Hotel Management and Financing Overview

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Players in Hotel Market

The hotel market consists of three types of players: hotel owners, hotel operators and hotel distributors.

Hotel owners own and manage hotel properties, hotel operators manage the daily operations of the hotel and hotel distributors, market and manage bookings for the hotels that are part of the organization.

Collaboration between these can vary from three different companies who occupy the respective roles in the same hotel, to one company that holds all the roles.

Hotel Owners & Operators

- Hotel Property Owners

Hotel Landlords own and manage hotel properties, which means that they ensure the properties' long-term value. Lease agreements are signed with each hotel operator who is a tenant and operating a hotel business in the building.

- Hotel Operators

The daily management of the hotel is managed by hotel operator. Hotel Operators with a chain concept are currently the most successful when they have economies of scale in, for e.g., purchasing, distribution and sales. They form an attractive partner for hotel distributors.

Hotel Distributors

- Hotel Distributors

Hotels Distributors operate under their own brands and market and manage bookings for the hotel operators.

Some hotel operators are also hotels distributors. It is common to co-exist on a global level and the hotel distributors are included in international distribution and travel organizations.

Chain-controlled hotels dominate the U.S. hotel industry. About 75% of all U.S. hotels are under some flag. The reasons are simple. Chains bring strengths in site selection, access to capital, and economies of scale in purchasing, advertising, and reservations. Chains attract the best management talent and provide the consumer with brand recognition.

Despite their importance, hotel chains do not build hotels. Those who build may not own, and those who own may not manage. So builders, lenders, and owners turn to the chain.

Parties to the deal

There are several different parties are involved in the development and operation of a hotel. One participant could have several roles.

The developer (party number 1) sees an opportunity, acquires the site, and puts the plan together. The developer could also be the owner (party number 2), which would fold the five parties into four identities. Many sources provide mortgage loans. Private-equity firms and REITs have been especially active in the past decade, but traditionally loans have come from commercial banks. That lender is party number 3. If none of the parties are capable of running the hotel, a management company (party number 4) is needed. If that management company has no recognizable logo—is not known to the public—a franchise license is obtained from party number 5, the franchisor, who provides the brand recognition.

Franchise "Flags"

There are a number of structures available for the ownership and operation of a hotel. Comparatively few modern hotels are operated by their owners. Hotels are frequently operated as franchised businesses, with the franchisee taking on the style and brand reputation of a leading chain under license. Franchising is all about name recognition. The franchisor sells its "flag" to the franchisee. Franchisee and parent are so alike that guests make no distinction. The physical hotels are indistinguishable. The differences lie in the ownership and management.

Buying a franchise allows the franchisee to operate as an independent entity but have the benefits of the chain. Those benefits come with costs. Franchise fees are a major operating expense, upward of 10% of room sales. There is a counter balance, however. Brand identification adds upward of 10 percentage points to occupancy and $20-plus to ADR.

Contrariwise, some hotel owners are dropping franchises in favor of Membership groups. Membership affiliations, also called Brand affiliations or Referral groups, have shorter contracts and fewer restrictions. Franchise fees typically cost four to five times more than memberships fees.

Best Western is the oldest, largest, and the best known of the brand-affiliated groups. Two emerging affiliates are Best Value Inns and Magnuson. They now coexist with more senior alliances such as Historic Hotels of America, Preferred Hotels, Budget Host, and Utell.

Franchise Costs

Hotel franchisors (those who sell franchise rights) charge franchisees (buyers) a variety of fees that may total 8% to 10% of gross sales. (Reminder: As room rates rise, so does the innkeeper's franchise fees, as a fixed percentage of the higher rate.) Franchisees gain access to national reservation systems, which may account for a large percentage of the franchisee's occupancy.

Representative Franchise Fees[a]

Fee	Representative Terms	Alternative Terms
Application[b]	The greater of $45,000 *or* $400 times the number of rooms	A lesser fixed amount plus a per-room fee over, say, the first 75 rooms.
Royalty	4%–6% of Gross room revenues	3% of gross revenue; *or* a minimum per night, say, $8
Advertising/ Marketing	1.5%–3.5% of room revenue	2% of gross revenue, *or* a minimum per night, say, 1.50 per room
Training	0.5% of gross revenue plus cost of attending school	None; franchisee bears all schooling costs for employees sent away.
Reservation	3% of room revenue plus $5 per reservation	Not rent of frequent traveler.
Frequent Traveler	1.5%–2.0% of room revenue	$10 per reservation, *or* a minimum per night, say, $10 per room.

[a] Other possibilities include email costs, global reservation costs, termination costs, accounting charges, and participation in frequent guest promotions.

[b] All or some (90%–95%) of the application fee is returned if the application is not approved.

Market Criteria

A Feasibility study will determine which customer segment your local market is driven by, what room rates should be charged and the occupancy levels that could be expected and the financial viability of the hotel.

