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Third-party asset managers adapt to demand

When *Hotel Business* asked several asset management insiders about the current conditions in the industry, they provided valuable insight into CapEx investments, competition among other asset managers and greater demand of asset management services. Demand for third-party asset managers shows no signs of slowing down in 2014, as asset management companies, such as the ones featured here—Capital Hotel Management, LLC, Three Wall Capital, LLC, T.R. Engel Group, LLC, Hotel Asset Value Enhancement, LLC and Warnick + Company—continue to effectively drive profits.

—*Matthew Marin*

1 Are you urging owners to invest more CapEx into their properties as industry performance improves?

Crandell: It is truly a case-by-case basis, but in general, we're urging our owners to spend smart. Capital planning is not a one-year event. We are working with our owners to balance the short-term requirements to enhance competitive positioning through product improvements and support continued ADR growth.

Dick: Yes, but generally on a case-by-case basis. We recommend CapEx investment when brands require maintenance and upgrades to their respective standards and, most definitely, when a return on investment (ROI) warrants. Our position on investing CapEx may be slightly more generous during periods of performance improvement, but we review each CapEx issue on a stand-alone basis and typically through prioritizing, phase in the expenditures throughout a specified period of time.

Engel: On a selective basis. For hotels that have been capital starved since 2009, we have stepped in as asset manager after some form of recapitalization. In these instances, our asset managers are evaluating potential financial gains associated with CapEx spending for either focused areas or total repositioning/reflagging.

Russo: I wouldn't say urging. Owners are less cash constrained. The opportunity to evaluate ROI on projects and address deferred maintenance is greater so it is a good time in the market to do so. There is a direct relationship between guest service scores and RevPAR in the select-service space.

Warnick: Not necessarily. We look at assets on a case-by-case basis—and we do so on a one-, three- and five-year time horizon. Industry cyclicality is a factor but, in fact, the best time to invest capital may be in the down cycle so a hotel can be well positioned both during and coming out of a recession. In general, capital investment should support and follow a strategy.

2 Does overall demand for your services typically increase during growth periods?

Crandell: It's been an interesting shift in demand over the past 20-plus years that we've been in the business of asset management. For example, in the second half of the last decade, we experienced a slight increase in demand as the market showed signs of softening, as ownership groups looked to align with an expert to devise a strategy for mitigating the downturn.

Dick: To the extent that new development occurs, yes. However, in the case of existing assignments, we monitor performance to ensure that a specific hotel is maintaining and increasing its market penetration—and that the resulting increases in revenues are not being eroded by unnecessary increases in operational expenses—both fixed and controllable expense items.

Engel: Our advisory and asset management team and fee income stabilized and has grown since the depth of the recession. We have also benefited from geographic expansion into Central Europe and Qatar, where we now have an office in Doha and are the only hospitality advisor and asset management firm in that country.

Russo: Interestingly, the demand for our services is similar in good and bad times. During the good times, our clients are buying hotels and immediately want to maximize value. Since our average NOI improvement is $3 million per assignment, owners want to take advantage of that right away to recognize NOI. During the bad times, lenders and special servicers are taking back hotels and employing our services.

Warnick: Demand for our services does increase in growth periods, primarily because of new supply additions. Growth is also occurring today because so many hotels are changing hands. We also experience growth when times are bad because owners typically perceive a more pressing need for deep industry expertise, which we have in abundance.

3 Has competition increased among asset managers within the last few years?

Crandell: Hotel asset management has gone mainstream, garnering a lot of attention and demand from ownership groups. In response to that, we see asset management added as a service by many hospitality consulting firms as well as a few new players, many of which are spin offs of management companies or other, larger asset management groups.

Dick: Yes, competition has increased. As both owners and investors have realized the importance of monitoring performance and the success of strategic oversight that a hotel asset manager can provide, the demand for asset management has increased and, consequently, the market of asset managers has increased commensurately.

Engel: Clearly, the number of hotel operational asset management firms has grown since T.R. Engel Group first hung out its shingle 15 years ago. We were among the very first firms. Today's investors understand hotel operational asset management's potential value-add much better than 20 years ago.

Russo: I've found the competition for asset management assignments increases during the downturn as hotel management companies, brokers and operating partners in hotel investments solicit third-party asset management services as a source of cash flow.

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Michelle Russo
Hotel Asset Value Enhancement, LLC

Richard Warnick
Warnick + Company

Asset Manager

special Hotel Business advertising profile

RLJ Lodging Trust

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goal to be the aggregator or major player in the select-service space and we're certainly one of the largest lodging REITs today. So that's always been a primary objective," he said.

The purchase price for the assets was some $313 million and Baltimore described the terms as "fair and balanced." With the pending completion of the deal, the company will have spent some $900 million since its IPO in 2011. However, Baltimore pointed out that the company executed "a lot of transactions the year before going public." In fact, he added that RLJ has acquired some 46 assets and spent just south of $2 billion over the last four years.

> *"Our balance sheet is in excellent condition and we have plenty of liquidity. We still see ourselves as a net buyer right now in this part of the cycle."*
>
> *—Thomas Baltimore Jr. RLJ Lodging Trust*

That said, Baltimore noted the company is far from done in terms of acquisitions. "Our balance sheet is in excellent condition and we have plenty of liquidity. We still see ourselves as a net buyer right now in this part of the cycle," he said.

The most recent deal includes 10 hotels totaling 1,560 rooms. The company described the properties, many of which were acquired by Hyatt in 2011, as "high performing, young and well located." As part of the deal, a Hyatt affiliate will continue to manage the hotels under new management agreements.

