HVS Key Takeaways: Boutique Hotel Investment Conference 2016

July 5, 2016 / *By Susan Furbay*

The following are some key takeaways from this year's Boutique Hotel Investment Conference.

Over the past several years, hoteliers have become aware of the rise of the Millennial generation of travelers and the shifts in consumer behavior its preferences have brought about in the field of hospitality. Price still matters. So does convenience. Increasingly, travelers seek out more than just a bed and bathroom, wanting their hotel stay to connect with the culture of the local city or neighborhood.

Hotels that have historic significance and/or unique, locally influenced restaurants, décor, or amenities fit the bill and attract this growing set of travelers. As evidence, the supply of lifestyle and boutique hotels has outpaced overall growth in the U.S. lodging market, growing by over 5% per year since 2000.

The local culture, history, and entertainment and culinary scenes of markets such as New York City, Chicago, Miami, San Francisco, and Washington, D.C. provide the most complementary environment for a memorable boutique hotel experience. Deeply ingrained historical and cultural aspects of such markets allow for a thriving boutique hotel industry with room for growth. As younger people flock to urban locations to work and live, city neighborhoods are undergoing gentrification and renovation projects in previously underdeveloped neighborhoods. This is fertile soil for boutique hotel developments, which can be a keystone of local revitalization efforts.

Some lenders still see the flag of a major brand as the mark of legitimacy for a proposed hotel project, making it hard to make the case for a loan for an independent hotel. Since the 2008/09 recession, however, many institutional lenders have come to find enormous potential in independent hotels.

When underwriting for boutique and lifestyle hotels, lenders give close consideration to the quality of sponsorship and their past and current relationship with a particular sponsor. With sponsorship approved, lenders look for a rock-solid business plan and at the quality of the real estate. Insiders at the 2016 Boutique Hotel Investment Conference report that, compared with last year, construction financing is becoming scarcer, and spreads have become wider for both balance sheets and CMBS loans. Loan to value ratios now range from 60% to 65% for most lifestyle/boutique products throughout various markets.

Along with debt providers, equity investors—both private equity and REITs—are becoming more active participants in the independent hotel sphere. According to JF Capital Advisors, over the last seven years, public

Summary

The conference keyed in on ways for independent hotels to gain ground in today's market, from financing avenues to booking channels. Changes in consumer behavior, with tastes favoring the hotel "experience" more than price or brand, were a highlight.

1 Comments

FILED UNDER CATEGORIES

Lending | Hotel Operations | Valuations & Market Studies | Economic Trends and Cycles | North America

REITs have acquired more independent than branded hotels—98 versus 92 properties, respectively. Furthermore, REITs paid more per key for boutique hotels—$400,000 versus $309,000 per key for branded hotels. Among the REITs, the most active buyers of boutique hotels include Pebblebrook Hotel Trust and LaSalle Hotel Properties.

Private equity players active in the boutique space include groups such as KHP Capital Partners, Sydell Group, and KSL Capital Partners. Capital sources for these groups consist for the most part of institutional investors (95%), with 5% coming from high-net-worth individuals. Typical holding periods range between five and seven years and generate IRR returns in the high teens to low 20s. While some private-equity investors build hotels from the ground up, most create value by acquiring existing hotels and converting them to lifestyle/boutique properties in urban markets.

Independent hotels face a well-known challenge in that they do not have access to a brand-wide reservations system, which hotel franchises employ to such great extent in making bookings. Independent hotel owners must find ways of attracting business without the support of a parent company.

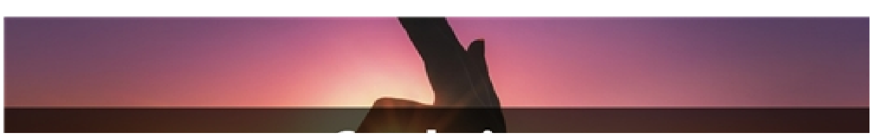
In a survey conducted by the BLLA, 59% of independent hotel owners and operators said most of their bookings come through their hotel's website or over the phone. Another 18% come via Online Travel Agencies (OTAs), which some hoteliers, with a measure of seriousness and cynicism, term the "frenemy"—a reflection on the fees and some of the challenges imposed by OTAs.

The bottom line is that word of mouth and grassroots promotion are crucial for independent hotels. Friends and family who have heard about or had direct experience with a boutique or lifestyle hotel help spread the word to other travelers and encourage bookings. Local establishments, too, can help guide travelers to recommended boutique hotels, which tend to advertise in more exclusive avenues to highlight their unique flair.

Like reservations systems, brand loyalty programs are a key component of operations for the big hotel chains. Of course, the rewards apply to branded properties nationwide, a major convenience for frequent travelers. Given the single-location nature of independent hotels, delegates at the conference discussed the potential merits and challenges of boutique-oriented rewards systems.

A BLLA survey asked owners and operators if they participated in loyalty programs such as Stash Rewards, Preferred Hotels, or Leading Hotels of the World. Only 33% said they use a loyalty program, while the other two-thirds said they do not.

For most who responded in the negative, the reluctance stems from questions about the benefits and advantages of a loyalty program to an independent hotel, or even a large boutique hotel group with multiple properties. The key, according to experts at the conference, is to dial in promotions and discounts at an individual hotel while connecting the property to a larger network of boutiques. The resulting critical mass potentially makes the rewards piece relevant and cost effective; reportedly, the programs can be enormously successful in generating business for the hotel and additional revenue for investors.



The 2016 Boutique Hotel Investment Conference highlighted some important shifts in the business of developing, owning, and operating an independent hotel in today’s market. Undoubtedly, the broad-ranging financing community of public REIT owners, private-equity investors, and balance of CMBS lenders has welcomed investment in independent hotels, whose boutique and lifestyle offerings attract demand from millennials and style- (versus price-) conscious travelers. Apart from the potential demand capture and price point, these hotels also offer greater flexibility in both design and management, as well as higher operating margins, making them an attractive investment in today’s market.

Securing bookings without a brand-wide reservations system and generating repeat visits in the absence of a loyalty program remain challenges for independent hoteliers. But the scene is evolving on both fronts, as hoteliers find innovative ways to attract customers and learn more about the benefits of boutique-oriented loyalty programs. In essence, however, independent hotels rely on travelers seeking a unique hospitality experience and, in this regard, their customer base and loyalty goes beyond the scope of brands.