The rapidly changing economic landscape has drastically reduced demand for resort and hospitality projects—and, along with it, the ability of developers to move forward on projects. As a result, these developers and hotel operators are being forced to reposition and rethink their strategies to adapt to the current market.

Amid the doom and gloom, opportunities still exist, many created by the necessity to step back and reevaluate project plans. Developers and resort/hospitality operators now are trying to anticipate the market’s mindset coming out of this cycle in order to prepare for a return to normalcy.

“Developers are looking for less capital-intensive methods to get projects started,” notes Jim Tinson, chief executive and principal of Hart Howerton, an international planning, design, and development advisory firm in New York City. He says he has seen an uptick in business from clients looking for conservative ways to get projects started while limiting risk and exposure. “This can include a step back from the megahotels into smaller, boutique hotels with an intense focus on experience and authenticity,” he says. “Developers are digging deeper to differentiate their projects and concentrate on delivering the right products at the right time.”

In the U.S. mountain resort world, operations are being hit as visitor numbers are dropping. A January 11 Wall Street Journal article, “Vail Says Fewer Skiers at Resorts,”

Retreat, Retrench, or Rebound?

The rules are changing daily as the realities of today’s economic turmoil take root in the resort and hospitality industry.
noted that even the stalwarts are facing dwindling revenues, with total skier visits down 5.8 percent, lift ticket revenue down 7.5 percent, and bookings off 14.8 percent at Vail Resorts’ five Colorado properties. Likewise, for the two weeks around Christmas and New Year’s Day, Aspen Skiing Co. reported an 8 percent decline in skier visits. “We believe the greater decline in ski-school revenue [roughly 20 percent] was due to lower guest spending on certain higher-priced items during their trip, a trend that was matched in lower check averages at certain of our fine dining restaurants,” Rob Katz, chief executive of Vail Resorts, told the Wall Street Journal.

In Steamboat Springs, Colorado, a new luxury condominium, hotel, and club product is taking a phased approach. The club component, St. Cloud Mountain Club—a members’ lounge with food and beverage services, private lockers, a ski valet, valet parking, and concierge services—is open for business with new members signing on, says Jamie Temple, principal of Momentum Partners, based in Steamboat Springs. This represents a marketing advantage for the condos and hotels to be developed in later phases, activating the St. Cloud brand in the marketplace while providing the firm the opportunity to rethink the design and market for their for-sale product.

Those involved in the development of resort and hospitality properties are taking varying tacks depending on their specific situations. Ed Mace, chairman of Mace Pacific, a development and hotel operating entity, places developers of distressed projects in three categories—those in the planning stage who own land but have not begun construction; those who have begun construction on a project but work is not yet complete; and those with recently completed projects still financed with a construction loan but looking for replacement debt or other refinancing.

While developments in the planning stage may have land acquisition loans to service, well-capitalized developers and their lenders will generally work through their valuation issues and continue planning to come out the other side of the cycle.

Developers with projects under construction need to complete their projects to satisfy completion guarantees and/or to get residential sales contracts in escrow—in those instances where buyers are not walking away or suing for return of deposits. The most difficult situations may be those involving recently completed projects with construction loans maturing and no takeouts or replacement financing available. In situations such as these, developers need to be creative. For example, Mace says he is involved in a resort condominium project—in a good location but that remains unsold—that is being converted to a hotel as a holding strategy until the residential for-sale market returns.

Many developers who have already started construction are, quite simply, in trouble. According to Smith Travel Research, 93,219 hotel rooms had been abandoned in the construction pipeline this past November, an increase of 75 percent from a year earlier. This increase is due both to lenders renegotiating financing terms and developers deciding to wait out the storm.
Jan Freitag, a vice president with Smith Travel Research, predicts that occupancy for domestic hotels will drop 3.9 percent this year.