Baltimore acknowledged the company's ongoing relationship with Hyatt helped the deal come to fruition. "We've been in discussions with them for many months about different opportunities. This portfolio really makes sense for both companies. It gives them a chance to recycle capital and certainly keep an opportunity to continue to manage, as well as franchise. For us, it gives us an opportunity to get an excellent portfolio with seven of those hotels located in California, which is an area we've wanted to grow and expand for some time," he said.

The seven California properties, five of which are in the Bay Area, include Hyatt House properties in Cypress, Emeryville, San Diego, San Jose, San Roman and Santa Clara, as well as a Hyatt Place in Fremont. Baltimore noted the company has "more of a coastal bias right now" and described the Hyatt deal as being "very compatible" with that.

Baltimore was quick to assert, "We also like the other assets we got in the portfolio." Pointing out, for example, that the 151-room Hyatt Place Madison/Downtown in Madison, WI, "is in a state capital and is a university town." Meanwhile, the 70-room Hyatt Market Street, The Woodlands in Woodlands, TX, is located in what Baltimore described as an "upscale market with commercial demand generators and a great retail center." The 163-room Hyatt House Charlotte/Center City in Charlotte, NC, is adjacent to the Time Warner Cable Arena in downtown Charlotte and represents "a great young asset, one we're really bullish on."

The overall portfolio will represent more than 7% of RLJ's projected 2013 EBITDA and more than 7% of its total enterprise value, according to the company. RLJ estimates that the portfolio's 2013 aggregate RevPAR will be greater than $120, which is more than a 10% premium to the company's projected RevPAR for 2013. Within the portfolio, the company is looking to put some $25 million into renovations over the next 24 months. "There's about five assets that have significant capital [needs], and a bunch of others that require little or no capital," said Baltimore.

Select-service segment

Baltimore touted the value of the Hyatt brand and the company's progress in the increasingly competitive select-service segment. "I've said for some time that I believe the select-service, focused-service branding race is really a three-horse race between Marriott, Hilton and Hyatt," he stated. He further noted, "We are excited about expanding our strategic partnership with Hyatt and we're going to continue to explore ways to grow with them."

Finding ways to grow has been something of a specialty for RLJ, and Baltimore acknowledged that property values are on the rise and there is a good deal of competition for deals these days as equity capital firms become more aggressive and debt becomes more readily available. Nevertheless, he remains confident the company will find deals that pencil out. "We've had a long history of finding assets that were either limited bid or off-market, and a lot of that credit goes to Ross Bierkan [chief investment officer and EVP] and our deal team. We spend a lot of time looking. We'll compete if it's an attractive asset, through the brokerage community, but we've had a history of converting deals kind of off-market or limited bid and we'll continue to seek opportunities," he said. HB

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Warnick: Substantially so. On the supply side, more consultants are saying that they do asset management. Brokers, too, have supplemented their business model with asset management. Fortunately for us, there is a big difference between saying you do asset management and actually doing it well. On the demand side, more owners are recognizing the benefits of qualified asset management. The institutionalization of lodging ownership has increased the demand for professional asset management.

4 Has your firm broadened its scope of services in the last several years? If so, how?

Crandell: Capital Hotel Management's sole business line is hotel asset management with all of our tools and resources designed to provide excellent asset oversight with no other competing lines of business. So, from that perspective, we have remained true to our core. We have, however, in recent years experienced an increase in demand for asset management services earlier on in the process with investors seeking our input and requesting representation during the acquisition due diligence phase, where we spearhead the underwriting process and develop the overall investment strategy supporting the acquisition.

Dick: Yes. We have increased our efforts in the area of revenue management, social media management and general overall positioning of properties.

Engel: Our asset management model is built around highly experienced former hotel operations executives taking charge of the entirety of their hotels—operations, food and beverage, sales and marketing, CapEx—coupled with junior executives with a background in finance and creating/restructuring a capitalization plan for a hotel for whether it is a new development, acquisition or problem child. T.R. Engel's scope of services has remained unchanged over the years.

Russo: Our services have been stable and include acquisition due diligence, underwriting and ongoing asset management. Ancillary services include management and brand selection and negotiation and major renovation and repositioning analysis. We are known for extracting value from entrenched operators and managers via our collaborative approach. On average, we improve cash flow by a minimum of $3 million per assignment.

Warnick: Because of the breadth and depth of experience of our team, we have always provided a wide range of services. Our firm offers a purpose-built platform that includes deep expertise across the full gamut of required asset management disciplines. We're kind of like an NFL team: We have position players, but we have teams involved in each asset management assignment vs. a single individual.

5 What types of properties are you most involved in asset managing?

Crandell: Hotels ranging from 500 to 1,000 rooms, branded full-service commercial and resort markets, which today comprises roughly 75% of our asset management portfolio. Additionally, convention center headquarter hotels is a very specialized niche that we have been able to carve out.

Dick: Luxury, resort and select-service properties.

Engel: Our specialty tends to be branded/unbranded upper-upscale and portfolios of premium-branded select/limited-service and extended-stay properties.

Russo: Our portfolio of over $2 billion under management is primarily full-service and luxury hotels with a minimum asset value of $50 million. We also asset manage portfolios of select-service hotels.

Warnick: More complex, full-service, higher-end assets. We asset manage resorts and convention hotels, boutique and lifestyle hotels, traditional upper-upscale and luxury hotels.