



By Rick Swig

CapEx Discussions Require Balancing Brand, Owner Needs

WHEN ALL THE COSTS ARE CONSIDERED, ARE hotel brand standards affordable, effective and efficient in supporting an individual hotel's asset value? Although the answer is not simple, the real issue lies in finding the appropriate balance between brand and owner needs, both competitive and financial.

Standards discussions are quite contentious, as they naturally pit brand companies against hotel owners. Owners claim that hotel brands arbitrarily require them to spend money on capital improvements whose value is unproven, but they are shackled to long-term franchise or management agreements with no choice but to comply. Owners further claim that the brands are enriching the value of their own companies through these mandates while not equally enhancing the individual hotel assets.

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The dynamic that has emerged between brands and owners is quite interesting. Hotel owners will be the first to claim that brands are significantly important to development, acquisition financing, competitive market penetration and exit sale values, among a myriad other benefits. Yet they will also claim that franchisers require spending activities that inhibit net cash flow, expose them to inappropriate capital investment and reduce net sales proceeds.

Brands, meanwhile, argue that strength is sustained through product evolution based on customer lifestyle and expectation trends. They rightfully claim that customers expect at least a comparable experience from one- or two-night hotel stays versus the creature comforts of their own homes. This would follow logically with new requirements for such product improvements as flat panel televisions, comfortable mattresses and high-speed connectivity.

Although the independent hotel segment is important, fertile and substantial, the brand segment still maintains the heaviest leverage in hotel real estate. Brands have developed solid equity with customers to stimulate swift stabilization of a new hotel or the solid positioning of a newly converted or legacy asset.

The debate becomes even more complex when market forces are at odds with business goals. While this current hotel cycle surges with continuing, albeit slowing, demand growth and aggressive room rate increases, the threat of new supply is once again on the horizon. When supply increases overcome demand escalation, then that market force will strain and stretch the brand/owner dynamic, since it threatens to tear away both profitability and asset values.

Any branded or independent hotel asset's competitive positioning lies with its product differentiation and integrity. This does not come without significant reinvestment, whether it is a brand standard requirement or a competitive need. Customers are more fashion-driven and product aware than ever before, as evidenced by the trendy new decors of both leading edge independent hotels and even some big brand affiliates.

The International Society of Hospitality Consultants, in conjunction with the Hospitality Asset Managers Association and the American Hotel & Lodging Association, has released another definitive capital expenditure report, "Capex 2007." Its general findings reiterate that successful hotels require ongoing and growing capital investment for product improvements to stay competitive. The report illustrates that there was a dearth of capital improvement between 2001 and 2003, as hotels suffered from terrible income declines and cash flow shortages. There is a clear implication that hotel owners then fell behind the capital expenditure curve, while brands were less stringent in requiring either new brand standards or universal compliance. As a result, the current fervor of standard compliance may simply be a reasonable and customary process to catch up on postponed necessities.

It is still arguable whether every new brand standard is appropriate for each affiliated asset, but there is strong evidence that consistency supports the brands' ability to deliver customers and market share. Unfortunately, this concept may be contrary to the needs or expectations of some owners and their quarterly earnings buzzards. ♦

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