



Hedging Investment Risk Through Focused Due Diligence

Entering the New Year, hotel investors are touting equal parts **optimism** and **caution**. Statistics indicate that hotel transaction volume is down slightly, but pricing has remained stable. RevPAR growth is projected to slow after several strong years, yet anticipated growth still surpasses historical averages. The hotel development pipeline is beginning to swell, yet high construction costs and scarce financing have kept actual development below historical supply booms. While no one will deny that the hotel industry is cyclical and presently at the summit of Mt. Evergrowth, lodging fundamentals are still sound, even if we are coming off recent high growth levels. In today's market, ensuring continued profit growth in light of higher labor and fixed costs becomes increasingly more challenging. So, as we find ourselves in this state of **optimistic caution**, we suggest investors act accordingly – be optimistic about continued opportunities to invest, but review each deal with a keen focus on those areas with the greatest potential for vulnerability. CHM offers the following insight and strategies for assessing the risk profile of hotel deals in today's marketplace:

Get The Story

While historical operating performance provides the single greatest indicator for assessing future performance, it is equally as important to understand the environment in which historical results were achieved. Likewise, projecting the degree to which this environment may change in the future is key. For instance, you may be underwriting a "Steady Eddy" – same brand for years, decent product, and market RevPAR leader. Typical risk focus for this type of property might include identifying potential rival brands coming on line, property condition and renovation schedule/cost to maintain position, market rate ceilings and business mix opportunities for increased profitability. Maybe you are considering acquiring a "Born Again" – recent conversion to an up-market brand, recently renovated, and a new management team. Risk detectives here should focus on the ramp up time and post-transformation performance. How has the new product been received, does the management team have their act together, has the conversion unlocked new business mix opportunities, are they competing within a new set, what is the incremental rate potential and will the expenses associated with this brand be higher than historical levels? Getting to know a hotel's "story" and reviewing/projecting performance within that context will ensure a more focused assessment of risks.

Fixed Exposure

Getting comfortable with departmental profit margins is essential to preparing a risk adjusted proforma. However, unlike (most) operating expenses which can be flexed with fluctuations in business, fixed expenses are fixed....or are they? When reviewing historical levels of insurance, taxes, management fees or FF&E reserve contribution, it is important to remember that despite their name, they may not necessarily be "fixed". Take the time to understand the management agreement; is there a step up in FF&E? Does an incentive fee kick in once a performance threshold is reached? When was the last time the property was assessed or taxes challenged? Has a major renovation recently been completed? Any local change to tax rates anticipated? What about insurance? Do historical premium prices reflect a blended portfolio policy or corporate brand coverage that may in fact be eliminated upon sale or brand change? Does the current coverage reflect lender requirements? Simply carrying historical fixed expenses forward into the future presents a huge risk.

Investment Risks

Hotel performance is not the only area that presents risk or potential impact to price. Sometimes the initial investment is only the beginning. Working capital warrants careful review to understand historical spending practices, funding, seasonality of income, type of business accommodated and associated accounts receivable balances. Will the working capital stay with the hotel upon sale or will it require funding upon acquisition? Of course, there is always the issue of future capital requirements. Will FF&E reserve balances be sufficient to cover future projected capital projects? Does the capex plan meet brand specifications? And finally, there is always the ever changing investment climate..... debt markets, financing terms, and going in and terminal cap and discount rates.

CHM has a proven strategy for systematically facilitating the due diligence and highlighting risk factors throughout the entire process. CHM has advised investor clients on more than 250 hotel deals. Whether you are looking to acquire or sell hotels, we can help. Please call us today at 978.522.7000 or visit our website at www.chmhotel.com to learn more about our investment advisory services.

Ken Wilson
CEO

Chad Crandell
President



PRSR FIRST-CLASS
US POSTAGE PAID
PERMIT #59
BEVERLY, MA

548 Cabot Street
Beverly, MA 01915
978.522.7000 (telephone)
978.522.7008 (fax)

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Hope to see you at the ALIS Conference!

Baekey Is Back!

CHM is pleased to announce Mr. Geoff Baekey as our newest SVP of Asset Management. Although representing the newest member of the team, Geoff shares a history and close working relationship with senior management that spans more than a decade at various firms prior to this appointment.

Geoff brings more than 20 years experience in commercial and resort lodging, including historical hotels and major leisure destinations, recreation, and food and beverage strategic planning, asset management, business development, and operational analysis. For the past seven years he served as practice leader for a leading international, multi-faceted consulting company. During his tenure he was the principal point-of-contact for the Director of National Park Service Concessions and Senior Project Manager in spearheading the redesign of key business processes for the National Park Service Concession Program (NPSCP) where he was responsible for enhancing returns in excess of 100%.



GEOFFREY A. BAEKEY
SVP, ASSET MANAGEMENT

“As part of CHM’s long-term plan, we are heavily focused on growing the investment side of our practice, which in turn will increase the number of hotels for which we have responsibility,” said Ken Wilson, CEO of CHM.. “Further enhancing and expanding our asset management team with proven industry veterans like Geoff represents a strategic move as we prepare for the new economy and continue to focus our efforts on maximizing hotel value.”

Geoff will be based out of CHM’s corporate offices located at 548 Cabot Street, Beverly, MA 01915 and can be reached by telephone at 978-232-3609 or email at gbaekey@chmhotel.com.
