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Transactions

Owners search high and low for elusive value-add plays

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Hotel owners talk about how they look for value-oriented assets, what consolidation trends they see and how investors look at the current hotel sector.

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NEW YORK—Investors have to look far and wide to unearth the value opportunities available in today's hotel investment market, according to speakers at this week's 40th annual New York University International Hospitality Investment Conference.

Panelists participating in the "Treading water, leaping into the deep end, or staying out of the sun altogether?" general session agreed that value can be defined differently depending on the deal.

"I wouldn't say there's a secret sauce. It's more difficult than it's ever been," said Dan Hansen, chairman, president and CEO of Summit Hotel Properties. "We're not seeing what you'd call a middle of the fairway deal that's kind of in the first cut."

Tyler Morse, CEO and managing partner for MCR Development, added that "it's a very heterogeneous cycle that we live in.”

“No piece of real estate is the same as another piece of real estate,” he said. MCR owns and operates 94 hotels comprising more than 11,000 rooms.

Morse said MCR has been a net buyer for the past couple of years and plans to continue that strategy.

“It’s opportunistic—not all assets are created equal,” he said. “I’m very fond of saying we love buying hotels from dentists. For some reason, a lot of people dabble in the hotel investment world—of the 8,000 hotels that we’re interested in buying, (that) we’d be happy to own, I think 1,500 are institutionally owned and operated. There’s plenty of white space to run hotels better.

“We’ve bought hotels from a cotton farmer; we’ve bought hotels from dentists, from divorcees, from golf-course foursomes—people who are not institutional operators of hotels,” Morse added. “It’s a complicated business, and it’s not for faint of heart.”

Management landscape
Value, in large part, comes from the effective management of hotels, panelists said.

“The only out that’s left in the market right now is management—finding the right managers and making sure you’re (controlling) expenses—at least in the select-service space,” said Suril Shah, managing director and head of U.S. hotels for Starwood Capital Group. “Full service is completely different. There’s a lot more you can do with renovations and changing the product or if you’re changing a brand.”

“The difficulty is that these are all local business, especially in the select-service space,” said Mit Shah, senior managing principal and CEO of Noble Investment Group. “Getting the best general managers and directors of sales is the most important thing you can do.”

Mit Shah said the management-company landscape is becoming more challenging for companies like Noble, which does not operate any of the approximately 40 hotels it owns.

“Management-company consolidation is something that is creating these larger, bigger operators that—much like the larger, bigger brands—don’t necessarily have the greatest ability to drive local performance at all times,” he said. “There are fewer great operators today than there were in times past, which now makes that equation really, really difficult.”

Dan Hansen (left) of Summit Hotel Properties, told conference attendees that good deals are hard to find in this part of the hotel cycle. At right is Tyler Morse of MCR Development. (Photo: Jeff Higley)

Brand universe
Another key to the value proposition is branding. The panelists said brands matter in most cases.

“We’re big believers that loyalty drives behavior, so branding is important to us,” Hansen said. “I wouldn’t say the traditional brands have greater appeal to us than maybe some of the soft brands, so that may be something a little bit different. We like to find (assets) that are undiscovered, that are hidden gems that we can add some value.”

Morse said brand value often is dictated by the type of real estate the brand is attached to.

“In gateway cities, where there’s not this latent demand, the value of the flag is not as much,” he said.

The brand universe in which the hotel industry operates often provides opportunities for companies that own unencumbered assets, such as LaSalle Hotel Properties, which currently is in the process of being acquired by Blackstone, Mit Shah said.

“Look at this strategy out there with LaSalle and all their assets—the incredible real estate, the vast majority of it (has) no brand affiliation,” he said. “It will be interesting to see what happens there. And two, does a part of that strategy include a brand strategy?"

Suril Shah said it makes a lot of sense that companies—including his own—have had an interest in acquiring LaSalle, a real estate investment trust that owns 41 hotels comprising more than 10,000 rooms.

"It's a portfolio that's independent that's not tied down with a lot of brands," he said. "They've got a premium number for a lot of their assets, which is the flexibility that people see."

The ability to convert some of those assets to brands is attractive, and Suril Shah said Starwood Capital looked at the portfolio—and perhaps half-jokingly said his company is still interested in the portfolio.

"Our edge, or our alpha, was converting a lot of the portfolio to a 1 hotel, which is one of our brands. … We'd still like to talk about that," he said.

REIT M&A

The consolidation of the hotel REIT sector also proved to be a key topic among the panelists.

"I always believed that REIT consolidation would happen," Suril Shah said. "It makes a lot of sense, and there's a lot of value you can create with REIT consolidation. … I still think it will happen."

Hansen said he's tempering his expectations of significant REIT M&A.

"I think there will be always less than is expected," Hansen said. "That doesn't mean I don't believe it makes sense because there are some synergies and scale. There are portfolios out there that are more alike than they are different.

"What investors are saying is they want the liquidity. Part of (REIT consolidation) is these mutual funds (as investment vehicles) getting larger and having the need for liquidity. The other side of that is the bigger you get, the harder it is to differentiate yourself."

However, the recent formation of CorePoint Lodging—a REIT on which Mit Shah serves as chairman of the board—counters the idea that there's a need for consolidation. Mit Shah said CorePoint's sole focus is on the midscale and upper-midscale segments.

"In today's environment, there's never been a REIT exclusively focused on this segment and a RevPAR that is well under $100—it's clearly a cash-flow opportunity," he said. "Midscale and upper midscale has been the big push. You've seen launches across a wide section.

"It's because that owner-operator and that franchisee is loading up—they already own Hamptons and Holiday Inn Expresses and the like, and they're coming back in and building Trus and other product because of the cash-flow nature," he added. "Their thesis is very simple: Build to a double-digit unlevered yield. And they're going to cash flow to that extent. That's what this segment is all about. It's a cash-flow story, and it's one that's been extremely successful in the private markets. There are going to be investors that are going to pay a lot of attention to it."

Because "Wall Street is a RevPAR snob," Morse said he is a little less optimistic about the REIT's prospects.

"Hotel assets are better owned in private hands because of the volatility inherent in hotels," Morse said, adding that the wild fluctuation of hotel performance is often based on factors such as market conditions and weather conditions. "To be able to withstand that without … having to answer to Wall Street gives you a big advantage."

Careful investment

Hansen, whose company was repeatedly referenced as a success story after its launch seven years ago, said any publicly traded hotel company needs to stay disciplined in its investment approach.

"We did start seven years ago with a strategy that nobody really believed in," he said. "(Summit's) RevPAR was $55 when we went public—I'm pretty sure the initial investors we met with were thinking, 'I just paid more to park my car today than that.' Part of it was a cash-flow thing. At that point, I was not thinking we would have this premium multiple.

"Finding a strategy and a path, like CorePoint is doing, is appreciated over time by investors."

Regardless of the structure, the importance of knowing where value lies is of the utmost importance, according to Mit Shah.

"This is industry where people say, 'I just focus on independent city-center hotels,' or 'I just focus on extended-stay hotels' or 'I just focus on the luxury segment,' and a lot of them have success across all boundaries," he said. "I do believe that the differentiating point is when you can specialize in one of those areas—you can really drive performance across cycles."