HVS

MARKET REPORT

Top 6 Hotel Success Factors

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In this article, Luigi shares what he believes to be some of the most important factors that must be considered in the acquisition or development of a hotel, which ultimately lead to a property's financeability, profitability, and long-term success.

What makes some hotels more successful than others? It is true that the selection of a site, market, brand, and management team are crucial to the success of a property. But after many years at HVS in the Consulting & Valuation division, and hundreds of consulting assignments later, I contemplated the question, "Aside from these things, what really makes some hotels work?" In this article, I share what I believe to be some of the most important factors that must be considered in the acquisition or development of a hotel, which ultimately lead to a property's financeability, profitability, and long-term success. I have focused on owners, developers, or hospitality teams that consistently outperform the market with their acquisition or development projects, and have set to distill their priorities into an easy-to-understand summary. While some of the points below may not be anything new to some, it is important to keep in mind that it is the fact that these are considered a priority, not an afterthought, that leads to the success of hospitality projects.

1. Proximity to Demand Generators



We have all heard the real estate adage "location, location, location." While this remains true for hotels, nothing is more important to a hotel than its proximity to demand generators, as well as understanding the depth of those demand generators. For example, let's take a major U.S. market like Manhattan, where a hotel's demand generators are likely to be in the same building, on the same block, or in the immediate area. Companies in Manhattan often establish negotiated rates with hotels that not only meet their needs, but that are also located near their offices. They will likely turn down the opportunity to send their clients to a better hotel if its farther away, as this will add extra traveling time, along with transportation and safety implications to their employees.

Now, of course, this scenario changes in other cities that are less dense, but it still holds true; hotel development is frequently "clustered" near major demand generators in respective submarkets, such as a Central Business District, Uptown District, or suburban business park. Visitors to one submarket are unlikely to stay in a hotel in a different submarket. As developers look to acquire or build hotels, it is vital for them to understand not only the location of

the demand generators, but the depth of that demand. Will the hotel be located proximate to the demand generators, and will that demand be sufficient to support the hotel and/or its competitive set?

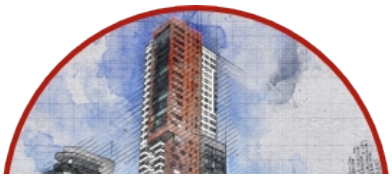
2. Proximity to Retail & Pedestrian-friendly, Vibrant Neighborhood/District



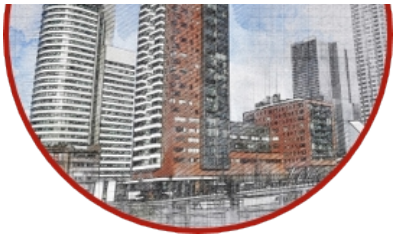
It is important to note that proximity to retail and a pedestrian-friendly vibrant neighborhood or district alone will not guarantee the success of a hotel project (aside from one scenario, in my opinion, explained in more detail below); however, today's traveler, whether for business or leisure, is looking to experience more of the area that is being visited. This is where proximity to retail, restaurants, bars, or simply a vibrant pedestrian-friendly neighborhood adds value to a hotel. More and more, we are seeing hotels developed within mixed-use communities that include retail, office, and residential. Today's traveler is increasingly seeking to experience the surroundings and nearby amenities, which is the easiest way to add to the lodging experience. The inconvenience of either renting a car or using a driver service, such as a city taxi or Uber, simply to go to a restaurant will eliminate a hotel from being selected by such travelers. While the larger, dense urban cities have a built-in advantage in respect to a typical hotel's proximity to other venues and attractions, this becomes increasingly important in other less-dense urban areas where the car is still king.

There is one exception, from my experience, where a hotel's location close to retail and/or in a more desirable neighborhood of the city has guaranteed its success, and this occurs in developing markets. In such scenarios, while the hotels were not located near the area's demand generators, the neighborhood surrounding those demand generators were so undesirable that travelers opted to travel farther to stay in a more vibrant and/or desirable location. This is common in developing countries that are undergoing growth and redevelopment, or simply cities that have not experienced as much growth. The only caveat with developing such project away from the demand generators is that, over time, cities grow and the lodging market become more segmented (i.e., more and more hotel submarkets are created). Retail or other attractions are eventually built closer to the demand generators, decreasing the attractiveness of the hotels farther away. When this happens, the demand that was previously accommodated by the hotels farther away is siphoned to the newer, more proximate lodging facilities, thus affecting the future performance of the original properties.

