Why independent hotel development requires special attention, research

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LAS VEGAS—Ten to 15 years ago, a brand was almost a requirement to secure financing for a hotel development or renovation. But how important is it now?

At the third annual InnDependent Lodging Executive Summit, held at Las Vegas' Hard Rock Hotel & Casino, a panel of five investors and industry specialists took a swing at the independent space, and hitting on the point that there is more interest in these hotels from an investment standpoint than at any other moment in history. But lenders aren't just throwing money at anyone who plans to build a hotel.

"Lenders, 62 percent of the time, they still want to see a brand," said Guy Maisnik, partner & vice chairman, Jeffer Mangels Butler & Mitchell Global Hospitality Group. "If you tell a lender you don't want a brand…you'll have to fight an uphill battle to explain why you don't want one."

Maisnik admitted there are plenty of reasons for hotels to avoid signing on with a brand these days: high costs, high fees to retain association, contracts that lock hotels into extended relationships and difficult deals to unwind from, to name a few. But according to Maisnik, lenders don't weigh these factors as heavily as they do the benefits of a brand, including the direction they provide during the development process, their attachments to vast booking engines and broad support during down markets.

Essentially, to get the money, independents have to make a great case for their individuality.

"You have to treat your lender like you are talking to a 12-year-old," Maisnik said. "Even as an independent, give your hotel a category and show them it makes perfect sense. It helps if you have a lot of equity or can show you've seen this movie before."

Successful relationships between independents and lenders also hinge on the strength of the market at the time of investment. Maisnik said the availability of EB-5 financing five years ago relaxed some lender expectations with regard to independent experience. Now that this foreign financing is drying up, operators need to show their stuff and inspire confidence early on that they are capable of pulling a project together.

The Palace Hotel, Tokyo

A Case For Creativity

The internet is arguably the biggest asset to independent hoteliers, helping to get their name in front of scores of travelers who would never hear of them otherwise. Often this is done through online travel agencies and social media advertising, but Evan Weiss, executive managing director and principal at LW Hospitality Advisors, said OTAs are not compelling sources for lenders to rely on to ensure the success of a hotel.

“You have to be aware of your net revenue when dealing with OTAs,” Weiss said. “In that case, it is helpful to hire a revenue manager or invest in technology to assist with that. For a couple thousand dollars, you can level the playing field.”

Weiss said that technology is such a compelling factor for independents to leverage during the investment period precisely because they aren’t held down by fees associated with a brand. Without those fees, independents are free to invest in the tools they want, but they better be spending somewhere.

“In New York City, there are hotels that have de-branded and watched their [revenue per available room] go up, and it helps that they don’t have franchise fees,” Weiss said. “That’s market dependent, but it can be done. Technology has allowed the little guys to get access to what Marriott only had through partnerships with companies like Avendra for purchasing. Programs like ALICE are available to help independent employees be more effective operationally, and things like that make technology a game changer for this space.”

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According to Weiss, debt is not currently easy to secure for independents, but it is available. He reasons that this is because retail is not in a good place for development at this point in time, and lenders are looking for unique ideas in which to stash their cash.

“Multifamily yield is net negative in some markets right now,” Weiss said. “The second largest [commercial-mortgage-backed securities] lender in 2016, they prefer to have 20 percent of their funds in hospitality but currently it’s more like 40-45 percent. We are rather busy.”

Weiss said that in order to get their hands on that debt, independents should seek out a sponsor. To lenders, your balance sheet, experience and team are all that matters, and conducting a feasibility study before approaching them about a project can help push the needle toward a deal getting done.

“You need to have a better box to compensate for not having a brand to check those boxes,” Weiss said.

“The technology you are using in your hotel is very important, but the first thing I look at is how to create value,” said Richard Bosworth, managing partner at Bosworth Hospitality Partners. “The easiest way to do that is to shift your sales structure from discounted to premium channels.”

For example: Coming out of the last market crash, Bosworth said Marriott capitalized on the changing tides perfectly with the launch of its Autograph Collection. By signing on with this soft brand, many failing independent hotels were able to shift from 60-percent to 80-percent OTA bookings to single-digit percentages, creating what Bosworth called a “tremendous increase in net income” that has somewhat leveled out now.

“The operator behind the technology is the most important factor,” he said. “That’s what I’m looking at.”

The Pier One Hotel, Sydney

Keep Both Eyes Open

Jonathan Falik, CEO at JF Capital Advisors and moderator of the panel, pointed out that a stronger U.S. dollar is making it difficult to attract foreign travelers to the U.S. at this time, and suggested prospective developers consider going down a star or reducing their projected length of stay in order to adapt to the market as things slow down in the years to come.

“We got to the point last year where we saw RevPAR for the industry as a whole go lower,” Falik said. “When RevPAR was sub-3 percent and operating expenses, payroll, etc. were all above 3 percent, it was difficult to get your arms around how you’re going to make more money.

“When you are looking at subinflationary growth on the top and double inflationary growth on the bottom, it’s tough to determine why you want to be a lender for that industry,” Falik said.

When asked how he feels about future investment in independents, Gary Carter, CEO of the Resort Owners Group, said looking five years out is the most important aspect of investment right now.

“What did the economy look like five years ago, and compare that to today,” he said. “It feels like we are at the top of the market, it feels like interest rates are starting to take over, but you have to look forward, beyond that, when presenting your case to lenders.”

Maisnik agreed, specifically pointing to China and what he refers to as a series of standards that are rarely enforced.

“We do hotels all over the world, and the one thing that keeps people coming back to us is loss,” Maisnik said. “I have a big problem in China, and we don’t have an answer to it. They have a wonderful set of laws that aren’t enforced. When [Richard] Bosworth puts out capital here [in the U.S.] he knows there are a set of rules that will keep his investment safe. You see that in Europe as well, but it isn’t true in China.”

Weiss said that, despite current market conditions and global uncertainty, U.S. hotels should focus on themselves in order to retain investment interest and the interest of travelers globally.

“It’s up to the U.S. to remain the premier destination of the world,” he said. “And I believe it is the premier destination in the world.”