EPISODE 1266

[INTRODUCTION]

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Whitney Sewell (WS): This is your Daily Real Estate Syndication Show and I'm your host, Whitney Sewell. Today is a Highlights show that's packed with value from different guests around a specific topic.

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[INTERVIEW 1]

0:00:24
WS: Our guest is Nichole Stohler. Thanks for being on the show, Nichole.

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Nichole Stohler (NS): I am so excited to be here. Thanks, Whitney.

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WS: So I know nothing about the hotel business, but I know numerous people who have invested passively in hotels and different things. But I'd love for you to just elaborate on why you all have selected hotels as the asset class for you as opposed to strictly saying multifamily or single-family even?

0:04:23
NS: It's a great question because we did get our start really in multifamily. My husband was managing large 300, 600-unit apartment complexes, and that is really the place that we come from that we understand very well. The way that we got into the hotel industry was kind of two-fold.

I talked about the fact that we keep everything local to Phoenix. For us, our network of people is here. The referrals that we have for the best attorneys, CPAs, folks that know different niche areas within the industry are all within the Phoenix metro area. We were actually introduced to someone who's been in hotels for 20 years by one of our brokers about two years prior to buying our first hotel.

We were starting to explore that as an alternative niche already. Then about two years later, we received an unsolicited offer for one of our apartment complexes, which we finally ended up taking. Then we were under 1031 Exchange, and we could not find multifamily that met our criteria, that provided the returns that we expect, the CAP rates, etc. Not in the Phoenix Metro area. That is when we pivoted into hotels.

I think part of the reason that we have the confidence to do that is we did have basically a hotel mentor. Someone that was able to find an off-market property. Someone who’s able to say, “Hey, here’s the value,” and really teach my husband as we went along and then bring the resources and recommendations again in the market for us to be confident and successful with that hotel.

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WS: I think you really hit the nail and head there, but you had a mentor. You had somebody that had been there, done that, gave you confidence. Gave you the confidence to understand this type of asset class for business and going into that. So what are some things we should be thinking about as opposed to – most of us are probably thinking multifamily — I know a lot of listeners are in retail and mobile home parks as well.

But as far as going from multifamily to hotels, what are some of the things we should be thinking about? Even when underwriting or just the different asset class. Hotel is not my specialty at all, so could you elaborate on that?

0:02:55
NS: Yes. To start with, the same thing that holds true in any real estate niche location becomes still your number one priority. It's interesting, because when you're buying a hotel, and I'm talking about hotels that are what's called a flag hotels, franchised hotels, limited service, catering to business travelers. That's really the space that we’re in. You are 100% looking first for location. Then you will observe the flag itself, the brand. But we are not buying because it's a specific brand. We’re buying because there are economic centers. There's development going in.

There are a lot of reasons to be in that particular space. That is really the same as multifamily, where you're looking at the location first. Some of the things that are different is that hotels, depending on your market, have seasonality. So you do not have a consistent steady occupancy rate that you would see, for example, in multifamily once you've been able to get the property to the level that you expected.

So you will definitely see seasonality in Arizona. Our off-season is during the summer. So those are challenging months. It's similar to — if you were to talk to someone who owns long-term rentals versus someone who owns short-term rentals. They have seasonality as well, but the profitability can be much higher on the short-term rentals and similar to hotels.

The profitability per unit, and I'm going to say that in the hotel industry, it's called a key. So a room, how many keys do you have versus units or different rooms themselves. You actually use keys. So on the per-key basis, the profitability is higher than apartment complexes, but you do have variables that you wouldn't see necessarily in the multifamily space. You also have more levers in a hotel. So it is more of a business than it is real estate, but you do buy for real estate first.

Then you're looking at the business components. Some other things are similar. You may have property management for your multifamily. In our case, we have a general manager, and there are levels of companies that will provide operations management, accounting, those kinds of things specific to the hotel industry.

You would also have – maybe you are buying some supplies in your multifamilies like cleaning for your pool and those types of things. We have the same thing. Only our supplies are on a much higher basis. The cleaning is happening every single day. The pool needs – that's happening all of the time. So those pieces are different. There is generally a free breakfast. So there are all these incremental business component pieces that you can start to take a look at to say, "Okay, can I negotiate better contracts? Can I leverage volume discounts?" So you can start to look at that because you're part of a franchise or you have other hotels.

The other piece that you can do is just monetize the hotel itself. What can you do, for example, with the spaces? Like our breakfast area is only used for breakfast, and then it sits there the rest of the day. So that could be used as a conference space for small groups. How can you be adding snacks and mini-bars and things – there are a lot of different ways to monetize the hotel, negotiating corporate contracts, and selling digital space on your Wi-Fi splash page. So what I love is that there are so many of these, and it's almost like the sky is the limit in the things that you can do within that specific hotel space.

