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What's the Deal By Daniel Lesser

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The importance of an exit strategy

(The views and opinions expressed in this blog are strictly those of the author.)

According to the National Bureau of Economic Research (NBER), the current U.S. economic recovery is now 112 months old, the second-longest on record after the 120-month expansion that ended with the bursting of the dot-com bubble in 2001.

High levels of American consumer and business confidence are being fueled in part by low unemployment rates and rising wages, both of which continue to have positive effects on the U.S. lodging industry. Additionally, hotel room night demand continues to rise at a greater pace than supply, which has resulted in record-setting levels of national occupancy, average room rate and RevPAR. Domestic and foreign institutional capital continues to be lured into U.S. hotel properties, both for single-asset and portfolio investments.

While savvy investors know that the fate of a lodging venture is predicated on the cost basis of an acquisition, a well-reasoned exit strategy as part of the overall investment thesis is crucial to the economic success of a deal. Ongoing capital expenditures during the holding period of a hotel investment are invariably necessary to replace physical or worn components to maintain brand standards and upgrade the overall facility. Daily leasing coupled with continuous repricing of guest rooms create volatility which can alter, sometimes dramatically, a pre-determined exit strategy.

Throughout the hold period of a lodging investment, sophisticated sponsors periodically conduct a rebuy analysis that considers current property and markets conditions, new opportunities and potential threats, capital requirements, ROI objectives and consideration of alternative available investment prospects.

If at any point a rebuy analysis results in a lower unlevered and levered IRR than what a sponsor perceives it can achieve by redeploying capital based on the acquisition opportunities currently available in the market asset, disposition should be considered.

Global trade policy tensions, an emerging debt market crisis or an unforeseen shock may occur. However, any black swan event(s) would need to be large and sustained to undermine growth in the U.S. economy.

While few are anticipating a major market crash, the duration, depth of a prospective economic recession and risk of a downturn is higher now than it has been for more than five years. The hotel business has perpetually been and will continue to be cyclical. A focus on bringing about a favorable conclusion to an investment is a critical factor to be considered at the inception of capital deployment into hotel assets, particularly during robust markets such as those which exist in today’s environment.

10/29/2018