

Limited-service sector gains momentum

By STEFANI C. O'CONNOR

NEW YORK—The limited-service sector remains an achievable goal for portfolio growth for both veteran owners and developers and those making a foray into lodging, although to many hoteliers, the industry has created a paradox with the segment. Historically embraced for its relative ease of financing, tight footprint and lack of significant frills, the segment, driven by increased competition, has morphed over the past decade into one that has suffered from amenity creep, sub-segmentation and a semantic disconnect by those who refer to the same brands in the segment as select-service.

In addition, the segment offers features and services, usually free, that upper-end hotels routinely charge for and post to a guest's folio.

Still, the addition of complimentary services, usually mandated for limited-service properties attached to a major brand, has made the segment popular with consumers who feel there's a great value-add to deluxe continental breakfasts, free high-speed Internet access and policy guarantees that tout that if they're not satisfied, they don't have to pay the bill.

A recent sampling of hoteliers active in the segment found them bullish heading into fourth quarter.

"We believe that now is an ideal time to invest in the limited-service sector, as prices are coming further in line with buyer expectations," said Greg Friedman, CEO of Atlanta-based Peachtree Hotel Group, which has Starwood, Hilton, IHG, Choice and Marriott product in its management portfolio and several Marriott products under development. "That being said, we also are interested in purchasing discounted first mortgage notes secured by limited-service hotels."

At Chatham Lodging Trust, EVP/CIO Peter Willis said the lodging REIT will be sticking to the fundamentals of buying "premium-branded, select-service hotels in outstanding locations" in the top 20-25 MSA markets. "For the fourth quarter and the foreseeable future, we'll continue to look for markets where there is potential for outsized RevPAR growth or where we can add value to the asset through repositioning or better management," he said.

The Palm Beach, FL-based REIT's portfolio includes limited-/select-service and extended-stay properties from Hyatt, Marriott, Starwood, Choice and Hilton.

Mark Laport, president/CEO of Concord Hospitality Enterprises in Raleigh, NC, indicated the company is targeting several goals. "As we negotiate LNRs (locally negotiated rates) for the coming year, we are focused on being as aggressive as possible with the objective of achieving strong rate growth year over year. Our target is 5%-6% on average. Operationally, our objective is to contain year-over-year cost creep by continuing to focus on cost-control activities as we did during the recession, including focusing on negotiations with suppliers, managing real estate taxes. We are also strategic about formulating our benefit plans so that employees are provided with good choices that are cost-effective and stem the inflationary spiral," he said.

Growth is also predominant among the hoteliers' strategies. Concord, for example, has 19 hotels in its active pipeline, representing 10 different brands under development, which Laport considers a "marked

expansion" of brands in the portfolio.

Similarly, Friedman sees Peachtree expanding its limited-service portfolio for the foreseeable future. "We continue to focus on acquisition opportunities and expect to acquire an additional 18 to 24 assets within the next two years," said the CEO. "We have acquired more than 30 hotel assets over the past two years via non-performing/sub-performing hotel note acquisitions and traditional hotel real estate acquisitions. We expect this trend to continue through 2014."

Chatham also intends to grow and, like Concord, is focused on acquiring select-service and extended-stay hotels. It also expects to divest some properties.

"We constantly review our portfolio and periodically will prune assets that no longer fit with our strategy and redeploy the proceeds. One or two properties in our wholly owned portfolio currently have that potential," said Willis. "We also are a JV partner in a 58-hotel portfolio with Cerberus. With a portfolio of that scope, you always are actively pruning."

Each asset, he noted, has a carefully thought-out disposition strategy.

Laport said divestment—"to harvest the value that has been created"—is consistent with Concord's efforts to maintain and grow a portfolio of hotels with an average age of about six years. "In 2012, we have either sold or listed for sale seven assets," he said.

All three executives concurred the segment is attractive as an investment vehicle.

"This segment is attractive both short and long term given the actual investment yields being achieved compared to yields available elsewhere," said Friedman. "Both the industry and the segment are performing exceptionally well, and all indicators point to this continuing for the foreseeable future. For some time now, owners have been sitting on the sidelines, encumbered by a lack of debt and 'good' deals. Those issues finally are moving from the windshield to the rearview mirror."

There is an abundance of capital for the right deals, according to Willis, who observed given the low yields otherwise available to large scale investors, the hotel industry and the investment fundamentals match up well.

"There's been enough growth incubated on the held assets and enough activity returned to the market that a well-structured deal can now match buyers' and sellers' expectations," he said. And while lenders are active and available, he added, terms are not as aggressive as most private-equity groups would like to see. "They're still requiring more equity than in recent years. That tends to give REITs a greater advantage because they don't use a lot of debt to leverage their deals."

"Simply put," said Laport, "Upscale select-service hotels generate the highest investor returns, on average, of any segment in the lodging industry."

In assessing potential deals, Concord evaluates opportunities in multiple markets that it believes will generate "good cash flows and a minimum 20% IRR over a five-year period," he said.

Peachtree Hotel Group has two different acquisition strategies, depending whether it is a hotel note or real estate investment. "On the real estate side, we are focused on certain brands, locations, room

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Lodging REIT Chatham Lodging Trust's portfolio includes Homewood Suites by Hilton, such as this property in San Antonio.



Concord Hospitality has a variety of Marriott product, including SpringHill Suites like the one proximate Ohio State University (above) and another downtown in Columbus, OH, which both feature contemporary decor.

Peachtree Hotel Group includes Hampton Inns in its portfolio, such as this property in Pell City, AL (below).