0:06:40
WS: Wow. It's neat though. You're thinking more business-wise. I mean, the real state is still a business, but it's – I don't know. That just seems very different, but you have so many other levers there as you talked about that I haven't thought of before. Just like that space. You see everybody having breakfast there in the morning. But then the rest of the day, it's just empty.

0:06:57
NS: Exactly.

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WS: What else could you use that for? And just all these little things, even selling the digital space. You talked about that. It's very interesting and all these different things. So you're getting very creative. I mean, you are exhausting all these avenues to increase the income and obviously the value. So as far as this seasonality and it's something I really – I mean, you think about it, but think about how much it affects that asset class.

Location is going to affect the seasonality as well, depending on where in the country and hot, cold, all those things. You said in the summer times, your slow season, where a lot of times if you were in Florida, that's probably the busy time. Or no, that may be the opposite as well. Or let's say up north in a colder climate, the summer is probably going to be a busier time.

Depending on what their attractions are, what are some other things that we should be thinking about if I'm looking at moving into the hotel space? How am I going to find that hotel? How are you all finding hotels that you're looking at acquiring, and what does that process look like?

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NS: We're finding hotels because of our network of people and being local to the Phoenix area, and I emphasize that a lot. My husband and I are active in rotary. I'm regularly reading the Phoenix Business Journal. Keeping an eye on what's happening in our market is how we're able to determine not only just, "Okay, we're looking at a property but what do we see that's up-and-coming and what are we aware of that may be the current owner isn't paying attention to?"

So I will tell you this hotel that we're currently under contract. The owner is kind of a mom-and-pop, had a smaller rural property sold at 1031 into this particular property, which is now in Metro Phoenix. The approach that the current owner is taking, they're not understanding a lot of things. For example, they let their corporate contracts expire and didn't really see the need for that. I see that they don't respond to reviews online. When you think about the hotel industry, it's very much of a relationship business. Those corporate contracts are going to be key. Your relationship with your guest, there's a customer support aspect of it, a customer engagement.

It's the few things like that that we look for. So we saw this hotel opportunity, and we said it is undervalued because of a number of factors. Not to get too deep into the weeds, but one of the things also is that you may be under a particular flag when you first buy a property. Then as that contract comes up, you may decide to switch brands. This owner decided to switch brands and did that in the middle of the busy season in Arizona. So if you think about it, construction in the lobby, remodeling going on in a hotel, it's not very conducive for people coming to visit. So it starts to hurt revenue. There's a time to do that and a time not to do that.

So he did it during the wrong time, which is the busy season, and that impacted his revenues. So then we were able to look at that and say, "Okay. Obviously, that's not going to be happening again. We see revenue growth. We understand what the base is here. These corporate contracts have gone away. We see that there is not a customer engagement." Those are all things that we looked at and said, "Okay, we can improve upon that. These are some very basic things that we can do, not even out there, crazy. Just having business fundamentals and understanding the market."

[INTERVIEW 2]

0:10:20
WS: Our guest is Mike Ealy. Thanks for being on the show, Mike.

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Mike Ealy (ME): Hey, thanks for having me, Whitney. Thanks for sharing your platform with me, man. I love to talk and listen. Let's do it, brother.

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WS: So, Mike, let's jump into the $1.8 billion worth of hotels that you have in your portfolio right now. I'd love to dive into that asset class a little bit because you see, you talked about your bio, how people are surviving in that right now and hotels, just the downturn, how it's been affected, what you all have done, what you see now, but I think you're on the buying side right now, right? And you're jumping back in. The hotels, even though there's probably a lot of people running, so a lot of times, that's a good time to buy.

So, just dive into that a little bit in just your hotel portfolio, maybe what's happened and how you're managing that?

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ME: Yeah, I think Warren Buffett, says, "When people are fearful, that's when you should be greedy." People are being fearful, which is understandable. I mean, I'm more calculated risk here. First of all, I believe the hotel market will come back. It's come back through the Great Depression, it came back in a Great Recession, and it will come back through this COVID. Because look, it wasn't that the economy was doing bad, it strictly was COVID. What's the solution? Get a cure for COVID. I know I'm saying it like it's so simple. But actually, in these last two days, they already announced that Pfizer has a vaccine that's 90% effective, 90%. That was one thing. I don't know if you know, I'm going to veer off for a second. I didn't know if you knew, but as long as a vaccine, when they go to the FDA, as long as it proves 50% effective, they pass it.

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WS: That's scary. Yeah.

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ME: I was like, "Wait a minute! Wait a minute! You mean, so half the time we'll take these pills, it may not work?" That's why I'm not going to be the first guy to take the shot. Okay. I encourage other people too, but not me.

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WS: All right, back on the hotels.

