

Experts see uptick in hotel construction

30 August 2012

By Jeff Higley

Editorial Director

jeff@hotelnewsnow.com

Story Highlights

- Mark Laport of Concord Hospitality said the lending pendulum is swinging back in favor of the hotel industry, and lenders are actively looking for projects to fund.
- Finding the right site is the biggest key to unlocking the vault for construction financing.
- The cost of construction has been reasonable, and even the price tag for LEED-certified projects is more affordable than ever.

MEMPHIS, Tennessee—Don't look now, but that muted supply growth that hotel industry pundits have been praising as a reason for a swift recovery from the recession is in danger of disappearing. Of course, it won't happen overnight, but new hotel construction is on the horizon, according to speakers during last week's Southern Lodging Summit @ Memphis.

Craig Mance, senior VP of franchise development in North America for Hilton Worldwide, said there's been an uptick in interest in new-construction projects during the past six to eight months.

"We'll see a doubling of construction projects started in 2012 versus 2011," he said. "The vast majority of those are focused service."

Darand Williams, VP for D&D Construction Services of Orlando, a Florida-based company that has a primary focus on building hotels, said his company has seen an uptick across the nation with owners building additions, remodeling, refreshing and looking at building new hotels.

Concord Hospitality, a North Carolina-based hotel development company, has 18 new-construction projects in its active pipeline, said president, co-founder and CEO Mark Laport.

"The ultimate proof is that this is obviously a very capital intensive business, and when banks call on us again (for debt), you know something's happening, you know the pendulum is swinging," he said. "That's happening now. We're getting three or four quotes on a ground up (project). Eight months ago we were struggling to get one quote."

A focus on focused-service hotels

Laport said Mance was correct about the vast majority of new construction being focused-service properties (also called select-service hotels by some companies).

"The day of the full-service suburban hotel is passing," Laport said. "They have reached a high level of functional obsolescence."

Bruce Lowrey, managing director of RockBridge Capital, said it's difficult to justify the cost-per-key to build a full-service hotel in today's economy.

Very few developers can build full service for less than \$250,000 per key and in many markets it's \$300,000 per key, Lowrey said. "The old rule of thumb is you need \$1 in (average daily rate) for every \$1,000 put into a room still holds water, so for a \$300,000-per-key project, you need a \$300 ADR. That's unlikely in most markets today."

Mance said many of the 25-year-old, 250-room big box full-service hotels are still sound but the move away from massive food-and-beverage operations leaves them with a lot of wasted space.

"The trend is that food and beverage is becoming a less critical component just because the numbers on that aren't working, especially if you're working in a collective bargaining agreement environment," he said.

Liquidity is returning ... slowly

The panelists agreed that liquidity is coming back into the hotel market and debt is available for the strongest developers with the best real estate and the best brands committed to the project.

Lowrey said that while his company has yet to jump back into the fray, there is a lot more capital available to build new hotels. "You'll see more development, but this time it's a little different than in past cycles because it's going in fits and starts."



Bruce Lowrey
RockBridge Capital

"The economy, the (November) election and Europe have combined to change how capital is flowing," he said. "If you have a good deal and you have experience ... if you fit that profile, you're going to find capital."

Ron Lustig, partner, Earl Swensson Associates, said that during the same time frame there's been an upturn in hospitality work for the Nashville, Tennessee-based design and architecture firm.

"There have been a lot of phone calls from that scary developer who's never done one," he said.

He said the most frightening phone call is from the developer who built an office building or a park and thinks the area is ripe for a hotel but hasn't done the due diligence.

"Everyone thinks, 'I've done four successful buildings, three successful apartments and now I can go get in the hotel business,'" Lustig said.

Mance said there's a mindset that scares him even more: "It doesn't scare me when someone who hasn't built a hotel wants to do it," he said, but it's the ones who think "they want to get into it because it's a sexy little business," which scares him.



Mark Laport
Concord Hospitality

Laport said Concord has been able to tap into regional lenders to quench its thirst for building hotels during slow development cycles.

"Institutional equity is rare, but it's still out there," he said.

When asked by moderator Lee Hunter, president of Hunter Realty, for the best way to start a development project, Laport said it boils down to one thing: "Go find sites with a great passion," he said. "Many times the supply in the market is old and tired. We know if we present a fresh new globally represented brand in these markets we're going to win."

He said that approach has helped Concord achieve revenue-per-available-room index scores in the 120s and 130s during the first year of operation.

"If you're going to be crazy enough to be a developer, it's all about having a great story," Laport said. "You have to convince (lenders) there is a great reason to build a Hilton Garden Inn in Texarkana. It's a unique business. You better have guys on your team that understand the process."

Construction costs play a role

The increased building activity also can be partially attributed to lower construction costs, the panelists said. That might not be the case for long, according to Williams.

"We're seeing a good part of the nation where costs have definitely been down ... but in certain markets, pricing is starting to creep back up," he said. "We're starting to see increases in dense markets."

Part of the reason for the lower costs is that builders were in no hurry to build during the early days following the recession and that gave them time to value-engineer the projects that were most important, Williams added.

Laport said construction costs per square foot for select-service products are fairly consistent in many markets. That's where the value of a top-notch construction company that can trim any excess fat is of the utmost importance.

The panelists also said properties being built to meet Leadership in Energy and Environmental Design certification from the U.S. Green Building Council are increasing. Lustig said prices for materials for LEED projects are now feasible for more hotel developers.

"Five years ago you had to seek out green-building certified materials and there was a little bit of a premium," he said. "Now they're common and priced accordingly."

Laport said costs for LEED projects have dramatically dropped. Five years ago, the LEED component of a \$15 million to \$20 million development could add \$1 million in costs, he said. Today, it's about \$300,000.

"There is a cost to it, but our larger clients can tell you that the extra dollars that go in can help them save money in the long run," Williams said.

Mance said that while the consumer has been hesitant to pony up the extra cash to stay at a LEED-certified property, some companies mandate that their traveling executives seek out such hotels.

"The savings for the owner is in the operating costs on a day-to-day basis," he said.

Best Regards,

Jerry Daly
Chairman

Daly Gray, Inc.

620 Herndon Parkway
Suite 115
Herndon, VA 20170

(703) 435-6293 (office)
(703) 624-7187 (cell)
jerry@dalygray.com

Concord Hospitality Enterprises Company <http://www.concordhotels.com>
Delivering Quality * **Living** Integrity * **Supporting** Community * **Growing** Profitability

Celebrating 25 years of service to our associates, guests and partners across North America!

Think Green! Please consider the environment before printing this email.