Customer Segments

1. Business & Conference guests (Mon - Thurs.)

2. Group & Leisure guests (Friday, weekends)

3. Resort guests (Sunday – Saturday)

Market Segmentation

Economy: Super 8, Microtel, Motel 6, Red Roof Inn, Travel Lodge, Econo Lodge

Mid Market: Hampton Inn, Courtyard, Fairfield Inn, Holiday Inn Express, Ramada Inn, La Quinta,, Clarion

Upper Mid Market: Crowne Plaza, Inter Continental, Courtyard, Hilton, Hyatt Place, Marriott, Renaissance, Radisson, Westin, Sheraton, Double Tree

Extended Stay: Residence Inn, Homewood Suites, Cambria Suites, Staybridge Suites, Embassy Suites

Hotel Management Agreements

Standard: A base management fee of X% of total revenue and an incentive fee of Y% of gross operating profit (GOP) after base fees.

On Layers: A base management fee of X% and an incentive management fee based on a threshold of GOP levels. Scaled in the first operating years and increase by the stabilized year.

Hybrid: Base and incentive management fees are associated to a guaranteed return to the owner or subordinated to debt coverage.

Management companies pay rent (lease) to owning companies for the right to run the hotel and keep the profits. With management contracts, owners pay (hire) management companies to manage; profit or loss remains with the owners.

Hotel Leases

Leases are popular when times are good. The management company wants in; it pays rent but keeps profits. Leases are win/win if the rent is high enough for the owner to pay the mortgage, with some left over.

Examples of lease agreements are as follows:

Fixed Fee: Fixed rent with indexed growth. Has a guaranteed return which bears the least risk to the property owner.

Share of Revenue: Rent is calculated based on the sales generated. Property owner shares the risk linked to the performance of the hotel

Share of Net Operating Income (NOI): Rent is linked to the NOI after all expenses have been deducted. This scenario carries the highest risk to the owner.

** Both Revenue based and NOI based rents can include a base rent, which is a guaranteed return to the owner.*

Financing

Hotels are different from any other real estate in that they generate their revenue from:

- Rooms
- Food and Beverage
- Spa, Gym, Health Center
- Minor Operating Departments

Hotels are operating businesses, but for lending purposes, hotels have traditionally been financed as real estate.

Many sources provide mortgage loans. Private-equity firms and REITs have been especially active in the past decade, but traditionally loans have come from commercial banks. Some financing might even come from other parties to the deal. Mezzanine financing, a secondary source of borrowed money with higher interest rates, is often used during construction. It falls between equity funds and senior mortgage debt. There may be numerous mezzanine loans and some may convert into equity on completion of construction.

Financing Criteria- Construction

Minimum $5,000,000 - no maximum

- First position lien, Five-year note
- Loan amount will not exceed 60% LTV of the completed value and not to exceed 65% LTC, all-in, of the total project costs.
- Borrower must have the other 35% of the project costs in cash and/or equity in the land.
- Points, broker commissions and interest reserve out of the gross loan proceeds on the first draw. The first draw will not exceed 70% of the As-Is-value-in-place.
- The interest rate will be 8% to 10% per year and set after the underwriting.
- Interest-only payments paid monthly for the first two years then 20 year amortization for remaining 3 years of this 5 year loan term.
- Lender Origination fees are 5 points (the points will be deducted out of gross loan proceeds at the close)
- No exit fees
- Prepayment penalty (PPP) is the interest for half the term of the loan
- Requires a strong guarantor(s) who can demonstrate that the required cash is available, liquid, good credit, experienced, etc.
- There is an out of pocket fee upon acceptance of the LOI, and then a deposit when a commitment is issued, which will be applied to the 3rd party costs and legal (commitment deposit)

Financing Criteria- Acquisitions

Permanent Loan Details:

- Nationwide US and Canada only
- Minimum $2,000,000 - no maximum
- Flagged hotel, resort, suites, full/limited service, limited stay (high-end
- unflagged also possible.)
- Must comply with all Property Improvement Plan (PIP) requirements
- Rate under 5.0% (subject to change) 5 & 10 year terms - 20-25 year amortization
- Points 2% payable at Closing
- 45 day closing

A or B property with A or B borrowers.

- Stabilized or Unstabalized Property - Property should be in very good condition, quality flag or destination resort, performing at better than average against competitive set defined within STAR report;
- Quality borrower required.

Bridge Loan Details:

- construction and major rehab ok - Nationwide US, Canada and select Caribbean countries only

Financing Criteria- Renovations

Capital Expenditure (CAPEX) and Furniture, Fixtures and Equipment (FF&E) Loans

Can be used for: ▫ Hotel renovations ▫ Property improvement plans (“PIPs”) ▫ Brand conversions. These loans typically range from $200,000 to $25 million and are amortized over the useful life of the improvements, typically 3-10 years.

Transaction Size: Up to $25 Million

Use of Proceeds: Up to 100% of cost for the acquisition of FF&E

Interest Rate: Fixed rates from 7–10 percent based on credit review and scope of project

Typical Terms: 3 – 10 years based on useful life of the equipment (typically 5-7 years).

Interest only period of up to 18 months available based on cash flow and stabilization needs.

Debt Service Coverage Ratio (DSCR) Requirements: Minimum 1.25x at stabilization (typically 18-24 months post renovation)

Leverage: Total overall debt on property not to exceed 80 percent of cost for new construction or 85 percent of stabilized value for an existing property

How we can help you

- Land Acquisition
- Management Contracts/Lease Negotiation
- Financing – Construction, Acquisition, Renovations, FF&E
- Time share sales and marketing
- Condo Conversions
- Hotel Operations Review / Business Plan Review

Contact us

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