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ME: Yeah, there you go. So, with COVID, we knew we kind of knew the timeline, because actually I had a lot of people that work in research and development, and they knew that a vaccine will come out. That vaccine was the solution, but it will be a time lag. This means, even though we have this vaccine, there'll be mass production, the market is not just going to come right back. It's not going to be like 2019. In actuality, now that this vaccine is coming out, there's going to be a pent-up demand and the public perception will change that, "Hey, I can actually go out and I won't get sick, and if I do, I can get treatment at the hospital." Therefore, you're going to see an uptick in the market, in the traveling market, in the retail market, and therefore some hotels will move from that 29%, 30% occupancy to 40% to 50%, which is the breakeven point.

With that in mind, they then can hold on for the long run because the market will come back. In 2022, occupancy will be back, '23 ADR we'll be back, which is your average daily rate, some in apartments call it a monthly rent, we call it in hotels your daily rate. So, when that comes back, the market will be back, car to the market won't be there as the business traveler because of Zoom and people not traveling, but it's going to take about three years to get back there. When you do, now, you're buying these deals for pennies on the dollar, and now, instead of making a two X multiple, you're making a five X, seven X, eight X on your deals. So, that's why we're going after hotels, long story, and remember, FDA is 50% effective and 90% sometimes, okay.

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WS: Appreciate you bringing that to light. It's something to think about especially, I mean, how a vaccine could affect the real estate market, and specifically, hotels. It's really neat to think about that. I love the quote from Warren Buffett as well. We've seen it through so many cycles, and people still get fearful and jump out and there are a few that jump in and make it big.

What are your thoughts on somebody getting into the hotel space right now? So, maybe we talk about that as a passive investor first, they're thinking about, "Okay, is it time to invest with somebody like Mike in hotels?” What are some things, maybe they’re looking at other operators, what should they be considering as a passive investor, or questions they should be asking that operator that’s looking to buy hotels right now?

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ME: Well, so as an operator, if you’re looking to invest and you need to operate, you want to look at an operator that made it through the last Great Recession number one, okay? Because that’s everything. Then number two, you want an operator, owner sponsor, developer, that understands restructuring of the debt because that’s one of the key things. Now, even though we’re going in assuming the debt, unless you’re paying cash, you got to restructure that debt, because, understand, most of these hotels that we’re buying, and we’re buying branded Hilton, Marriott, IHG, and for those who don’t know, that’s like Holiday Inn. When you’re buying these hotels, in that 8 to 10 million, your cost a month to operate is in that 80 to 115,000 a month. That’s including taxes, insurance.

So, a big portion of that, almost 30,000 to 50,000 of that, is going to be mortgage payments, taxes, and insurance. Your first thing to control the burn is to restructure that debt. When you get a forbearance, when you go interested only, when you’re going to speed the taxes, and then you bring enough money in to cover the burn because that burn could last six months. It could last until March, it could last all the way into July, it can last all the way in 2021, ‘22.

Those are some of the key things and just knowing that they have experience because unless you’re in the area that is what we call transit in demand, transit meaning like over there in Mount Rushmore or down in Florida, where people are still traveling. Look, some of those guys may still hit their numbers for the year but, where there are hotels, where there’s dependent on the business traveler, those are the ones that are struggling, those are the ones that are hitting in that 20% to 30%, while other hotels are averaging 39% to 43%.

Those are some of the key things you want. When you invest, at least in a hotel, know that you won’t make any money that the first year, unless, again, you’re in these areas where the hotels are already performing over 50%, then you probably will make some money. But, if you hold in for the long haul, and you budget it, I can’t guarantee you, but I’m pretty sure that you’re going to do extremely well once the market comes back because people are going to travel. There are a lot of people that want to get out.

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WS: What about that investor that invested, say a year ago in some hotels that aren’t doing so well right now? Should they be trying to hold out? What should that operator be doing right now? I know you mentioned this a little bit, but I’m just trying to think on the passive investors' side, they’ve already invested, maybe they don’t feel so good about that investment now.

0:17:49
ME: It's all on the plan they have. So, with ours, we use a perfect example. With ours, we manage properly. Now luckily for me, if you remember, I said back in 2000, you know, 9/11, I didn't budget for reserves or escrows. I didn't save for that rainy day. Well, guess who saved for those rainy days this time?

So, we had plenty of reserves. We are fortunate enough to get the economic disaster loan and the PPP, which got us through all of that, and we still have reserves left. Then I'm hoping, but if not, we'll be fine, but if we get another round of that PPP, man, we'll do extremely well. If your sponsor, your developer, your operator has a plan and has healthy reserves, hey, I think you can hang in there if there's some upside, but if you bought at the top of the market, you bought retail, it could be a long haul. You may want to get out of there.

[END OF INTERVIEW]

[OUTRO]

0:18:50
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