Four Key Takeaways | 2015 AAHOA Annual Convention & Trade Show

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The AAHOA Annual Convention & Trade Show is a cornerstone event for owners, managers, lenders, and other stakeholders in limited- and select-service hotels. This year's conference brought to light challenges and options for hotel development and financing in today's market.

The Asian American Hotel Owners Association (AAHOA) convened in Long Beach, California for their annual convention and trade show on April 22-25, 2015. One of the U.S. hotel industry's biggest events, the AAHOA conference brings in some 3,000 attendees every year, with delegates spanning all angles on the industry. Hotel owners, lenders, brand representatives, consultants, and appraisers were on hand to educate and share insights on the industry, chiefly from the perspective of limited- and select-service hotels. Here are four key takeaways:

Important Considerations for New Hotel Development

A panel of leading hotel developers in the Asian-American community shared insights from recent successes. The triple rule of real estate is, famously, *location, location, location*. This adage is particularly true for the limited- and select-service side of the industry. The more prime the location—close to an airport, highway exits, downtown areas, retailers and restaurants, and clusters of local demand generators—the more likely a hotel is to capture demand and command higher rates.

Brand selection also weighs heavily into how well a hotel will perform. Competition amidst all hotel tiers has been fierce, and the intensity is picking up. Developers found that superior brands with a large following of brand-loyal guests generally achieve a higher occupancy penetration level and command a higher average rate, both of which mitigate potential investment risk and franchising costs.

Furthermore, the panelists unanimously recommended new construction as a development vehicle for local and regional entrepreneurs, in comparison to redevelopment or adaptive reuse projects. This recommendation relates mostly to the unknowns associated with existing building structures. These can include functional obsolescence and all kinds of issues with a building's structural integrity, as well as costly, mandated upgrades in response to local building-code requirements.

Developers also stressed the importance of proper due diligence prior to breaking ground, with many creating their own five- and ten-year pro formas, in addition to purchasing a feasibility or STR market trend report. Lastly, the panelists emphasized the value in choosing architects and constructors who have worked on similar hotel projects—there is no substitute for knowledge and experience when it comes to avoiding potential pitfalls during the construction of a multimillion-dollar hotel.

Some Challenges Remain for New Hotel Development

Occupancy and average rates are not only up but are still climbing in many markets nationwide. This performance growth has served as a lure for hotel developers, who see enormous profit potential in the upcycle. Many local and regional entrepreneurs, however, report facing challenges to new development. These include the rising cost of construction, tight lending constraints, limited brand availability, and more stringent franchisee requirements.

Most developers agreed that construction costs have increased 20–30% in the last two years, making many of their more recent projects much less profitable than those completed in 2010 and 2011. Factors leading to the rising cost of construction include higher costs for labor, basic materials, impact fees, and FF&E. The last is largely attributed to the implementation of higher-quality FF&E components in new brand prototypes.

Tight lending requirements, including lower loan-to-value ratios, stemming from the recent recession have increased the amount of equity required prior to the start of new construction projects, and this has contributed to the slow recovery of new hotel supply growth. In addition, the limited availability of hotel brands in many urban areas has compelled creative thinking from hoteliers and brands alike. Many local and regional entrepreneurs have refocused their attention to growth areas in secondary and tertiary markets with an abundance of brand options, while hotel brands have continued to expand their product lines; Hyatt Centric, Starwood Tribute Collection, Canopy by Hilton, and AC by Marriott are among the dozens of new hotel brands that have arrived in the U.S. in just the past few years. Moreover, due to the limited availability of brands in many markets, select brands have implemented more stringent franchisee requirements, such as the retaining of a management company or the establishment of a board of directors. Again, as with hotel operations, the competition for branding is fierce.

More Availability and Options for Hotel Financing

Viable options for limited- and select-service hotel financing in today's marketplace include SBA loans, EB-5 U.S. visa investments, Commercial

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Mortgage Backed Securities (CMBS) loans, and tax credits, in addition to the mainstays of private equity and local and regional banks. The bottom line is that the money is there, and lenders are ready to put it into all kinds of hotel deals, including new construction. The key for hoteliers is matching acquisition, refinancing, repositioning, or new development deals with the right source or sources of financing. An AAHOA panel of lenders revealed that low-interest debt financing is readily available for a 65% to 70% LTV; the catch is that this applies to cash-flowing assets with superior brand affiliations in major or secondary markets. For hotel assets with inconsistent cash flows and inferior brand affiliations, however, debt financing can be much more costly.

As CMBS lending has gained momentum and more lenders are competing for business, leverage has slowly shifted to the borrower and lending has opened up to relatively small-figure, highly leveraged loans. Traditionally, CMBS loans have seldom been offered under the $20-million threshold; however, an increasingly hotel-friendly CMBS market has begun embracing riskier mezzanine debt, as well as floating-rate non-recourse deals. AAHOA panelists noted that the CMBS market focuses on debt yields, or the net operating income of the pool as a percentage of loan debt. Properties in primary hotel markets generally require a 10% or lower debt yield, while hotels in secondary and tertiary markets will need between 11% and 12%. While trophy assets have generally been prime candidates for CMBS financing, the CMBS market has increasingly shifted toward midscale, limited-service properties in need of renovation.

The Next Generation of Hoteliers

The AAHOA Convention & Trade Show also highlighted the up-and-coming generation of Asian-American hoteliers. Having grown up in the thrills and throes of hotel operations for most of their lives, these young hoteliers possess a strong, first-hand grasp on challenges of hotel ownership. These second-generation owners also inherit a solid foundation of financial resources established through the successes of their forebears, many of which have been in the hotel business for decades. The combination of property, finances, and hotel operations experience puts the ascending generation of Asian-American hoteliers in a position to take advantage of an evolving hotel marketplace. They are also poised to lead AAHOA into a new generation.

About the Authors

David has conducted hundreds of consulting and appraisal assignments for limited-service hotels in markets across Texas and the western U.S. David formerly worked in the rooms division and engaged in all aspects of operations at the Omni Parkwest Hotel in Dallas. Contact David for a sample report or to find out what we can do for your hotel endeavor.

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