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LODGING

SMART MONEY

INVENTIVE HOTEL REITs ARE SHOWING HOW GOOD DEALS GET DONE

CREATIVE FINANCING STRATEGIES FOR YOUR NEXT PROJECT

3 TECHNOLOGIES RESHAPING HOTEL OPERATIONS

AVOID GETTING A BAD RAP FROM ONLINE REVIEWS

MICHAEL MEDZIGIAN
CHAIRMAN AND MANAGING PARTNER
WATERMARK CAPITAL PARTNERS, LLC

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FRONT DESK

NEWS, IDEAS, AND INSIGHTS

SUCCESS STORY

On the Money

MICHAEL MEDZIGIAN IS TAKING A NUANCED AND MULTI-FACETED APPROACH TO HOTEL REAL ESTATE—AND IT'S PAYING OFF **BY JESS DOWNEY**

FUND RAISER
"We don't invest in the hotel space because I'm a hotel person. We're money managers looking to generate attractive risk-adjusted returns for our investors."

MICHAEL MEDZIGIAN was something of an anomaly when he first began raising investment funds in the early 1990s. Having graduated from the School of Hotel Administration at Cornell University in 1982 and matriculating directly into hotel operations for Marriott, his background was dramatically different than most of his peers.

"I can't think of many people in the early 1990s who had been hotel operators and were running big discretionary equity pools that were buying real estate," Medzigian says. "We were coming out of the horrible downturn, and there were few investors in the real estate industry and not a lot of capital available. So having an operating background 20 years ago and running a big equity fund was rare. Now it's more commonplace."

> "The markets have clearly recovered significantly from where they were, but there are still a lot of under-capitalized owners."

Today, Medzigian is chairman and managing partner of Watermark Capital Partners, a privately held real estate investment management firm, and the president and CEO of Carey Watermark Investors, a non-traded real estate investment trust (REIT). Over the past two decades, he has carved out a niche for himself as a bold investor with a keen ability to read markets and artfully reposition assets.

STRATEGY FOR A MELTDOWN

After working for Marriott, Medzigian established a hospitality consulting practice at Deloitte and Touche. Despite the economic havoc wreaked by the S&L crisis, Medzigian steered the practice through the early '90s recession. That experience provided him with a road map to turn to when the 2008 economic downturn hit.

He'd sold most of the firm's assets prior to the downturn as a response to "expensive" assets, so Watermark was well positioned, he says. "When this downturn hit, it had a number of the same underpinnings as the one in the early 1990s," Medzigian recalls. "We decided we were going to respond to it similarly—we were going to put a significant equity pool in place to take advantage of it, and that's what we did." Without the burden of being laden with overpriced assets as transaction activity began to percolate in 2010, Watermark was able to capitalize, investing in under-valued or troubled assets.

The two parts of Medzigian's company, Watermark Capital Partners and Carey Watermark Investors, are private and public operations, respectively. →

THE LONG VIEW
In a joint venture with HRI Properties, Watermark Capital did a $17.7 million renovation on this New Orleans property, which is now the Hyatt French Quarter, a luxury hotel with balconies overlooking Bourbon Street.

As a privately held REIT, Watermark has flexibility in what markets to target and how it can structure its deals, Medzigian says. "We are a REIT, but we don't have a narrow strategy where we only want to be in the top five or six markets," he says. "We also do joint ventures, and that's one of the key differentiators between us and other REITs."

FINDING MR. REIT

Few hotel REITs, if any, do joint ventures, he says. Public REITs, which are followed by the analyst community, are hesitant to enter into joint ventures, partly because they can be more difficult to evaluate. "There's no question that there's work associated with [joint ventures]. As opposed to just asset management, you have to manage the relationship with your partner," Medzigian says. "But we believe it's worth doing the extra work for those additional opportunities that get presented to us. If someone has a real estate situation, and they need a partner to capitalize it or buy an asset, we'll come in as the majority investor to help them out. Typically REITs don't do that, though some private equity funds do. We get some of our best opportunities working this way."

Watermark focuses on balancing two major components in its portfolio growth/income and capital appreciation. The former typically includes high-quality, premium-branded select-service properties in urban markets, such as a vertical construction Hilton Garden Inn or Marriott Courtyard. "We like them in urban markets," he says. "They provide some barriers to entry—it's a lot tougher to build something new to compete with us in an urban market than it would be in a suburban one."

