Q&A with Jeff Kolessar, GF Management

24 March 2011 8:06 AM
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Jeff Kolessar, senior VP of development for GF Management, on 7 March 2011 spoke with HotelNewsNow.com's Jeff Higley during a break at the Hunter Hotel Investment Conference.

Jeff Higley: "Hi, Jeff Higley with HotelNewsNow.com here at the Marriott Marquis in downtown Atlanta. We're here at the Hunter Hotel Investment Conference, and joining me is Jeff Kolessar, the senior vice president of development for GF Management. Jeff, thanks for taking the time to join us."

Jeff Kolessar: "Thanks for having me, Jeff."

Higley: "First of all, give us a little bit of insight into your company. Where are you at property wise, what do you do, and how do you see the environment shaping up as of March 7, 2011?"

Kolessar: "GF Management—we're a hotel management company based in Philadelphia, Pennsylvania, which is where our headquarters are located. We are a hotel company that owns hotels, we manage hotels, and a large portion of our portfolio today is working on the distressed hotels on behalf of special servicers, financial institutions, etc. Our portfolio as of today, March 7 of 2011, consists of 117 hotel properties, a little over 18,000 rooms, and we're doing about (US)$420 million in total revenue. So it's an exciting time for us as a company."

Higley: "And those hotels run the gamut in terms of brands?"

Kolessar: "Absolutely. Our portfolio consists of all the major franchisors, consisting of limited-service hotels to large, full-service hotels, resort properties—even a few golf courses sprinkled in there as well."

Higley: "How is the mix of ownership versus management?"

Kolessar: "Currently, the portfolio, as I mentioned earlier, has grown considerably on the workout side. We have 15 hotels that we have the majority of the ownership in. We've owned those for probably 15 years on average. We have another 15 properties that are third-party managed for individual owners, real-estate funds, pension funds. And the remaining portfolio, which is approximately 80-plus properties, is in that receivership, REO, management/workout side of things."

Higley: "So do you consider those short-term deals, or do those tend to be longer term in this kind of environment?"

Kolessar: "Certainly, they're shorter-term projects, and it really varies on the client or the institution that we're working on behalf of, whether they want to try to get rid of the property very, very quickly; whether they want to hold it or sell it and we're able to create some value in the property. So those average assignments are anywhere from 12 (months) to 18 months on average."

Higley: "And do you guys have a specialty? Do you prefer extended-stay or select-service? What's your wheelhouse?"

Kolessar: "Historically, our wheelhouse has been larger, full-service properties, 200-plus rooms—the Hiltons, the Sheratons, the Holiday Inns and the Radissons. But over time we've kind of morphed into a company that can kind of handle the select-service hotels—the Hampton Inns, the Hilton Garden Inns, the Holiday Inn Expresses—that kind of thing. A lot of that has to do with our client base, in terms of them asking us to get involved with some of these smaller properties, and having the comfort level with us that we can handle smaller properties as well as the larger properties."

Higley: "So when you go into this environment and you have both hats on in terms of an owner and as a management company, how do those meld? What can you take from one hat to the other to make it work for the other side? Does that make sense?"

Kolessar: "Absolutely. We're unique because when you look at our portfolio as owners and operators for the 23 years that we've been in the business, if we're dealing with a bank property or a third party, we treat it as if it's our own property. We put together a strategic plan in terms of, 'OK are we going to hold this property for six months? Are going to hold it for 12 months? Are we going to hold it for three years?' So we strategically put a plan in place. … We have strategic plans in place for our own portfolio, where it's third-party managed: Is there a proper exit strategy; are you going to hold; is there a five-year hold with some of the funds that we're involved with. And then the bank properties: whether it's a six-month hold, a 12-month hold, an 18-month hold. The one word in the industry that we don't use in that work outside is—you hear the term 'babysit' these properties. We don't look at that when we're dealing with those particular properties. From the management perspective, they get the same approach whether they're 60 days or whether they're three years. It gets the same intensity and management expertise."