3. The Perfect Business Mix



Following a hotel's proximity to demand generators and its location near amenities in a desirable neighborhood, is the perfect business mix. This "perfect" mix will be different and will vary by each market. Generally speaking, properties that are too dependent on one source of demand have a higher risk



of being affected or completely collapsing if that source of demand disappears. Returning to the Manhattan hotel example, we can see how a property in Manhattan can receive a steady flow of both business and leisure travel throughout the year. This mix can be drastically different for a traditional business-focused hotel in a suburban business park. While it may do extremely well in capturing business demand Monday through Thursday, occupancy levels may decrease substantially on Friday through Sunday nights. I use this example for illustrative purposes. Ideally, the business-park hotel will seek to maximize group and leisure travel during slower periods in order maintain or improve its operational performance. However, what happens if there is no group business or leisure travel to be captured? What happens if the single corporation supporting all hotels in the business park decides to relocate? Ultimately, the hotel's performance will be negatively affected. There are other well-established markets where the one-industry rule is often ignored and hotel occupancies remain elevated year-round, such as Miami Beach, for example. Nevertheless, even those markets experience seasonality, and it is crucial for hotels in those markets to maximize their demand segmentation. For those hotels, even though they are mostly dependent on leisure business, the capture of group, FIT (free independent traveler), and wholesale demand needs to be maximized so that the property is not dependent on one source of leisure business and is better able to handle the market's seasonality. A healthy mix of business, group, and leisure, along with a well-balanced demand segmentation, adds to the long-term success of a property.

4. Well-controlled Costs



While there is no doubt that top-line revenue is important in the performance of the hotel, this become meaningless if expenses are so elevated that they erode the profitability of the hotel. Some owners and developers make the mistake of assuming "standard" expense factors when completing their initial analyses and pro formas, and while this may be helpful in quickly understanding an asset, the reality is that expenses can vary significantly by region, and a full understanding is a must. Some of the most common offenders are labor costs, utilities, and property taxes. Remote locations or unionized hotels often have to operate with elevated labor costs that are near to impossible to change. Utilities can vary drastically, as well, and can be extremely high in various parts of the country or the world. Property taxes can also vary by county or jurisdiction, and are best forecasted through an in-depth analysis of the tax burden for competitive properties, along with a full understanding of that jurisdiction tax rates and assessment standards (e.g., property taxes can easily be less than 1% in some parts of the world, but closer to 10% in other areas). Understanding and preparing for a property's respective costs from the onset is a key component in the success of a hotel.

5. Fully Understanding Supply Dynamics



While we all know that there are two sides to the supply/demand equation, supply changes are often overlooked in the acquisition or development

process. Besides the possibility of a main demand generator leaving the market, nothing can affect the future performance of a hotel more than unexpected changes in the supply dynamics. Hotel markets are always changing, and this may include future hotels closing (unlikely), as well as future hotels opening (highly likely). If new supply is not on the horizon in the near future, it is almost guaranteed that, at some point in the asset's holding period, new supply will enter the market. The impact that this new supply will have on the subject asset will depend on its competitive weight and the size of the market. If we are discussing a 4,000-room hotel market with 200 rooms planned to open, the impact will be minimal. However, this scenario drastically changes if we are discussing a highway exit market with 400 rooms and 200 rooms planned to open. In the latter scenario, the increase in supply represents a 50% increase. Will demand suddenly increase in line with the increase in supply? If not, we can imagine the negative impact this increase in supply will have on the future performance of all hotels in this market.



6. A Unique Experience

More and more guests are craving a unique travel experience, and hotels that reflect the uniqueness of their surrounding are well positioned to capture this demand. It is not a coincidence that hotel designs are becoming less standardized and more reflective of the local area, even for national brands. Similarly, in recent years, new brands have been released that seek to appeal to either the uniqueness of the traveler or the neighborhoods in which the hotels are located. This desire to experience more of the local surroundings also explains the rise of Airbnb. Technology continues to change the way we travel. Websites such as TripAdvisor, Kayak, and Booking.com, as well as many others, are making it incredibly easy for travelers to see in detail what they are purchasing before arriving at a property. Written reviews, photos, and even videos that point out all the good or bad can provide assurance to travelers that they are making the right or wrong decision, regardless of a hotel's brand affiliation. As such, all quality aspects being equal, a traveler may choose to go for the hotel that provides a more unique experience. This factor is now important to understand and take into account in the hotel's design, facilities, and amenities offering. How can the hotel be innovative and in line with the latest standards and expectations in order to add to the guest experience?



The acquisition or development of a hotel property can often be complex, forcing one to review and consider many factors. Often, the performance of the property or market, along with branding, management, and/or transaction considerations, can cloud other key aspects. There are owners or developers that consistently acquire or develop well-performing assets. It was my goal to set out to distill those priorities or nuggets of wisdom in this short article. By having a full understanding of these factors, owners and developers can incorporate them as priorities, allowing them to make informed and educated decisions that lead to the hotel's long-term success.