The second part of the portfolio—capital appreciation—focuses on complicated full-service assets, which often require market repositioning, brand changes, management changes, and renovations. As one example, Medzigian points to the New Orleans Hyatt French Quarter. Originally built in 1849 as a DH Holms department store, the property was converted to a hotel in 1995. "Post-Katrina, it went through the same struggles as a lot of properties in →

GOOD ADVICE

MEDZIGIAN'S FIVE KEYS TO AN ATTRACTIVE HOTEL ASSET

1. **Quality of the real estate** Location, quality of the physical structure, brand, overall market presence, visibility, and quality of the physical asset are all part of the evaluation process
2. **Keep your competition away** Figure out how difficult it would be for someone else to enter your market and compete with you
3. **Diversity of demand generators** Preferable assets are located in a drive-to market that has corporate and leisure demands
4. **Strong economic fundamentals in the local economy** Ideal assets are in cities where people and companies want to move
5. **Branding and management** A building in a great market with a solid brand and a successful management company will likely get more favorable pricing than on an asset that requires a lot of fixing

New Orleans did," he says. "When we found the opportunity, it was really in need of capital, so we did a $17.7 million renovation to the property, and today it's an entire city block on Bourbon Street—very different than what it looked like a couple years ago.

"This was significant construction—little returns over the short term, but over the long term we have a great opportunity to create value."

CREATIVE CAPITAL

With so many owners and operators still underwater or upside down, there are opportunities for REITs like Medzigian's to step in and help an asset change its fortunes. Even though the markets continue to improve, industrywide solvency is still a long ways off, he says. "The markets have clearly recovered significantly from where they were, but there are still a lot of under-capitalized owners. There's still about $1.7 trillion of commercial real estate debt that has the potential to become due between now and 2017," Medzigian explains. "There are some assets in our portfolio where, in some cases, the owner had no choice—he or she either needed to sell the asset or do a joint venture and raise new equity because they couldn't refinance the debt on their own."

According to Medzigian, in commercial real estate, lenders today might be willing to go up to 65 percent loan to value, which means there needs to be significant cash flow in place to cover the debt service payments. If not, there needs to be some reworking of the loan structure. "We view ourselves as capital providers. If somebody has a good asset, and they've got a capital-structure problem and they are faced with the choice of selling the asset or raising money to get the capital structure on more solid footing, often they'll want to keep their asset and raise new capital in order to keep it."

For Medzigian, each asset requires a unique prescription for building value. In some cases, it's a capital infusion. In others, it's a buyout and renovation process. But if it will lead to growth/income and capital appreciation, he's prepared to be creative and do the heavy lifting.

"Hotels are my first love, and it's where we primarily focus," he says. "But we don't invest in the hotel space because I'm a hotel person. We're money managers, and we're looking to generate attractive risk-adjusted returns for our investors."

TOOLBOX

The REIT Stuff

REITs were created to provide individual investors with an opportunity to earn money from commercial real estate without actually having to go out and buy the physical assets. Hotel REITs specialize in acquiring hotels with money raised from public equity and bank loans. Here's how they work:

HAND OFF THE DAY-TO-DAY
REITs are restricted to passive real estate investments, which means they can't operate the businesses that occupy the buildings they own. They use management companies to run their hotels.

PUT MONEY IN THE RIGHT PLACES
REITs need to invest at least 75 percent of their total assets in real estate and cash.

MAKE WEIGHT
A REIT needs a minimum of 100 shareholders after its first year, and no more than 50 percent of its shares can be held by five or fewer individuals during the last half of the year.

PAY OUT TO SHAREHOLDERS
REITs must distribute at least 90 percent of their taxable income to shareholders annually in the form of dividends.

KEEP THE REST
REITs commonly use the remaining 10 percent to pay down their debt or to buy more assets.

– SOURCE: THE U.S. SECURITY AND EXCHANGE COMMISSION

$1.7 trillion of commercial real estate debt has the potential to come due between now and 2017.

– SOURCE: NEWMARK GRUBB KNIGHT FRANK

IMMIGRATION REFORM

ON APRIL 23, at AH&LA's Legislative Action Summit in Washington, D.C., industry experts had plenty to say about immigration reform. Here's a taste:

"[The lodging industry] generates a lot of jobs... Even for the hardened anti-immigration people, they do understand jobs."

PAUL WHETSELL
President and CEO, Loews Hotels

"We don't automate, we don't outsource. We cannot run our hotels without these workers that come into the United States."

DEBORAH MARRIOTT HARRISON
SVP, Governmental Affairs, Marriott International

"If we can fix immigration and really get it working, that's just that many more customers for you."

DOUG SMITH
Asst. Secretary, Private Sector, Department of Homeland Security