

## Ownership

# Increasing costs aren't enough to kill owner optimism

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Hotel owners on a panel at the Hunter Hotel Conference acknowledged external pressures on their business, but said the pros outweigh the cons when it comes to the U.S. hotel industry.



By [Stephanie Ricca](#)  
sricca@hotelnewsnow.com  
@HNN\_Steph

ATLANTA—Hotel owners feel good right now.

At least that was the sentiment of owners on the “State of the industry” panel at the Hunter Hotel Conference last week. Speakers said that they are recognizing the opportunity in hotel investment and development, despite pressures from labor, wage increases and other rising costs.

“2019 is going to be a steady year. Everybody feels good,” Rockbridge CEO Jim Merkel said. “They’re cautious but optimistic about doing things. A couple years ago, people were much more fearful of a recession, and now people are just trying to do things.”

Other owners on the panel said they’re also in action mode, finding lots of opportunity for deals, even if they may look a little different than they have in the past.

“We think it’s a great time in the industry,” said Scott Trebilco, managing director of Blackstone Real Estate Private Equity. Blackstone is close to completing fundraising on its latest fund, a \$20-billion-dollar initiative. “We feel extremely good about hospitality. Demand is at an all-time high, but at the same time, the industry is going through a period of moderation and there are certain things affecting flow-through.”

### **Where are the opportunities?**

Owners on the panel spoke to their company's strategies and positions as net buyers or net sellers, all agreeing that there's still plenty of opportunity.

Merkel cited his company's recent purchase of the Halcyon Hotel Cherry Creek in Denver from Sage Hospitality as a typical type of deal Rockbridge likes.

"We saw an opportunity to buy a hotel that was two years old that we felt had cash flow and some operating efficiencies we could drive and generate value that way," he said. "We're trying to find that great value."

He said Rockbridge right now is a net seller, having sold 15 assets in the last 12 months, but it's always in buying and selling mode.

"We tell our investors that we're in business, because owners love to take money out of properties and not put it back in," he said. "And consumer preferences change, so we think there's always opportunity to add value."

Tyler Morse, CEO and managing partner of owner-operator company MCR Development, agreed that there's plenty of opportunity for hotel deals, not just because of asset availability and how hotels are performing compared to other real estate asset classes, but also because today's landscape of many first-time hotel owners means there's a need for operational efficiencies.

"There's a lot of places to add value; our alpha is adding value through operations," he said. "It's a widely fragmented industry and that creates opportunity."

He said his company likely will be net buyers this year, with a plan to acquire 22 to 24 hotels in 2019.

Dan Hansen, chairman, president and CEO of Summit Hotel Properties, said the industry's location in the current lodging cycle doesn't necessarily play a huge role in getting deals done.

"Every year it's kind of the same story," he said. "I don't know if we're entering a recession or at the bottom. I think there's always going to be opportunities. There definitely are challenges ahead, but I don't think that means there aren't opportunities—it just means that it's harder."

### **Dealing with cost challenges**

All the panelists talked about the issues of dealing with labor and other cost challenges.

"We're faced with a prolonged low (revenue per available room) environment that we haven't operated in in quite a long time, and we're finding GMs that have their finger on every little expense item," Hansen said.

Morse said that hyperfocus on operational efficiencies—looking at everything from staffing to time spent on housekeeping—is key to coming out ahead in the current environment.

"It's kind of like death by a thousand cuts," he said. "You have to get under the hood, pull back the covers and go through every single line item to find these little Easter eggs."

He identified three major challenges, two having to do with cost:

"First is wage pressure across the U.S. We've raised wages in every hotel across 65 markets in the last year and a half," he said. "It's very hard to find good team members, and it's absolutely affecting margins."

"The second thing is property taxes across the board are going through the roof," he said. "It's wildly outpacing inflation."

His third challenge is supply, particularly driven by industry consolidation.

Hansen chimed in on the challenge of construction costs, saying that the added time it takes to get projects built adds another layer of challenge.

"Subcontractors can turn down a job if it's too small," he said. "You can spend a lot of money and the project is a week late or a month late or more, and all those things add cost."

Merkel agreed that development jobs are taking longer to get done because of the construction crunch.

"People are having to re-underwrite too," he added. "They're getting the numbers back and having to figure out how to get the rest of the equity to get the deal done."