Owners like the returns of select-service segment

By Stefani C. O'Connor

NEW YORK—With the economy still unsettled, HOTEL BUSINESS® recently decided to see how two industry players—Norfolk, NE-based Supertel Hospitality Inc., a publicly traded REIT, and Raleigh, NC-based Concord Hospitality Enterprises Co., a traditional developer/management firm—are approaching the limited-service segment—traditionally defined as properties without food and beverage operations—in the second half of the year.

Key for Concord heading toward fourth quarter is breaking ground in Pittsburgh, PA, and Raleigh, NC, in late November for two Hyatt House hotels, a brand concept slated to supplant Hyatt's Summerfield Suites.

"We're also breaking ground on two Courtyards, one in Knoxville (TN) and another in downtown Cleveland near Ohio State University. Each of these assets—in fact, all of our assets going forward—will be LEED-certified," said Concord president/CEO Mark Laport. Concord also is in a 50/50 JV with legendary golfer, Arnold Palmer, for a SpringHill Suites in Latrobe, PA.

At Supertel, CEO Kelly Walters is completing a transition begun in second quarter, going from a single management company to three operators "who have strong regional expertise in the markets where we own and want to acquire hotels…They bring fresh perspectives as we look for how we can best apply our capital to preserve and enhance

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Legendary golfer Arnold Palmer atop bulldozer at ground break for new SpringHill Suites he's doing in Latrobe, PA in a JV with Concord Hospitality.

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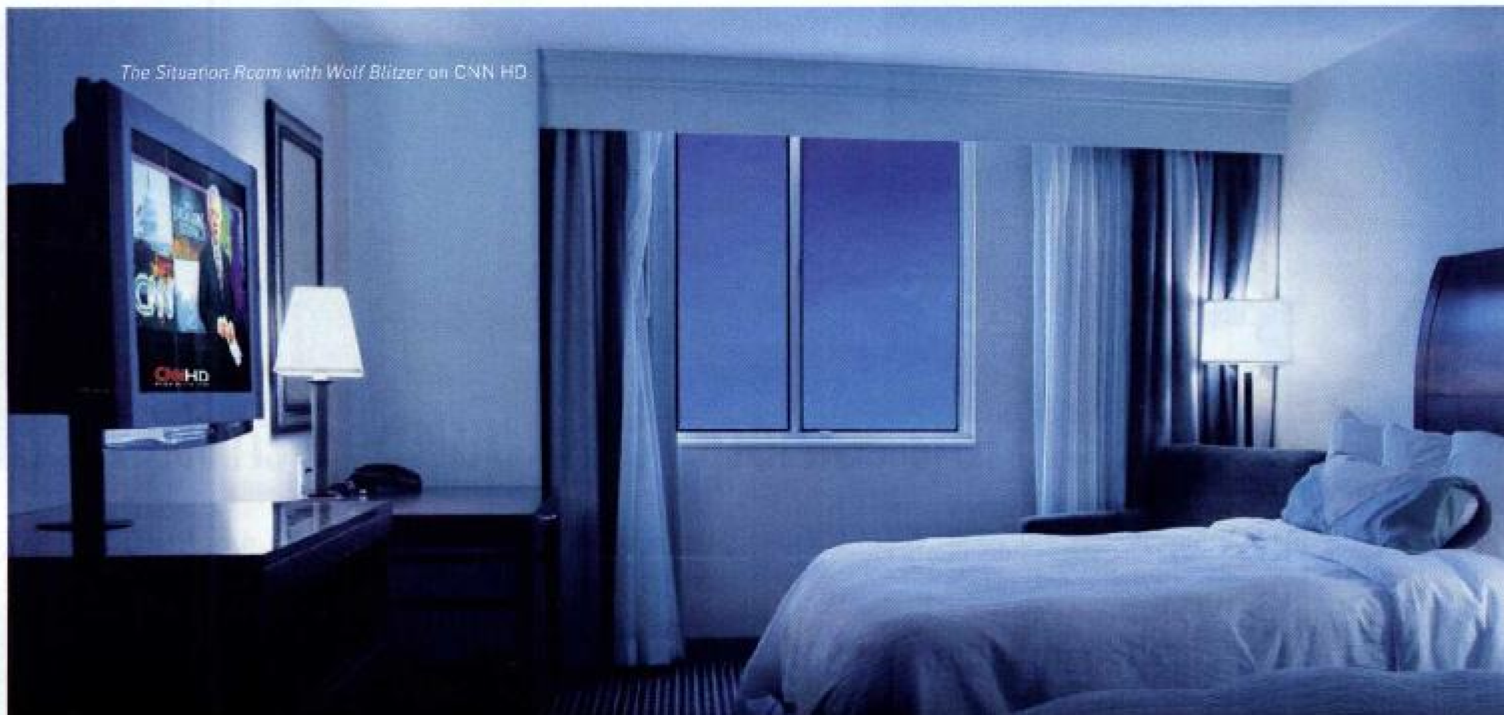

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Select-service properties remain well represented in owner's portfolios

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value in the portfolio. About 20 percent of our portfolio is now classified as 'held for sale' and we will maintain those to brand standards, but the bulk of the dollars will go toward the 85 hotels currently classified as our 'core' portfolio," said Walters. Both executives have significant portfolios and each acknowledged some assets are not quite up to par, but nothing that proactive strategies could not ameliorate.

"We're fortunate," said Laport. "As an operator of 83 hotels, I'm only dissatisfied with the results at a few, and we're financially strong enough that we can support them through these tough times, until the better times that I believe are ahead for those few properties."

He indicated Concord is "definitely" focused on growing through new development and believes money can be attracted to the right limited-service projects.