Higley: "When you talk about those short-term properties from the banks, have you seen a trend? Is there one of two things that really stand out as always being an issue that you have to go in and address? And how do you address those?"

Kolessar: "… One of the first questions that I always ask, Jeff, is, 'When was the loan originated on that property?' and 'When was that property acquired?' If it was acquired in typical '06, '07, the height of the market, when the lenders were leveraging the deals up quite a bit, naturally those properties in today's climate have lost value, and sometimes there wasn't a lot of equity in those deals, and if it was a loan that was a non-recourse loan, naturally the borrower's not going to continue to fund out of pocket, so they're essentially going to turn the keys back. Some of the other issues that we've seen as it relates to the properties on the franchising side if they haven't put the (capital expenditures) back into the property, they're in default with the brand both on a guest-service score level, on a property-improvement-plan level, and even on a financial basis where they're not paying their franchise fees—that's one of the reasons that may have caused the loan to go into default as well."

Higley: "Getting to the bigger picture of the industry, a lot of the talk at this conference has been, 'Is there a recovery? Yes or no? Is there or isn't there a recovery?' From your perspective in dealing with a lot of these distressed properties from the banks, do you see a recovery? Are we in the early stages or has it started yet?"

Kolessar: "I've spoken at many conferences over the last three years and people would ask me, 'Where are we in the cycle?' three years ago. I'm a baseball guy, and I would say, 'We're in the second inning.' And unfortunately I've been saying 'We're in the second inning' for three years now. … The good news is, if you have a hotel that's in—I call it the top 10 MSAs, your New Yorks, your Washington, DCs, even Philadelphia—that's attracting very strong investors, and I think as we can see by the transactions that have taken place, the REITs are very active in those markets. They're buying premiums, they're looking at, 'OK, I can buy this hotel for not 50 cents on the dollar, but maybe 80% of replacement value,' and they've got to put money out there on the streets. So you're seeing that activity taking place, and I really think that's skewing the volume of activity. You're reading about all of these transactions that are taking place. Well if you part out some of those larger transactions, there hasn't been a lot of activity that's taken place. But now we're starting to see some of those smaller deals move, but that's still all-cash buyers. You're seeing some SBA lending taking place on some of the smaller, and your regional banks are coming back a little bit. But until you see more of that—and there’s still a backlog of properties that are out there that are just starting to hit the streets in terms of marketing. But going back to your question about are we seeing any type of recovery in the market, I think if you look at the overall—what everybody gauges in the industry is RevPAR increases. You’re naturally seeing the increases year over year. But I always say if you take out some of those top 10 MSAs again in terms of the New Yorks of the world and you said, ‘OK what’s the rest of the industry doing? What are the other top 15 MSAs doing?’ I’d probably have to say you’re looking at not those double-digit returns but maybe somewhere around 5(%) or 6(%) if we carve out the larger, top 10 MSAs.”

Higley: “So there’s still a long way to go for the industry to even say that it has a lot of momentum riding?”

Kolessar: “Absolutely, and I think one of the big issues is that what drives the economy, really, is job creation. If you look at it as one of the economic factors out there, we’re still lagging in terms of the job creation that’s happening. Unemployment is still very high, and I think it’s still going to tick over and get to the point where it’s 10-plus percent, and until that takes care of it, everybody’s getting excited and we’re seeing a slight recovery, but I think it’s going to still be an additional long haul out here.”

Higley: “Of course, for every hotel owner these days, cash flow is king. Do you see in the 100-plus properties in your portfolio, is cash flow starting to become a little bit more consistent, regular, that you can say, ‘Yeah, we’ve stabilized?’”

Kolessar: “I believe in our portfolio, the properties we’re involved with, the properties we’ve been in longer than a year, we’ve certainly forecasted in 2011 upticks in the net cash flow of the properties for this year. So you’re starting to see a rebound, even on some of the distressed properties where we’ve been in there for a while and we’ve been able to do some things to the property, market it a little bit better, manage it a little bit better, and we’re seeing some definite increases in cash flow in some of the properties.”

