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So, you want to be in the hotel business? Hotel development is on the rise

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So, you want to be in the hotel business?

Apparently, you are not alone. The hotel segment is hot right now, and for good reason. Coming out of a deep two to three year recession hotels are back in a big way. Year after year record setting growth in revenue per available room (RevPar) is fueling a high level of transactions and a renewed interest in new hotel development. A recent article by Patrick Mayok in Hotel News Now outlined the status of new hotel construction:

"Supply has increased slowly and surely during the past few years. As STR's Jan Freitag pointed out in his monthly analysis of industry performance, January was the first time supply growth hit 1% in 47 months. That growth is only going to accelerate. There were 127,653 rooms under construction in the U.S., according to STR's development pipeline. That's up 31.8% from the prior year. Total rooms under contract (which includes projects under construction and in the "final planning" and "planning" stages) were up 18.8% to 438,957."

Yes, new development is back, but it is well below the historical 1.8% annual increase, and well below the "go-go" pre-recession days when it ticked over 3% in 2008. This leads to many questions including, when is it a good idea to build a new hotel, how does the process work, and who do I need on the team?

Finding a site and
selecting a brand:

The site selection and brand selection go hand in hand. Your market research and feasibility influence what brand is the best fit for the customer segments your hotel must attract. The forecasted RevPar, Net Operating Income (NOI) and free cash flow after debt service dictate how much you can afford to pay for the land. Typically, we build our investment model first and then determine how much the hotel can afford to pay for the real estate.

Selecting a hotel site is not dramatically different than any other real estate development. Visibility, accessibility and the quality of the surrounding area are all important factors. Remember that unlike other developments hotel customers are generally not from the immediate area and want to feel safe in both the hotel and in the surrounding neighborhood. Unlike the older motel locations in years past when ease of access to and from the highway was the highest priority, the growing trend is to develop hotels in mixed-use communities and urban areas allowing hotel guests to work, dine and shop in the immediate area. When time permits, more and more travelers are expressing a desire to connect with the communities they are visiting.

Permitting & approvals:

Once you secure the real estate and the brand it is time to recruit your team and seek approvals. In addition to the real estate developer, key members include an architect with hotel experience and a

civil engineer with a solid track record, specifically in the town you are developing within. Depending on the community and zoning and permitting challenges, an attorney and land planner may or may not be required. Typically, the costs associated for providing the required plans and studies runs in the hundreds of thousands of dollars. To save time and money, hire the best available professionals and consultants.

Financing the project:

As the new supply numbers indicate, lenders are once again making new construction hotel loans. Unlike 2007 and 2008, banks are doing more due diligence throughout the process. Instead of spending a majority of their time and effort on the marketplace and feasibility studies, bank underwriters are now laser focused on the sponsors. The financial strength of the ownership group, the track record and history of the hotel operating group and the hotel brand are all front and center. In addition, personal guarantees are back and probably here to stay through construction and stabilization. Loan to value ratios on new construction loans are finally reaching 70% for top tier projects.

Designing, building and opening:

The team you hired earlier in the process found the site, chose the brand, secured the permits and financing and designed the hotel and selected a construction management company. Now, it's time to build the hotel. It is essential for the hotel management company to be selected early in the process to not only assist in brand selection and design, but also from an operator's perspective, to assist with a pre-opening plan, including but not limited to, sales, marketing, recruiting, training and onboarding all of which starts about 9 months prior to opening. Most management companies charge a fixed monthly fee to execute this critical piece of the process.

Operations and return

on investment:

Unfortunately, when a hotel opens, customers do not typically flood the facility on the first night or the first month of operations (unless you are opening in time for a city wide event). Regardless of how well the pre-opening plan is executed it takes time for customers to change their travel patterns and their current hotel of choice. Generally speaking, it takes between 12-18 months to "stabilize" and reach 100+% market share which represents a "fair share" of the market.

Depending on your return hurdles and risk parameters, hotels provide solid investment returns. Although they are subject to the cyclical nature of our economy, performing hotels provide favorable short and long term returns, a hedge on taxes via depreciation and the unique ability to react to changes in the marketplace by quickly adjusting pricing. The downside; there are no long term leases. You are "leasing" every room in the facility every night of the year.

If you are eager to learn more about hospitality investment, development and operations I urge you to join us and many of our friends at the finest hotel conference in the nation, the HELP Conference, on April 13-14 at the Seaport Hotel in Boston. For more information visit www.helpconference.com

David Roedel is managing member at Roedel Companies, LLC. As a managing member at Roedel Companies, he is accountable for meeting or exceeding the companies' annual and three year strategic plans.

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