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ASSET MANAGEMENT REPORT

Focus put on rising costs and identifying efficiencies

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NATIONAL REPORT—Asset management is a vital part of the hotel industry. Like many other aspects of hospitality, the role and focus of an asset manager can shift depending on myriad factors, so *Hotel Business* checked in with a few industry experts to find out what challenges and opportunities asset managers are facing.

Michelle Russo
hotelAVE

Chad Crandell
CHMWarnick, LLC

Timothy Dick
Three Wall Capital, LLC

"We are still in good times," said Michelle Russo, founder/CEO, hotelAVE. "Even though RevPAR growth is decelerating, it is still 2-3x inflation, which is considered very healthy when evaluating the industry over the long term. Although there is another round of CMBS maturities coming in 2017, we don't expect the foreclosures will be as prevalent as they were in 2008-2010."

For his part, Chad Crandell, CEO/managing director, CHMWarnick, LLC, noted that RevPAR deceleration is his company's biggest concern. "We have enjoyed upwards of 6% RevPAR growth for several years, and the most current outlook for 2016 is roughly half that," he said. "If we want to continue to achieve meaningful NOI growth, it is going to have to come from strategic and deliberate tactics, and eventually changes to the operating model."

Despite this, Crandell wasn't pessimistic, calling 2016 mixed. "We're still finding opportunities for ADR and profit growth among the 50-plus hotels in our asset management portfolio but, at the same time, we are working much harder to optimize flow through hindered by increasing labor expenses and acquisition costs," he said.

So, what are asset managers focused on? "Identifying opportunities and implementing strategies for 'engineering profits' through an examination of costs that were historically more variable in nature and today, unfortunately, behave in more of a fixed fashion," said Crandell. "We are focused on factors impacting the profitability of room sales, including cost of acquisition, segmentation and pricing strategies, as well as on identifying opportunities to mitigate wage and benefit increases associated with labor contracts through more sophisticated forecasting methods and adjustments to the operating model."

Another concern, said Crandell, is supply. "We are seeing a much more pronounced increase in supply in select markets, coupled with the impact of C2C sites, like Airbnb and VRBO," he said. Russo commented, "It is critical that hotels are prepared for new supply long in advance of it opening. We create customized action plans that define and protect key accounts and key employees, and then work with the operator to be proactive against the new supply."

Additionally, there are new brands. "They're going to require some of the existing properties to become even more competitive because these new brands are more cutting edge, more current and fresher in many ways," said Timothy Dick, managing director and principal, Three Wall Capital, LLC.

The executives reflected on items that represent increasing costs, like technology, labor and refurbishments. "Technology will continue to be an increasing cost and a necessary investment in order to stay competitive," said Russo. "That is one reason that the Financial Management Committee created a separate line item for IT in the most recent edition of the Uniform System of Accounts for Hotels."

Dick noted that labor costs would increase. "With the unemployment flow in this country, it's hard to find staffing for certain positions," he said. "I think, at this point in time, it's going to force people to pay more because you have to steal people and you're going to have to pay them more to come work for you. So, it's going to increase payroll costs."

Added Crandell, "In addition to the cost of labor, we see availability of qualified talent as an issue as well given the low unemployment environment."

For her part, said Russo, "Despite the fact that a lot of cost was removed from the operation in the downturn, we continue to identify and monetize labor efficiency opportunities. We have been working with groups like PostScript and UniFocus to implement the labor efficiency opportunities."

Dick added that another factor to keep an eye on is the living wage issue. "When things get this far out of balance, crazy ideas come out with extreme consequences; they get traction because people are in drastic situations," he said. "The answer is being more reasonable and thoughtful, making increases when they're deserved instead of saying no all the time."

The cost to renovate and refurbish is also increasing. "Costs continue to outpace capital reserves further stressing the need to value engineer to fit projects into budgets," said Crandell.

Dick noted that many hotels are positioned well. "Because the brands have such stringent requirements in terms of quality, owners have had to maintain brands to a higher level than ever before," he said. "If and when we head into another recession, the properties are going to be in better shape. There should be, theoretically, fewer things that need to be improved upon from a physical perspective."

"I have to say that our full-service brand managers continue to be reasonable in working with us to achieve their brand standards with our cash available for renovation," said Russo. "There has not been as much flexibility in the select-service space where new standards have increased overall PIP cost and, in some situations, operating costs."

Another area of interest is revenue streams, with charging for amenities like WiFi in flux. "The days of charging for Internet is finite, and we have seen that in how brands are managing their tiered Internet offerings. Hilton and Marriott are leveraging free Internet to increase direct bookings and brand loyalty," said Russo. "The net impact of shifting business from OTAs to direct business less the additional cost of paying for the loyalty fees should result in lower total acquisition costs. We are monitoring this share shift and loyalty expense to confirm this thesis."

Russo noted that HotelAVE also encourages "all of our hotels in high compression markets and resort locations to charge a resort fee and offer a value proposition for the fee. One of those components is the complimentary Internet."

"If there is one thing that us asset managers bring to the table, it's an ability to help operators identify new opportunities to adjust the operating model to the plus side of the profit equation," reflected Crandell. "The airlines are a great model for how to provide service, but at a price to consumers. We'll give you free WiFi but if you want to do work and stream video, you'll pay a bit more. It's about evaluating every aspect of operation and adjusting the business model to strike that perfect balance between guest satisfaction and profitability."

Dick agreed that, in some ways, following the airline model works. "The hotel industry has been embracing technologies that other industries, like the airline industry, are already using," he said, adding that upselling is one way to increase revenues. "Before their stay, we send guests an email and ask if they'd like to upgrade, just like the airlines do. That's where hotels are recovering some of the cost."

He added, "We're also able to recover it because of the delivery of service—recognizing guests throughout their stay, responding to any ad hoc request a guest may have in a reasonable manner. Those have allowed us to charge higher rates on a consistent basis."

Russo agreed that there are other ways to keep the business profitable. "We recently dedicated one-third of our company retreat to revisiting energy savings and our best practices checklist. The opportunities are way beyond changing lighting, and the savings opportunities are significant," she said. "Almost all of these initiatives have no impact to guest or employee satisfaction and can generate an ROI in three months to two years, and there are a lot of public incentives. Many opportunities are manual, meaning they can be implemented within the operation without capital investment—whether closing drapes to reduce thermal impact as part of the housekeeping process or closing off floors during slow periods. Some have a small investment with high returns such as variable speed motors on kitchen hoods or timers on outdoor lights. I think this also speaks to the fact that we need to revisit the qualifications and training for our chief engineers and owner's right to approve the chief engineer position."

As for asset values, Dick noted they're at a high level, and Russo commented, "Asset values peaked, probably midway last year. The deceleration of RevPAR growth that started in Q2 '15, as well as the increased cost of debt in Q4 '15 and the fall in oil prices (that took some foreign investors out of the market) all contributed to that," she said.

Crandell noted, "What was arguably both a buyer's and a seller's market six to 12 months ago has now evolved to one in which value expectations on the seller's side are not being met. And, although the market has capital to deploy, it will be difficult to support current values as we approach what most see as the peak of the market. While we believe there is still performance upside left in the current cycle, value appreciation will have to come from either a longer-term hold that may not be possible until the next cycle or through a significant repositioning effort." HB