Higley: “Where do you see 2011, 2012, 2013 going for your company? Are you on the upswing? As a business development guy, what are you out there stumping for?”

Kolessar: “Absolutely. Our company, as I mentioned earlier, 2010, we took over 73 hotels in 2010. It was a great year for us. We almost tripled the size of our portfolio, where we finished the year. We’ve tripled the size of our corporate staff, in terms of how we can deal with it operationally. We’ve opened some satellite offices throughout the country. This year alone, in 2011, year to date, we’ve taken over 20 hotels from January 1 to March 7. We took over our 20th hotel today. We’re anticipating that we will take over, whether it’s third-party manage and/or on the bank side, we think we’re going to project between 80 and 100 transactions this year. So we see continued growth this year. From the other side of our business development, we’ve grown our acquisitions team within our company, so we’re starting to look at deals from an acquisition standpoint because at some point in time, the workout business is going to slow down and we think there’s probably another 24 to maybe 36 months of that business out there. So we don’t want to be left going from 117 hotels down to 40 hotels again. We want to make sure we stabilize somewhere, probably around 80 hotels is a good-sized company. I’d love to say we can keep it in the 100-plus area, but I think we’re realistic in terms of our goals in terms of where we’re at.”

Higley: “So you clearly deal with a lot of banks. What’s your take on the whole situation regarding banks putting hotels out on the market? Do you think there’s going to be a flood of hotels for sale through the banks or by the banks at some point?”

Kolessar: “I believe, again, you’ve got two different banks: You’ve got the financial institutions or the regional banks or the Wall Street banks that are there, and then you have the special servicers, which are involved with the securitization side. We’re seeing more and more hotels, I believe, this year, from those, I call them servicing shops that have come to the market most recently. But what’s changed things in the last 12 months, and even the last three (months) to six months, has been the note-sale process, where these financial institutions are saying, ‘I don’t want to deal with this issue.’ Especially on some of the smaller assets, where the loan or the perceived value of the hotel may only be worth (US) $3 (million) or (US)$4 million, that rather than take the property back, deal with the (property-improvement plan) issues, deal with a negative cash flow of a particular property, what they’d rather do is say, ‘I’ll take my hits now,’ sell the loan at a discount through an auction process and/or individually through some of the folks out there that market the loans. We’ve seen more hotels … if you looked at a transaction or looked at the hotel note sales that have taken place from August 2010 until I believe there’s another one that started today—I think eve it’s 20 hotel loans that are being auctioned off through (Rutland Economic Development Corporation)—that transaction, I believe the bids are due on Thursday of this week. So if you look at that, you’ve probably had 150 hotels sold, some that have been sold to other institutions, some where individual owners have gone out and tried to buy these loans. I think you’re seeing a lot of that activity take place, which is also slowing down a lot of hotels that are coming to market.”

Higley: “For your growth, do you anticipate that being part of your stable of potential acquisitions—hotels that maybe you take over for a bank?”

Kolessar: “Absolutely. If hotel notes are being sold, we’re being contacted by certain groups that may not be a hotel we’re working on currently, but investment funds are coming to us and saying, ‘Can you help us underwrite these? We’re interested in buying this hotel loan. We’re not sure about the operations. We’re helping underwrite it. Can you underwrite it for us?’ So they can put the opportunity to acquire that loan, and then with the assumption that we would step in, either as a court-appointed receiver or take over to manage it, if in fact they would foreclose on it as a loan-to-own situation.”

Higley: “In your growth mode, when you get to that stabilization point of around 80, will the percentage of owned versus managed be the same at your company? Are you looking to buy?”

Kolessar: “I believe what will happens is, as I mentioned earlier, our portfolio, I believe it's about 15 hotels that we have ownership—we anticipate that number to go to 30 or 40. And then also our third party, which I mentioned earlier, where we're institutional owners—not the bank workouts, but where it's strictly third-party, longer-term management agreements—we anticipate that number to grow as well. So you maybe have a ratio of 50% and 50%. We've always been in the distressed workout business—not to this level, but since we've been doing work since the early '90s, even when times were good we've always had 10 or 15 hotels that were in that bucket. There's always going to be problems out there. And what's happened over time is I mentioned our client base, our institutions that we're doing work for, our special servicers, I believe we’re doing work for 25 different financial institutions or special servicers as of today. And we anticipate that even if some other business does dry up, other sources are coming to us because of our reputation in the industry.”

