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THE WEEKLY UPDATE ON THE INSTITUTIONAL MARKETPLACE

Debut Hotel Fund Cuts Fees to Lure Equity

A hotel investment firm has taken the unusual step of reducing its fees in order to gain traction raising equity for its debut fund.

Integrated Capital, which is headed by three former **Maritz Wolff** executives, began soliciting $200 million for the value-added vehicle more than a year ago. The original goal was to hold a final closing by December, but Integrated struggled to make headway - especially after the credit crunch struck last summer.

The market downturn has especially hindered debut operators. So far, only a handful have cut fees to spur more interest from investors. But it's expected that more operators will follow suit to stand out from the crowd.

Integrated's move was prompted a few weeks ago, when it entered into talks with an unidentified pension system interested in committing $40 million as the lead investor, according to market players. The investor asked Los Angeles-based Integrated to reduce its incentive fees. After some back-and-forth, Integrated agreed.

The change effectively gives the fund's limited partners a larger share of the initial profits. The original structure called for investors to get a 9% preferred return. That has been raised to 9.75%.

The profit split was also adjusted. Integrated initially was to get half of the profits after the 9% hurdle was reached, until it amassed 20% of cumulative distributions. After that it would receive 20% of any additional profits. Under the new plan, after the 9.75% hurdle is reached, Integrated gets 20% of the profits until it amasses 12.5% of cumulative distributions. It then receives half of additional profits until it amasses 20% of cumulative profits. After that, it gets 20% of any additional profits. The upshot: Integrated now will not actually reach 20% of cumulative profits until the fund's internal rate of return hits 19%. Under the old fee structure, it would have reached that mark when the fund posted a 15% return.

The buzz is that two other institutional players that demurred last year are now showing interest because of the fee change, potentially adding $40 million to the fund's coffers. Integrated could now have a first close by midyear, with at least $100 million of equity, market players said. It would then have up to one year to have a final close with the full $200 million.

The fund, Integrated Capital Hospitality Fund 1, has a 16% return goal. It will target underperforming hotels that could be renovated or re-branded. Up to 20% of the capital can be used for development.

Integrated was formed in 2004 by managing partner **Kenneth Fearn,** who oversees fund raising and will source acquisitions. Partners **Daniel Kurz** and **Stewart Cushman** assist with fund raising and oversee due diligence.

The trio worked together at Maritz Wolff, the St. Louis hotel firm, from 1994 to 2004. They helped operate three vehicles in that company's Hotel Equity Fund series.

Fearn, who in 2005 was included in **Black Enterprise** magazine's "Hotlist" of African-American executives under the age of 40, plans to pursue properties flagged by Marriott and Hilton - companies that have developed a reputation for trying to increase minority ownership of their hotels. In that respect, his strategy will be similar to that of a value-added hotel fund series operated by **RLJ Development,** which is headed by **Black Entertainment Television** founder **Robert Johnson** and **Thomas Baltimore.** Integrated Capital is also looking at the various InterContinental Hotel brands, including Holiday Inn. ❖