



Barry S. Sternlicht

EDITORS' NOTE *Barry Sternlicht also serves as Chairman of Starwood Property Trust, Starwood Waypoint Residential Trust, TRI Pointe Homes, Société du Louvre, and Baccarat S.A. From 1995 through early 2005, Sternlicht was Chairman of Starwood Hotels & Resorts Worldwide, a company he founded in 1995 and also served as its CEO until 2004. While at Starwood Hotels, Sternlicht created W Hotels and built St. Regis Hotels from a single hotel to a global brand. In 2013, he was named the Most Important Person in Commercial Real Estate Finance by The Mortgage Observer. Sternlicht's humanitarian efforts have garnered prestigious national honors such as JDRF's Man of the Year, JDRF's Living and Giving Award, and JDRF's Chairman's Award. Sternlicht is a trustee of his alma mater, Brown University. He is on the Board of Directors of The Estée Lauder Companies, the Pension Real Estate Association (PREA), and the Real Estate Roundtable. Additionally, he is Chairman Emeritus of the Board of The Robin Hood Foundation. He is a member of the World Presidents Organization and the Urban Land Institute. Sternlicht received his B.A., magna cum laude, with honors from Brown University, and earned an M.B.A. with distinction from Harvard Business School.*

COMPANY BRIEF *Starwood Capital Group (starwoodcapital.com) is a private investment firm formed by Barry Sternlicht in 1991. It is focused on global real estate, hotel management, oil and gas, energy infrastructure, and securities trading. Starwood Capital's funds have invested in approximately 77,000 multifamily/condo units, 2,490 hotels, 50 million square feet of office properties, 48 million square feet of retail, and 49,000 lots of land in residential subdivisions. The firm currently manages more than \$42 billion in assets on behalf of its high-net-worth and institutional partners. It employs approximately 690 employees, plus 470 employees in its loan-servicing business. The firm maintains offices in Greenwich (headquarters), Atlanta, San Francisco, Washington, D.C., Los Angeles, Chicago, and Miami, and affiliated offices in London, Luxembourg, Paris, Frankfurt, and Sao Paulo.*

Sternlicht's Strategy

An Interview with Barry S. Sternlicht,
Chairman and Chief Executive Officer, Starwood Capital Group

Is this a time of opportunity or a time to wait-and-see?

There is always something to do and it is always about risk and reward, but the tail risk in the world is so much greater than it was before this past financial crisis.

We are investing now because our macro view is that there is a great deal of liquidity in the world. There are also very few alternatives for investors so money is coming out of the bond and treasury markets, and searching for yield across all the asset classes. It's late in the cycle now. The drop in interest rates has been working for so many years that you're seeing capitulation today from many capital providers. They simply can't take less than 1 percent yields on 60 percent of the world's treasuries. Yet, as investors become nervous that rates are going to rise, they may pull back sharply because nobody wants to invest in a rising interest rate environment. The consensus today, which makes me nervous, is that rates will remain low pretty much everywhere for a very long time. There will be plenty of time to get out if the rates do rise. People tend not to be clairvoyant.

We just closed our newest \$5.4-billion global opportunity fund. We've seen how the flow of funds has changed, how currencies are becoming increasingly volatile and how, given the political global uncertainty, investors are leaving unstable regimes to invest in more stable places like the U.S. Maybe they want to buy that office building in New York or that hotel in Manhattan, but a part of the equation may also be that they need to diversify out of their local currency and ride the U.S. dollar, which is likely to get stronger. Foreign capital needs to buy something that is not controversial so they will buy an office building, a hotel, or an apartment complex.

When we determine where to invest today, we're very focused on whether we can lose our money and about the likelihood of achieving our return target. Instead of having certainty that an investment will earn 20 percent per annum, we now must create a "bell curve" for the expected returns and evaluate the possibility of earning 30 percent, as well as the chances of losing your capital. It isn't about the static IRR per se on the piece of paper; it's about the shape of the curve and the range of possible outcomes you have to make or to lose your capital.

Based on that, our asset class is very well positioned to benefit from a low-rate environment in a very significant way. In the real estate world, you can still achieve very good risk-adjusted returns relative to other asset classes, and you'll enjoy some protection from inflation. There is a hard asset, and if inflation were to come back and get out of control, this is a better place to hide capital than most. Of course, it also depends on which individual asset and property type you choose in real estate.

Are real estate and energy complementary or do you see them as two separate businesses?

They're two separate businesses, but we follow the same discipline investing in both. We look at supply and demand, yield on cost, what we're going to earn on the dollar, and creating as secure of a longer-term income stream for the energy investment as possible.

If we're buying a plant, we look at replacement costs to ensure that we are not paying more than it cost to build. The same discipline issue relates to all real estate like office buildings. There is also the issue of obsolescence. Buildings that aren't wired properly or don't offer the systems you need make replacement cost irrelevant. You have to ascertain if the technology is going to be obsolete and if that plant can be competitive.

Especially in our early investments in the electrical grid, we would get a long-term contract – essentially a lease from a power company – to take all of the power that runs through that cable. We did that in Long Island and in New York City, and they were very successful investments.

Now we have branched out into wind, solar, and other transmission infrastructure, as well as power plants.

Where is innovation taking place today at Starwood Capital?

