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Boutique investors seek quality amid high costs, supply

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Investors and owners speaking at the Boutique Hotel Investment Conference say buyers and sellers of boutique and lifestyle hotel properties must keep a few trends in mind when considering a deal.

Glencove Capital's Glyn Aeppel, left, and Sage Hospitality's Walter Isenberg talk boutique asset investment at the Boutique Hotel Investment Conference. (Photo: Stephanie Ricca)

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NEW YORK—The pace of hotel investment overall has slowed down in the United States, and while boutique and lifestyle hotels are affected by these macro trends, investors at the Boutique Hotel Investment Conference said carefully thought-through boutique hotel projects still can get off the ground.

It all comes down to location, product quality and elements such as food and beverage and new-construction vs. conversion scenarios, said speakers on an investment panel at the conference, presented by the Boutique & Lifestyle Lodging Association.

"In the U.S., things are going to be flat for the next year or so in terms of new transactions," said Glyn Aeppel, president and CEO of Glencove Capital. "That being said, the profile of buyers has changed quite significantly. 2016 was the year of foreign investments into U.S. hospitality. Probably 2017 will be the year of domestic, likely private equity, funds coming to the end of their life."

Walter Isenberg, CEO of Sage Hospitality, said everything "depends on what you're trying to sell or buy," and boutique and lifestyle hotels are no exception.

Location, location, location
Speakers said some markets—namely those that face high supply infusions like New York City—certainly are less than ideal for boutique hotel properties.

"Nationally, we're at the tail end of a prolonged period of success for hotels, and New York City was at the front of that curve so we saw a large amount of development here," said Andrew Posil, director with Cushman & Wakefield. "Now we're seeing some fear about investing in New York because of the sluggish performance continuing in the short term."

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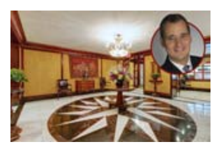

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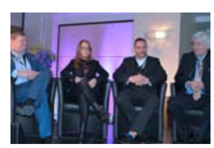

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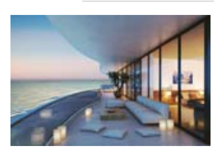

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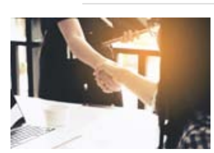

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For Seth Schumer, head of U.S. asset management for Quadrum Global, which has three independent boutique hotels each in New York City and Chicago in its portfolio, plus one each in Miami Beach and Orlando, Florida, supply in hot boutique markets can be troubling.

"We've seen oversupply and compression on average daily rate and it's been a challenge," he said. "Tourism still is relatively high and some fundamentals are there, but oversupply sometimes isn't getting absorbed."

Still, Posil said there is opportunity for boutique buyers in New York City.

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"Deals are taking longer, buyers are much more careful, and sellers continue to ask a price that may not be achievable in this market," he said. "But there's good certainty to close on the buy side. Deals can get done in more of a quiet marketing process. If you're a believer in New York over the long term, this is a good time to buy," he said.

High construction costs also have an impact on potential markets for boutique developers.

Aeppel said she has a platform currently in place to buy true unbranded independent hotels with some private equity in the United States, and the process has been daunting.

"It's extremely hard to find something where there's value-add," she said. "I was in Austin, and it's cheaper to build in Austin today than to buy assets I was looking at. … On top of that, the new supply was sort of extraordinary."

"There's a new supply issue, cap rates have gone up, pricing is at an all-time high and construction costs are high," she added.

Trends like that are moving hoteliers to other markets, which have their own pros and cons when it comes to buying, selling and financing.

"You're seeing investors go to secondary and tertiary markets because that's where you can find some yield in this business," she said.

Glencove Capital (https://www.glencovecapital.com/profile/) is investing in the Mob Hotel concept developed by Cyril Aouizerate, who created the Mama Shelter brand. The concept calls for hotels to be built around a cooperative mindset. Two Mob Hotels (http://www.mobhotel.com/paris_en/mob/) are open in France, including one in Paris; one is on the way in Rome; and hotels in the U.S. are under development in Pittsburgh, Washington, D.C., and Los Angeles.

"It's a little different in Europe, as there's some more fundamental value-add there," she said. "I'm struggling to find the value in the U.S."

Isenberg said construction costs mean that investors must pay very close attention to location.

"Construction costs have accelerated dramatically and new debt financing is declining, so those things don't work out to be very positive for new construction," he said. "On the acquisitions side, if an asset is of very high quality and has cash flow, we may not be competitive in acquiring that asset. Assets trading above replacement costs is something fundamental we won't do."

He said that those high construction prices are slowing starts down, which bodes well for hot locations potentially facing overbuilding.

Sage (https://www.sagehospitality.com/about-sage/) is opening The Elizabeth Hotel in Fort Collins, Colorado, this fall. Its full portfolio includes branded, independent and soft-branded properties across the United States with a high concentration of independents in the Denver area.

What makes boutiques work for investors?

Despite some performance and supply setbacks, still-steady demand for hotels from travelers is a positive that is underpinning hotel investment.

The investment picture benefits from boutique and lifestyle hotels that carve out a strong niche and are able to match their product and location with travelers who want it, speakers said.

Many of today's travelers seek that authentic and sharable travel experience, and that's what good boutique and lifestyle hotels deliver best, which bodes well for their viability in a tough competitive hotel landscape, Isenberg said.

"We're looking for locations that are underserved by lifestyle assets," he said. "We hear a lot about how these hotels must be a community asset and attractive to locals, and that's where we've been focused. This can run the gamut from a microhotel that might have economy pricing all the way up to the Four Star-plus range—it's the experience you're creating regardless of the tier you're competing in."

Those trends that characterize many of today's boutique hotels—small rooms and buzzing public spaces—pay off, the speakers said.

"Unique products can be successful," Posil said. "It's been a key differentiator for microhotels in particular—how that public space is activated."

Aeppel said it's absolutely critical to get public spaces right in boutique hotels. "If you don't get that right, it's hard to have a successful asset," she said.

All speakers stressed that while the product, design and amenities may be wonderful, hoteliers in this space can make it or break it based on service levels and back-of-house logistics—that can be what stands in the way of a deal.

"The most difficult part about (creating these hotels) is the operational execution with the staff and the training that goes on," Isenberg said. "We've moved away from being a transactional business. … Today's customers want to engage with your associates to find out what's going on in the place and the neighborhood."

The strength of that infrastructure plays in to how investors see hotel deals, and the same goes for internal accounting.

"One challenge (for these hotels) in achieving financing is that often they're running a great hotel, but it's in a bit of a mom-and-pop fashion," Posil said. "That's not necessarily institutional-quality accounting. I would encourage anyone who wants to sell or refinance or bring in a JV partner (for a boutique or lifestyle deal) to ensure your financial reporting and accounting is done in an institutional manner, so when brokers get involved, they can drive and justify value rather than just take your word for it."

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