Featured Stories

Buy low, sell high: A flawed strategy

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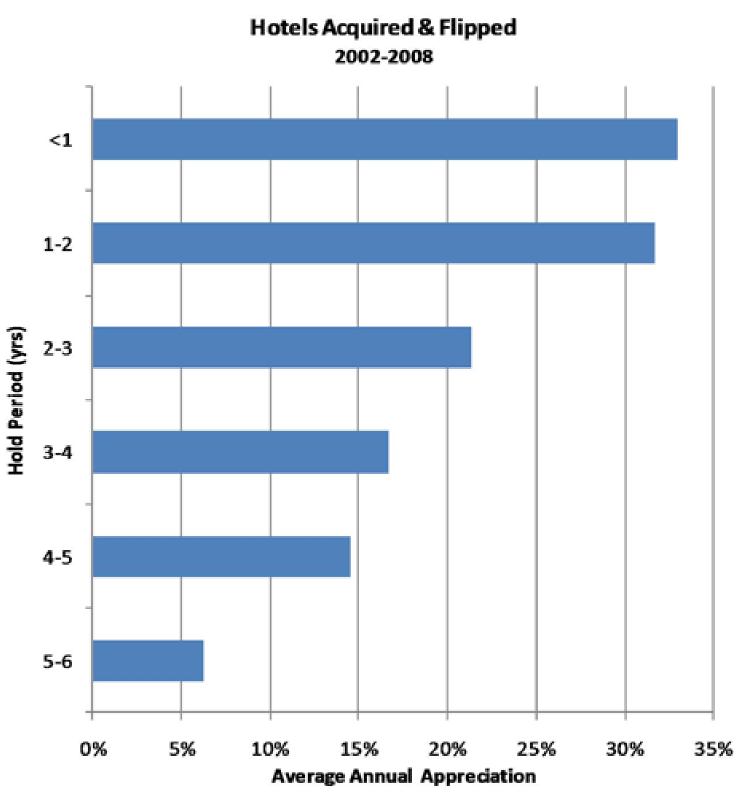
BOULDER, Colorado—As we witness the possible inception of the next acquisition cycle, many investors are hoping to reap the rewards of purchasing at the market trough and exiting when the market recovers. As in the prior cycle, many investors plan to acquire assets at a discount and dispose of them at or near the next market peak. And as witnessed during the prior cycle, this strategy is optimistic, if not outright delusional. The reality is there are very few investors that are smart/lucky enough to buy and sell at precisely the right time. More than a thousand upscale and luxury hotels changed hands during the prior cycle; a mere 12 percent of those assets were resold prior to the market collapse at the end of 2008.

Some investors tend to be clouded by emotions when selling hotel assets, particularly those at the high end of the asset class. With significant time and effort spent in acquiring an asset, it can be difficult to pull the trigger to divest of it prior to fully implementing the investment plan. There are also conflicts that may arise when the investment advisor is also the hotel operator. While a quick flip may produce a large incentive payout to the advisor, it may not be enough to compensate for the lost income stream to the management entity if the asset is sold unencumbered. Moreover, quite often investors remain attached to their investment plan which may take three to five years. This typically involves renovating and repositioning, and then managing the asset until cash flow and net income stabilize. However, based on analysis at STR Analytics, assets appeared to gain the most appreciation prior to the full turnaround. In many cases, assets were resold during or at completion of a renovation, yet prior to the full operational upside being realized.

On average, owners who acquired hotels between 2002 and 2006 and flipped them shortly thereafter realized more than 30 percent annual appreciation on their assets. Most investors who bought properties during that period and still hold them in their portfolio would likely record a loss in asset value if they sold them in today's market. One would think that the investors who produced the highest returns in the previous cycle were those who acquired properties at the trough in 2002 and held them until the market peak in 2007. However, this was not the case. The investments with the highest appreciation were those with short hold periods, regardless of when the assets were purchased. As illustrated in the chart below, investors who divested of their assets within two years of acquisition typically gained the most annual appreciation on their investments.



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Numerous investment groups are armed with capital for hotel investments, anticipating distressed properties coming to market over the next couple of years. However, nobody seems eager to jump in early and aggressively underwrite deals. Conversely, firms also fear missing the window of opportunity because once lodging fundamentals and the economic recovery strengthen, pricing is expected to quickly rise once again.

Yet, based on recent history, the window of opportunity does not appear to be limited to just the early period in the real estate cycle. Properties purchased in 2002 had significant increases in value, particularly in their first year of ownership. However, somewhat surprisingly, assets purchased in 2004 and 2005 exhibited a more rapid pace of value appreciation than those acquired earlier in the cycle. This bodes well for both pioneering investors who want to buy at the bottom and for more patient investors who are willing to wait for the right deal to come along. In either case, a short-term hold period appears to be the best strategy to maximize returns rather than attempting to time the market peak.