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While the real estate investment trust's are away, private equity must play!

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We began 2011 with a very encouraging surge of hotel transactions led by hotel real estate investment trusts's (REIT's), scooping up trophy properties in the top 25 MSA's. In Boston, FELCOR Lodging Trust bought the Fairmont Copley Plaza, Pebblebrook bought the "W" Downtown Boston, Chesapeake bought the Hyatt Downtown Crossing. The REIT's were able to draw from strong balance sheets and pay top market prices due to their low cost of funds. Private equity groups were at a disadvantage and, with higher investor yield expectations, found it difficult to compete.

The stock market dive in August 2011, caused that disadvantage to evaporate and the floodgates of private equity have opened for the hotel transaction market. This sector is now the driving force behind hotel acquisitions and we expect it to continue through the end of the year. With REIT stock prices off over 30% in many cases, the public companies are occupying the sidelines as private equity funds, large and small have stepped into the fray.

Unfortunately this has been a "body blow" to owners looking to cash in on low capitalization rates driven by the REIT's. In August and September, the market chilled quite a bit as cap rates backed up over 100 basis points and expectations went from mid seven's to mid eight's for stabilized cash flowing suburban Boston hotels. In the span of about thirty days, one hotel's value went from $27 million to approximately $24 million with that same cash flow. For a hotel owner that has been working hard to squeeze every penny through 2009 and 2010, that hurts.

The silver lining to this market digression it that hotel demand remains strong throughout the country and it was Wall Street jitters that troubled investors and caused them to over sell the hotel sector. Investors seeing an oversold sector will come back into this arena and boost the prices and the REIT's will be back out looking to grow, hopefully at the start of 2012.

Boston is blessed with a super strong market in 2011 and an even better market in 2012. Actually 2012 is projected to be the best year for the Boston hotel market since General Gage pulled his troops out of Charlestown and shipped back to England. Other cities are asking; "What does Boston got, that we ain't got"? The Boston Convention and Exhibition Center staff has done a fantastic job of booking conventions. It is expected that Boston will experience over 20 citywide sellouts in 2012. What that means for hotel owners throughout the entire state Massachusetts and the southern New England hotel market is that the contraction of room demand back to the core of Boston in 2009 has flipped and now rate conscious hotel room generators will be booking rooms further out into the suburbs. Meeting planners that book along Route 128 are now looking at I-495.

It also means that private equity investors will step up and be aggressive now, so that they can get in before we experience this projected revenue boost. It means that smart owners, looking to maximize their exit strategy will accept that higher cap rate, but base it on 2012 projected cash flow, allowing a new owner to acquire the hotel at the peak of performance.

There are a lot of hotels that have not shared the solid returns that Boston hotels have enjoyed. However, with positive projections for their markets, it is time for them to upgrade their facilities in order to push room rates higher and maximize their financial performance.

The timing is perfectly suited for private equity to step up and acquire hotels in segments that they normally would be priced out of. Take advantage of the high flying shoppers that have to sit on the sidelines and pick up some bargains. Hotels are available accompanied by the top brands, in the best locations and many with great upside potential upon conversion. The future looks very bright for private hotel investors.

O'Connell Hospitality Group, LLC, (OHG) was formed in 2000 and has grown to become one of the nation's top real estate firms specializing in hotel investment transactions. In that time, O'Connell has presided over more than $2 billion of hotel investments ranging from oceanfront resorts, major urban hotel projects and suburban, upscale-limited service hotels.

Previous to OHG, James O'Connell was senior managing director for Insignia ESG/Hotel Partners and ran the hospitality practice in the northeastern U.S. region. He is a proud alumnus of RECOLL Management Corp., where he managed hotel dispositions from the failed Bank of New England, an active member of the International Society of Hospitality Consultants, and a REFA sponsor and he is a 1982 graduate of Massachusetts Maritime Academy.