We're innovative, but we can be more so. Big data is going to have an impact on all of our businesses and we haven't mastered that yet. We don't do our daily tasks much differently than we did 10 years ago, so it's going to be a new frontier for us to change how we do business.

Our innovation is much like my tenure at Starwood Hotels – it has come more from the product side. At Starwood Hotels, it was about the W, the Heavenly Bed, the curved shower rod, bringing Aveda cosmetics to the room, getting rid of the armoire in the hotel, and doing

duvet covers. Everything we did was heresy at the time, but I didn't care even if we lost our AAA Mobile Four Star rating, because I felt that consumers would be happier with the changes we made. Everyone followed us because it was about applying common sense.

We also had a willingness to break rules. Our only rule was to pay attention to the customers and let them lead us to the right answer.

Other than ethics, there are few things in business on which you can't change your opinion. All of our work to create a brand revolves around reinforcing the central theme of the brand. For our new 1 Hotels, it is more than a brand – it's a cause. Our cause is making the earth a little bit better a little bit at a time. It's why we call it 1 Hotels – it's one world, and whatever we each do to the environment, to protect it or to harm it, impacts our neighbors.

With 1 Hotels, we wanted to make a difference in the world, and if people copied us, we'd be happy. We knew we'd find our niche, but it's innovation that gets me up in the morning. One of my greatest strengths is my awareness that you have to roll with the world and change all the time. You have to be open to the feedback that the marketplace provides you in order to change what you're doing.

When I entered the hotel business, I did a survey on the 10 things guests cared about most in choosing a hotel. Nowhere on that list was the comfort of the bed. Just 10 years later, when you survey the industry, the comfort of the bed comes in at around number three. Great innovation is about making things you do every day better.

Is it more about being an innovator or being a disruptor?

Both. Good innovation is going to disrupt.

I come at it with a broader paintbrush today – if we help society, we'll be rewarded. If that has an echo effect across the landscape, it's really great. I also think the innovator "wins" the space.

The hotel industry in particular has been cursed and blessed by two things: If you own a hotel in Manhattan, you don't necessarily care what is happening at a hotel in Tokyo. So you have this insular mentality that you can continue to do what you have been doing and people will come. But there can be someone you don't know about who can put you out of business tomorrow.

We recently bought a large group of malls because the mall has been a place people visit to have access to a variety of stores. Today, retail shops are going to have to up their game and figure out why people should get off their computers and make an inconvenient trip to a store. Stores have to innovate and they're doing it. They're thinking about the channel shift and they're mutually complimentary – the online guys are going into brick-and-mortar and the brick-and-mortar guys are going online. People are using the Internet to research and then coming to the store to make the purchase. In some markets where retailers closed stores, online sales fell precipitously. Perhaps that's why mall occupancies are at record highs.

Like any business, everyone has to get better at their game to win.



The entrance of the Baccarat Hotel & Residences - New York

Is it hard to communicate the purpose behind 1?

It's actually easier to build a brand today in the Internet age. It's so easy for people to discover you, the good and the bad. If I'm going somewhere, I might check the ratings of the hotel or look at what TripAdvisor says. You can't hide anymore.

It's all about affinity groups, and that is what the web allows us to do better. We come together around our group, be it via social media like with Instagram, or another outlet. It's micro-marketing and if we're good at it, we're going to save ourselves a lot of money, and we're going to own our demographic, and identify and understand what our customer likes today. It's much better than it was 10 years ago.

How big can the 1 brand become?

As big as our ambition as long as we deliver top returns and we're still having fun. It's not just opening hotels but what we do after that. I enjoy having people who care about the environment as my associates and leadership team. We will grow at the pace we can handle, and when people see what we've done with both Baccarat Hotels and 1 Hotels, they're going to know this isn't cookie-cutter. We're going to have to get our construction costs in line so we can go into cities that don't have the high rate profile of places like Miami or New York. We can go to London, Rome, Los Angeles, Boston, and San Francisco, and we expect to be in those markets over time.

What is the vision for Baccarat?

For over 250 years, Baccarat has perfected their crystal. If you go to the packaging line in the factory in Baccarat, France, which has been standing for several hundred years, there

are all of these trolley carts with glasses and candlesticks. When you pick them up and ask why they're not in the packing line, they'll say it's because they're not perfect. Yet, I can't ever find the flaw.

For 250 years, they never sacrificed quality. That was our inspiration to bring perfect service into the hotel space. You would be shocked at the number of problems people have at hotels. In no other industry could you disappoint 50 percent of your customers and still have them come back because it's no better elsewhere.

We can do this more easily at the high end than at the low end because we're building an incredibly loyal base. We want to be the home-away-from-home for the people that can pay that price all over the world.

It empowers your employees to satisfy the customers and that makes the experience of working in a hotel that much better.

With your awareness of attention to detail, are you ever satisfied?

It's really annoying for those who work with me. I need to celebrate our successes more. Still, you have to always look ahead. I feel responsible to my investors and partners. I'm very proud of what I did at the Baccarat in New York and I like to reflect on that. We did sell the hotel for the highest price per room ever achieved in North America. Details are core to an exquisite brand.

Do you get as much joy out of giving back as you do from the business success?

I love it. The benefit of being successful is being able to give back. This is the fruit of my labor. I can uniquely give resources, consulting, and money. It's not the best use of my time and resources to stand in a soup kitchen, but one day, I will do that as well. ●