"A year ago, it was hard to find money, but now there is a lot of equity that is willing to invest in 'best in class' select-service assets that underwrite well; projects where the return on cost will be 10 percent or better," said Laport. However, he cautioned, "There's not a lot of debt to be placed for new hotels. I'd characterize the opportunities for debt placement as thin. Big banks are on the sidelines; smaller community banks or regional banks will support developers in ground-up development, but only for companies with long and successful track records. There is SBA financing for small hotels (under $5 million) with an unproven developer, but the average select-service hotel is in the $12 to $18 million range. The going is tough for new kids, but those who've been around the block can figure it out."

Similarly, challenges faced at Supertel, said Walters, are rooted "largely in specific, identified, underperforming and over-leveraged assets in our portfolio. We will continue our strategy of shedding our noncore assets, reducing our debt and bringing stability to the portfolio before we can expect to attract new capital to begin acquiring again. We are working with a strong group of hotel brokers and have sold 24 properties in just over two years in what has clearly been a very difficult market. We will continue to prune and upgrade our portfolio to achieve the highest possible returns for our shareholders."

Supertel has sold properties in spite of the difficult environment, which, Walters said, suggests the investment paradigm "is reasonably good, at least for the limited-service economy segment. But buyers are careful and they know their comps. The typical buyer of our assets is accessing SBA money through a local bank with a 25 percent equity contribution and a personal guarantee. They are getting deals closed in 90-120 days from contract signing."

Concord is using "a lot of filters" to find the "right" limited-service deal right now, said Laport. "We look at a lot of opportunities in a lot of markets to find a winner. Just as a basis of comparison, we opened 13 hotels in 2009 and in 2011 we'll open four, but we have $240 million in the pipeline already for 2012. If you have intestinal fortitude to be a contrarian and can put together the capital stack in bad times, you'll be rewarded," he said.

Supertel trimmed its portfolio to 101 properties from the 125 it held at year's end 2008 and only recently began evaluating opportunities. "Our plan is to move methodically away from the economy sector in favor of more mid-scale and upper mid-scale/limited-service flags," said Walters. "Acquisition candidates that we are targeting are stabilized properties in markets where our management companies have proven experience. From a geographic standpoint, the focus generally will be in those markets below the top 25 but ideally still within the top 100. The right deal for us will deliver at least a 9 percent IRR with little to no expectation of terminal value growth over the next five-year holding period."

Concord Hospitality has the 134-unit SpringHill Suites Columbus OSU in Ohio (left) and a 124-room Courtyard by Marriott Washington Meadow Lands Washington, PA (below), in its portfolio.

Supertel has a variety of limited-service brands, including 63-room Quality Inn in Danville, KY (right), and a 71-room Comfort Inn and Suites in Warsaw, IN (below).

Concord is being opportunistic when it comes to limited-service hotels, which are not generally cast as "trophy" properties. "We bid on 20-plus hotels this year and only bought one, which means that we considered the winning bids to be too high" said Laport. "We will not and can not compete against REITs; their cost of capital is lower. Their business model works if they can generate high single-figure returns. They're satisfied with lower yields; we look for high double-digit returns. We only buy hotels that we can add significant value to by bringing our core competencies and our management ability to develop them into better hotels. We'll take more risk in re-development; they prefer something that's ramped up and ready. I expect that we will see more opportunities now that the REITs have gone dormant."

Supertel doesn't consider itself "dormant" and aims to be more strategic in its growth. "As a REIT, our investors expect us to acquire assets that generate a consistent rate of return sufficient to pay a dividend that is at least competitive with our peers, while garnering enough growth in asset value to deliver a total rate of return above the index over the long term," he said, noting all future acquisitions will be "strategically selected," said Walters, adding a "trophy" is in the eye of the beholder. "Trophy is a relative term. For a company like us that only owns assets in this segment, a hotel that produces a steady stream of earnings is a trophy we seek."

Of Concord's 83 hotels, 75 percent to 80 percent are what Laport considers limited-service. Brands include Courtyard by Marriott, Cambria Suites, Hilton Garden Inn, Residence Inn by Marriott, SpringHill Suites by Marriott, Hyatt Place, and the new Hyatt House.

"We have $400 million in operational revenue and approximately 80 percent of that is coming from upscale focused service," said Laport, who noted the company has been "very aggressive" over the past six to 12 months in pursuing limited-service assets. "We've bid, but not won a lot," he acknowledged.

Walters puts all of Supetel's 101 properties in the limited-service category, with seven of those being extended-stay. Brands include: Super 8, Comfort Inn & Suites, Baymont, Days Inn, Ramada Limited, Quality Inn, Holiday Inn Express, Masters Inn and Guesthouse Inn. "We will continue to divest economy-segment hotels in favor of more upscale mid-market, limited-service, branded properties," he said, adding the REIT hasn't begun pursuing new properties "in a meaningful way, primarily due to constraints in the capital markets. When those issues are resolved, we will focus on adding properties that have a durable earnings outlook without aggressive growth assumptions."

Walters said the opportunity in limited-service hotels over the next few years would likely be "for well-capitalized buyers to partner with cash-strapped owners who have equity in their assets but not a sufficient amount to re-finance their loans at maturity. In other words, distressed owners, not distressed assets."

Laport also believes the segment's future is bright. "It's the kind of hotel that most business folks want to stay in; they're new and technologically advanced. You can also build them in places where businesses are emerging, places where it wouldn't make sense to build a big, full-service hotel. And, they generate enough revenue that if you manage the margins well, you can generate handsome returns. I think it's a great business model with a brilliant future. We plan to continue to play." HB