty Associates. He is active in many facets of the hotel finance and hotel brokerage industry. Prior to joining Hunter, Lee held positions with responsibilities that included hotel asset acquisition, development, refinancing and repositioning. He managed assets affiliated

with Marriott, Hilton and IHG. Lee holds a Masters degree in Hotel Finance and Real Estate from The School of Hotel Administration at Cornell University, a Bachelor of Science degree with a double major in Accounting and Business Administration from Presbyterian College. Lee can be reached at lee.hunter@hunterhotels.net.

The opinions expressed in this column do not necessarily reflect the opinions of HotelNewsNow.com or its parent company, Smith Travel Research and its affiliated companies. Columnists published on this site are given the freedom to express views that may be controversial, but our goal is to provoke thought and constructive discussion within our reader community. Please feel free to comment or contact an editor with any questions or concerns.

Copyright © 2004-2011 Smith Travel Research /DBA HotelNewsNow.com (HNN). All Rights Reserved.