

Will full-service come full circle?

Hotel segment's lack of new construction projects helps keep industry's cycle strong

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Gary Stougaard [left], executive v.p. and chief investment officer, Sunstone Hotel Investors, and Mike Cahill, president and founder, Hospitality Real Estate Counselors and one of LIIC's co-chairs, participate in the LIIC roundtable.

limited-service sector, which includes Hampton Inn, La Quinta and Holiday Inn Express, among others. What's lacking on the construction front are 300-room full-service properties.

"I don't know where the end of the cycle is, candidly, because there are so few new full-service hotels being developed in this country—in fact, the only ones I can think of that are being developed, with very few exceptions, have some sort of government subsidy or some sort of advantage status, whether they have some free land or whatever," said Gary Stougaard, executive v.p. and chief investment officer for Sunstone Hotel Investors. "And even those are hard to find."

Part of the issue is that type of hotel is the hardest to entitle, the hardest to develop and takes the longest gestation. Therefore, they become substantially more expensive to build.

"Once we see those come on, the world's going to change," Stougaard said.

C.A. Anderson, executive v.p. of acquisitions and development for Interstate Hotels & Resorts, said construction costs will continue to keep a lid on full-service hotel development.

However, as the industry continues its robust performance in 2006, there will be changes in that pattern. Bill Blackham, president and c.e.o. of Eagle Hospitality Properties, said he expects the pipeline to look somewhat different a year from now.

"There's tremendous desire to capture this cycle on the part of creators of product," he said. "What you're hearing is a tremendous amount of skepticism because of the aggregate costs that are associated with the creation of the product. And notwithstanding, the point of the cycle that we're at on the rate side, the yield on cost doesn't seem to justify the creation of the product. That's why everyone is saying that it appears like the supply side will stay lower than the demand side for the foreseeable future, notwithstanding this pipeline that keeps getting diluted."

Because of the longer development period, full-service hotels are more affected by ebbs and flows in

NEW YORK—A sure indicator of when the lodging industry begins to have an overflowing construction pipeline is the number of full-service hotels in various stages of development.

Members of the Lodging Industry Investment Council, who participated in roundtables held in conjunction with the 28th Annual International Hospitality Industry Investment Conference in New York in June, said for the foreseeable future, the full-service hotel roster won't be having many additions, and that's good for the industry as a whole.

Mark Lomanno, president of Smith Travel Research, told attendees of one roundtable that the most construction is occurring with select-service brands, such as Hilton Garden Inn and Courtyard by Marriott, and in the



LIIC's mission

construction costs.

Mike Cahill, president and founder of Hospitality Real Estate Counselors and one of LIIC's co-chairs, said because numbers don't always pencil out correctly 18 months after a project is conceived and before the beginning of construction, developers are becoming more frustrated.

"We're getting people who come to us with first-class hotels, but we haven't had one that's been able to pencil out," he said. "It's always been, 'Go back to the city for some [financial] assistance' or, 'Do a tax-exempt bond deal.'"

The handful of large, full-service hotels that have opened recently, such as the Hyatt Regency Denver at Colorado Convention Center, benefited from locking into guaranteed construction prices before building.

"The actual true cost [of the Hyatt Regency Denver] was \$260,000 a key, under a guaranteed construction contract negotiated four years ago," he said. "Today, what would that hotel cost? The numbers don't match."

He said smaller full-service prototypes, such as the ones Starwood Hotels & Resorts Worldwide rolled out with its Westin and Sheraton brands, are attracting developers who think the 200-room hotel with 7,500 square feet of meeting space can get the rate premium needed for a project to work.

But developing those isn't an exact science either, given the rising cost of construction materials.

"We're actively involved with the aloft [Starwood's new select-service brand] development program, and when Starwood rolled out the program, they gave us kind of a benchmark of \$95,000 a key," Anderson said. "That was about a year or 18 months ago when we started engaging in discussions. We have two sites we're working actively on with construction drawings and we're finding that benchmark hasn't held true."

Cahill said new terminology is emerging as developers shift their eyes to full-service acquisitions.

"They'll come in and say they're going to be in at 25 percent of replacement costs when they buy, be in at 40 percent after they renovate it and at 70 percent when they exit," he said.

Stougaard said it's a matter of timing, and the timing sequence for acquirers is tough to predict.

"How much would you give to have a big box with 25,000 feet of meeting space, rather than 10,000 feet of meeting space, when you've got 400 guestrooms?" he said. "I'll tell you, I never, ever, ever thought I'd spend \$300,000 a key to buy an Embassy Suites, OK? And we did, and I don't think it's near replacement costs."

The glass is half full on many tables in the lodging industry.

"If you're a developer, you're optimistic," said Sean Hennessey, c.e.o. of Lodging Investment Advisors and a LIIC co-chair. "You think that it's your project that is going to be the one that is going to get the top price [when you sell]. That's what drives most full-service development."

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