Higley: “And as you're starting to explore the actual growth vehicle for ownership, how do you see the bid and ask right now. Is there a big gap? Are there some realistic expectations from sellers, or is it closer than what we may think?”

Kolessar: “I certainly think it’s getting closer over the last six (months) to 12 months. Part of it has to do with there's now liquidity in the market in terms of debt that's available out there so that people can put some financing on the deal. ... As you read about the (commercial mortgage-backed securities) market coming back, I think somebody mentioned this morning in one of the panels I think there's 22 securitized groups out there that are doing financing. Thank God 12 or 13 of them are interested in hotel properties. I don't think that you'll see the leverage that happened in the last cycle in terms of '06 and '07 where they were leveraging it up and then you were seeing the (mezzanine debt) put on it, and then you were buying deals with very little equity in the deal. I think there's going to be some caution there, at least initially. ... Because we know what will happen: Once it gets competitive again, the juices start flowing, and all of a sudden the 55% (loan-to-value rates) are going to jump to 60(%) and then 70(%) and then people are going to push the envelope a little bit. It's just part of our industry after seeing it for the last three cycles. And you know 10 years from now, unfortunately, we're probably going to ramp up again and we're probably going to have problems again in the industry if you look at how long we've been doing this—late '80s, we dipped, we came back; you know early 2000s, 2001, we dipped and we came back rather quickly. This cycle has been a much prolonged cycle with I think all of the other economic factors that are associated with it.”

Higley: “What's the hot button for GF Management in 2011? What's the mantra around the office right now?"

Kolessar: “It's exciting. There's a lot of energy in the office as we continue to grow whenever we hit a new threshold in our platform. Interestingly enough, somebody came up to me today and said, ‘Have you looked at the new rankings that have come out? We're ranked No. 5 in the industry.’ I didn't even look at the publication, but it's exciting. And if you looked where we stood two, three years ago as a company, we were somewhere around 40 to 50 hotels starting in 2009. So it's exciting times. There's an energy flow in our office. Everybody's one big team and everybody wants to take our company to the next level, and I really think we've done that."

Higley: "To kind of summarize again then, Jeff, looking ahead one year, we're sitting here in March 2012 at the Hunter Hotel Conference and at that point you look back at the year and what will you have wanted to accomplish for the remainder of 2011?"

Kolessar: "For the remainder of 2011, I think we definitely want to reach our goal of taking on 80 to 100 hotel assignments. I believe we're 20% or 25% of our way there already. I believe that we want to acquire a few hotels—again, strategically, as long as it makes sense. Our goal would be to pick up three to five hotels this year strategically on an acquisition to grow that side of it as part of our master plan. And again to make sure that we hire the right people as we continue to grow with the company and continue to expand our footprint. As I mentioned earlier, we're in 29 states. I'd love to get to the point where we're in 40 states across the country. Again, that just makes us a national company, again domestically in the United States. So that's just one of the goals that we have, and I think the owners of our company and the development team and the operational folks, we're all on the same page in terms of what we're trying to accomplish."

Higley: "Those three to five hotels that you could acquire this year—any particular markets? Are you looking in those top gateway cities? Those top 25?"

Kolessar: "Well as I mentioned earlier, it's very difficult if we're looking in the top 10 MSAs, it's very difficult to compete with the REITs that are acquiring in those market places. So strategically we want to make sure that we're acquiring where the deals make sense to us. We're not going to just acquire a hotel just to place money out there. We strategically want to make sure the deals make sense."

Higley: "Alright Jeff Kolessar from GF Management, thanks so much for taking the time."

Kolessar: "Thanks, Jeff."