Lessons Learned from the Market Shift

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2011 was a turning point. The first half was frothy as real-estate investment trusts gobbled up properties at apparent premiums. The second half slowed, but all the data and bar room stories demonstrated a continued deal flow among private investors. So deals definitely returned in 2011. But people also were constantly talking about a "paradigm shift" and a new environment.

Was it true? Did everything we know about buying hotels—and financing those deals—change? Had the industry learned some new lessons? With those questions in mind, I set out to reconsider the deals I worked on in 2011 and surveyed a trusted friend who would give me his thoughtful insights.

Gleaning purchasing insights

Dennis Moses, VP at Columbia River Capital Advisors, has crunched numbers in the industry for more than 25 years, including stops with Hilton as a controller and with Merv Griffin as the Griffin Group's VP of finance.

He gave me two diverging examples of what he saw while consulting on projects during 2011.

"The first deal was a domestic group looking for a full-service hotel in a gateway city with a 12% cap or higher. The returns they were looking for was a leveraged (internal rate of return) in the high 20s to low 30s on a five-year hold with 70% leverage," Moses told me.

He went on to explain how this potential buyer wanted "distressed" opportunities, had a lean deal team and planned to manage the property itself after the closing. Moses ran the numbers on a good deal that he found, but this buyer passed and is still searching for a deal that will meet those lofty goals.

"The second group was a well-funded international group. Leverage was not an issue, but this group was enamored with 'the incredible amount of distressed deals' in the U.S."

Moses mentioned another lean deal team, one that had never done a hotel deal in the U.S., and the desire to manage their own hotels. "I guess I was not surprised when I found a great deal for them, and they passed," he sighed. Again, another buyer is still out there looking.

I compared and contrasted these stories to my experience. I had seen some deals close, representing both sellers and buyers. Like Moses, I also had seen some deals go nowhere. Everyone I saw was looking for the right pricing for the market.

However, those buyers with solid deal teams closed deals. With a few exceptions, those buyers with a lean deal team or simply an interest in timing the market lost deals.

Changing perspectives

Both Moses and I saw the same thing. Perspectives had changed—investors wanted "distressed" and talked as if they were approaching deals differently. Plus the acceptable metrics changed, which is exactly what should have happened in response to the market downturn.

However, the investors and their deal teams (or lack thereof) went about the process in the same manner we had always seen. In other words, not much had changed to successfully execute a deal.

So a few lessons can be learned:

- Assemble the right internal team. Experience counts, and those finding the deals should work closely with the asset manager, as well as others who will have to live with the consequences of the deal.
- Engage in due diligence. Numbers will get that much more scrutiny in this environment, but deeper digs on all issues are necessary when the waves remain so hard to predict. For example, a bad call on a potential labor union or employment benefits situation may rob the investor of the expected margin.
- Tap the right advisers. Consultants, lawyers and others play a key role but manage them closely. Again, experience counts. The good ones will give you perspective on the bigger picture while still being efficient.
- Bring your potential management company to the party. Savvy investors not only will get "free" diligence, but the investor also will be able to set more realistic expectations (which should be reflected in the management contract) through the one-on-one interactions.
- Concentrate on deals and not timing. Timing the market is something where many have tried but all have failed. The human element is just too variable.

These lessons are nothing new. As Moses reminded me, while we may be speaking these days about the most recent distressed property or the upticks in rates and occupancy, "We are all still human." Computers may be making a lot of trades on the public securities markets based on the most recent swing in pricing, but hotels still exist for people to visit and people still work the deals to buy them. That is a good thing, and I hope that human element never changes.

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