AH&LA

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AH&LA's Government Affairs Department has a full complement of issues it is advocating on behalf of, cognizant that the election's outcome will clearly influence its chances of success going forward. EVP of Public Policy Marlene Colucci last month summed up three issues presently high up on the Association's list of concerns: visa reform, travel promotion and the Department of Justice's requirements regarding swimming pool lifts.

Visa reform is a central piece of the JOLT Act (S.2293) currently being considered by the Senate. JOLT is an acronym for Jobs Originated through Launching Travel. The purpose of the bill, according to Colucci and strongly supported by the AH&LA, is to redefine the country's visa process and make it more equitable for travelers wanting to come to the U.S.

"Certainly, it makes sense that if we have more travelers coming from countries like India, China and Brazil, we have more consular offices in those countries and more officials available to process visas," Colucci noted. Passage of the JOLT Act will make this possible.

Similarly, the bill will increase the number of countries eligible to participate in the visa waiver program. Travelers from these countries don't need visas to visit here. "Once a country is awarded visa waiver status, travel from that country jumps exponentially," Colucci explained, using South Korea as an example. Once granted this status, travel from South Korea

increased an estimated 45%.

In promoting passage of the JOLT Act, the AH&LA is working closely with the Asian-American Hotel Owners Association (AAHOA), the US Travel Association and the U.S. Restaurant Association, among other interested groups



Marlene Colucci
AH&LA EVP of
public policy



The AH&LA has continued to push back strenuously on U.S. Department of Justice regulations requiring swimming pool lifts in hotels and resorts.

public-private partnership authorized by the bill. Brand USA's sole mission is to advertise the U.S. as a travel destination in all its diversity, meaning "not just the gateway cities, but secondary and tertiary markets as well," Colucci pointed out.

The reason the Travel Promotion Act is critical to the lodging industry is because international travelers contribute more and more to the bottom line. From January through April of this year, for example, this segment of travelers spent \$54.6 billion here, up 13% from 2011. "That's a huge number. It makes our industry a big deal in the U.S. economy. One of our goals is to make Congress realize how important we are to the economic backbone of the country," she said.

The AH&LA's struggle with the Department of Justice over proposed changes in regulations regarding swimming pool

industry and welcome them to be our guests," Colucci said. "But we want to be sure on behalf of our members, who are property owners and managers, that the rules being issued by the Department of Justice are reasonable."

As originally written, the Department of Justice guidance required hotels to install pool lifts that were permanent and affixed to the ground. Hotels couldn't move a lift from the swimming pool to the spa, for example. Nor could it be stored when it wasn't in use.

The Government Affairs team pushed back strenuously, arranging meetings at The White House and hearings with the Judiciary Committee on The Hill, and encouraged Association members to write letters to their representatives questioning the regulations.

The pushback has had some success:

The compliance deadline has been extended to January 2013 and portable lifts will be acceptable. The AH&LA is still working to ensure the final rules make sense to the industry.

"The lesson here is that, if we don't seriously push back, we're ceding control and the government is free to issue all sorts of rules that are impractical," Colucci said.

It is in this spirit that Colucci urges all hotel owners and operators to be sure to vote in local, state and national elections next month for candidates that support the industry's position on a whole raft of issues. "Then make your views known to your legislators at forums like the AH&LA Annual Legislative Action Summit, which is being held next year in late-April. Your legislators need to hear from you."

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in a coalition called the Discover America Partnership.

A victory for AH&LA last year was the passage of the Travel Promotion Act, though Colucci and her team remain vigilant as provisions of the Act kick in, particularly regarding Brand USA, a

lifts under the Americans with Disabilities Act is a particularly sensitive subject, she acknowledged.

"It's an area we want to treat cautiously because we're hardly against people with disabilities. To the contrary, we encourage them to be a part of the lodging

industry's position on a whole raft of issues. "Then make your views known to your legislators at forums like the AH&LA Annual Legislative Action Summit, which is being held next year in late-April. Your legislators need to hear from you."

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count and IRR, while on the note side, we are primarily driven by absolute yield," said Friedman. He added that the company is primarily an opportunistic investor. "We typically purchase hotels at a discount-to-replacement cost in markets with diverse and stable demand drivers where we feel we can create value through our operation platform, branding strategies and injecting meaningful CapEx investment," said the CEO.

Peachtree currently has 38 assets: 20 hotel real estate assets and 18 hotel first mortgage notes. Asked whether they've seen opportunities in the segment around so-called distressed properties, the response was mixed.

Willis indicated not many surfaced that were viable. "We saw distressed partnerships and distressed forms of ownership, but a lot of those have been worked out. We've picked up a few assets from these

distressed owners or entities that needed liquidity. We like distressed opportunities when we can add value and turn them around, but for the most part, the assets in our sweet spot tend to ride the cycles pretty well," he said.



Peter Willis
Chatham Lodging Trust



Mark Laport
Concord Hospitality
Enterprises



Greg Friedman
Peachtree Hotel Group

Meanwhile, Friedman saw a lot of hotel acquisitions on a one-off basis driven by debt maturities, CapEx issues and other conditions, and Laport said Concord

was focused on "the one-off assets where we can create real value."

Looking ahead to 2013, the hoteliers expect opportunities for growth in the segment will continue. Chatham's Willis felt the return of business travelers,

along with leisure guests, would help bolster the segment as they "discover these hotels and appreciate the value they provide."

Concord's Laport anticipates new development will accelerate as deals underwrite better with RevPAR growths. "Within this environment, companies like Concord can accelerate new development growth as well as purchase and repositioning opportunities. It also appears that debt markets will continue to provide low-cost credit," he said.

As for Peachtree, Friedman believes several owners will be forced to sell as they face issues around debt maturity and capital expenditures. "We believe that we will be able to grow our portfolio via traditional hotel acquisitions, short sales and debt acquisitions."