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Digging into the transaction trenches

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Story Highlights

- From REITs to private-equity firms, there is plenty of money out there looking for assets to acquire.
- Private-equity firms are looking into secondary and even tertiary markets to find assets at price points that allow them to meet their hurdle requirements.
- While the desired asset type and location varies, one thing that remains is the lack of opportunity.

Following the NYU International Hospitality Industry Investment Conference, I found the "talk" very interesting. By now you have read numerous articles that covered the event, including HotelNewsNow.com. Now let me tell you what's happening in the transaction trenches.

There is plenty of money out there looking for assets to acquire. Real-estate investment trusts and public hotel companies have seen their stock prices rise, private-equity firms are raising capital in the hundreds of millions of dollars and regional management companies are seeing their investors' appetites grow. Even the small owner-operator wants to invest in more assets. However, the type of assets they are looking for varies dramatically.

Lee Hunter

What assets are good for you?
While the REITs and public hotel companies (not brands) still focus on acquiring full-service assets in top 25 markets, they are starting to talk select-service assets that are still in top 25 markets. Because of this focus, private-equity firms are now looking into secondary—and even tertiary—markets to find assets at price points that allow them to meet their hurdle requirements. They simply cannot compete with the REITs on cost of capital.

Regional management companies are being selective and staying within their core competencies (regional select-service assets), and the owner-operator is looking for deals. While the desired asset type and location varies, one thing remains the same: lack of opportunity.

Assets hitting the market
Given that hotel fundamentals are improving and supply is predicted to remain low, owners of properties in top 25 markets are not bringing assets to market. Instead, they are hoping to capitalize on the improved operating results. This is pushing investors to secondary and tertiary markets. But when these investors move to secondary and tertiary markets, their pricing structure changes. Gone is the 7% to 8% capitalization rate pricing structure, which is being replaced by 9% to10% cap rate pricing on trailing 12-month data (as opposed to projections). The seller of assets is expecting the lower cap rate pricing, and he or she is not getting it. The "bid–ask" spread is still there. Obviously deals vary, but this sort of pricing is fairly typical.

In the coming months, I believe we will see more assets coming to market. With fundamentals improving, you will have a certain number of owners of assets looking to sell them; you will have owners facing debt maturity and their inability to refinance at desired levels (they will be able to refinance, but there will be a gap requiring them to inject more equity to the deal); and you will have banks that foreclose and take back assets (even though "extend and pretend" appears to have worked). When these assets hit the market there will be plenty of interested investors.

What if you are a seller in today's market? If you're considering selling in the next year, I encourage you to put the asset on the market sooner rather than later. There are a couple of reasons why:

1. The more assets on the market, the

more choices buyers have and you, as the seller, lose pricing power. Instead of looking at three assets, an investor is looking at 10 assets (and they are not going to acquire everything at which they look), and

2. Taxes: I'm not a CPA or a tax attorney, but with the "fiscal cliff" coming at the end of 2012, you are certain to pay more in capital gains taxes should the government not do anything. Also, as a seller, you will need to take into account product improvement plans such as the "Change of Ownership PIP" (which is certainly more than the PIP your brand has given you to implement). Over the last few years, your brand has not pushed renovations, now they are. And with a change of ownership, they certainly will. This PIP will affect the pricing/value of your hotel.

In all, I expect the pace of transactions to quicken in the next few quarters, and there will be opportunities for buyers and sellers of hotel assets in the "transaction trenches."

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.

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