The hospitality industry continues to claw back from the impact of the pandemic - by David Roedel

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The hospitality industry continues to claw back from the horrible impact of the pandemic. We are approaching our second year of dealing with an invisible enemy that brought our entire industry to its knees. After the initial shock of watching hotel demand plummet in March of 2020, everyone was forced to make tough decisions regarding layoffs, attempting to cut operating expenses while dealing with new cleaning standards, and determining if it made more financial sense to close a hotel versus keeping it open. Not to mention negotiating with lenders, franchise companies and local jurisdictions to alleviate fixed operating costs when cash flow from operations disappeared. Fortunately, demand slowly returned causing additional challenges as operators found it difficult to replenish their hotel workforce. Hopefully, we are through the worst of the worst and in position to plan for a slow, but steady return to “normal” in the next three years.

Tracking hotel investment, and reinvestment, in the hotel business promises to be the most interesting in decades. Recently, discussion regarding lenders wanting out of the hotel space is considered one sign of hotel transactions picking up in 2022. Overall, capital investors were not able to acquire hotels at a widespread discount in 2021 as lenders continued to collaborate with borrowers during the pandemic. If this situation changes, expect more sales as investors look in invest in hotels with a five-year window to improve cash flows and asset values. At some point, owners will be forced to invest additional equity to keep the hotel open and/or make capital improvements to maintain hotel brand standards and extend franchise agreements. If they fail to reinvest, lenders will act, and new investors will move swiftly to purchase.

Hotel development over the next two to five years is another area to watch. The hotels that were under construction during the pandemic mostly completed construction. Depending on the strength of the market, hotels opening in 2021 could become the most valuable over the next three years. Assuming financial projections are met, a two-to-three-year hotel needed zero capital investment and plenty of years on its franchise agreement, will be at the top of the list for investors. For those looking to develop a ground up hotel in this environment will find it challenging. Lenders with large hotel portfolios are not looking to take additional risks on new projects. There are always exceptions but expect only the absolute best locations with additional equity required from experienced developer/operators.

Another development trend that is impacting hotel demand/supply are change-of-use projects. Meaning, taking an existing hotel and converting it to another use. This is currently taking place in markets across the country where the highest and best use for a hotel is no longer transient overnight lodging. Examples exist with cities and states attempting to deal with homeless issues, large, full-service hotels converting into senior care and assisted living facilities, all-suites and extended-stay hotels moving to for-rent apartments and, when convenient to colleges and universities, dorm space. Also, when the real estate value exceeds the value of the hotel, demolition to make way for brand new development projects. For example, recently, a full-service hotel in southern New Hampshire was sold to a luxury car dealer planning to demolish the building and build a new dealership. In most cases, the reduction in existing hotel supply combined with the challenge of developing new hotels will improve hotel demand faster in most markets.

Regarding investment opportunities, converting an existing hotel to different brand is gaining traction. Assuming the hotel is well built and in a suitable location a return is realized by “up-branding” the facility to improve revenue while maintaining operating costs and increasing Net Operating Income (NOI) and free cash flow. Not only does this present a good return on investment in the near term but the “up branding” should provide a favorable cap rate upon the sale or refinancing. When considering a new brand on an existing hotel, make sure to include all the soft costs associated with the project including, but not limited to, liquidated damages on the remaining years of a current franchise agreement, soft costs associated with developing construction and interior design documentation, architecture and engineering fees and project management time required from your operating group.

After opening a new hotel development this summer, we are now focusing on two re-branding projects in the northeast. One is a core brand conversion, meaning the brand standards and expectations are clearly outlined by the franchisor and it is up to us to make sure we can meet or exceed all standards in an existing facility. The other is converting a core brand to a soft brand associated with a national franchise company. In that case, the requirement to create your own local brand based on the community, local history and the character of the hotel. Not only is this the requirement, but the branding is also paramount to the success of the conversion. This takes more time, energy and investment from your internal team and consultants but in our case, we are confident the soft brand option will deliver the highest return on investment.

All the best to my friends in the industry and best of luck to everyone navigating through the pandemic. Fortunately, we choose to work in an industry that goes through cycles but always lands on its feet. Best of luck in 2022!

David Roedel is the business development officer and a member of the company’s executive team. He is responsible for new hotel development and acquisitions. In addition, he oversees Roedel Companies brand marketing, and public relations.