In the United States, the number of projects in the construction pipeline fell 4 percent and the aggregate pipeline room count sank 6 percent between the second and third quarters of last year, according to data from Lodging Econometrics’ third-quarter 2008 study. Similarly, the number of projects in the pipeline in Europe, the Middle East, and Africa declined by 6 percent and the number of rooms by 4 percent; in Latin America, those figures fell 4 percent and 7 percent, respectively. Most severely hit is the Asia Pacific region, with construction projects down 8 percent and rooms in the pipeline down 11 percent.

Projects built during the up cycle that were completed under a construction loan are finding it extremely difficult to obtain permanent financing. For projects with residential components, this is attributable in large part to a lack of residential sales. Even in instances where there are some presales, developers are unable to collect those revenues until the project is complete. Exacerbating the situation is the fact that values on second homes have fallen so much that many buyers are walking away from deposits as high as 20 percent.

For those able to get financing, the terms have changed: they are seeing deals that require 40 to 50 percent equity and recourse—a sizable change from nonrecourse loans requiring 10 to 20 percent equity, which were available before the real estate slump. Developers currently cannot rely on presales to offset development costs, points out Temple.

Instead, developers and lenders are creating partnership relationships that could be beneficial when the market emerges from its doldrums, although even those terms are changing. One hotel developer in Latin America says he was planning to expand an existing property, but the lender wanted to increase the rate on his debt from LIBOR (London Interbank Offered Rate) plus 325 basis points to LIBOR plus 1,000. As a result, the developer has shelved the expansion plans and, instead, has shifted his focus to extracting maximum value from the existing asset.

Such shifts in how money is spent can be expected in Latin America, says Brian De Lowe, vice president of acquisitions and development for the Los Angeles–based KOR Hotel Group, a developer and operator whose hotel brands include Viceroy and the Tides. “Rather than using the previously funded equity funds on predevelopment—architecture and engineering, permitting, and the like—for an expansion, we are using funds to make improvements to the existing resorts, including enhanced programming and improvements to the beach experience, the bedding experience, and the food and beverage experience,” he says.

Large equity contributions alone are not sufficient to obtain financing these days. “To get a new construction project financed, you’d have to have something really extraordinary in the way of spon-
John Bralower, president of the hospitality group at Carlton Advisory Services Inc. in New York City, told GlobeSt.com in early January. “Also, a lot of the development over the past few years on the hotel side was driven by a link to residential, and that has slowed down worldwide as well.”

These residential resort projects are being hit especially hard. As many note, the second-home market is often among the first to suffer in a downturn—and among the last to recover as the market comes back. At the luxury level, the notion that the high end can remain immune from downturns is proving simply to be wrong. The hurdles today are daunting: absence of residential buyers, an anticipated (and in many cases, already present) dearth of hotel customers, and the freeze-up of the credit markets and subsequent unavailability of debt.

Some subsectors within the second-home market will recover earlier than their resort counterparts, predicts Darren Linnartz, principal with Green River Partners, a Washington, D.C.–based owner/developer of hotels and hospitality-anchored mixed-use projects; among the projects he has worked on are Ritz-Carlton Bachelor Gulch in Avon, Colorado, and Montage Resort in Laguna Beach, California. Those subsectors include more approachable products with lower acquisition and carrying costs. “The three- or four-bedroom ‘cottage’ will be a much better seller than the 5,000-square-foot [465-sq-m] ‘estate home,’” he maintains. “Projects that are within driving distance of major metro areas will be among the first to rebound; those that are less accessible—e.g., offshore—will be the last to come back.”

In general, though, hotels are expected to rebound before the second-home market, so having the right operator becomes even more important as a differentiator in a hospitality industry unlikely to emerge quickly. Linnartz is direct when describing the importance of brands such as Ritz-Carlton, Four Seasons, or Hyatt. “Branded hospitality will win out over independents,” he insists. “In a downturn, global lodging brands, which have made significant legacy investments in distribution, will grow their revenue premiums at the expense of independent hotels and lesser-known chains. If your project includes a globally recognized hotel brand, prepare to be duly rewarded. Otherwise, get one of the scarce globally recognized brands before your competitors do.”

Brands, as advantageous as they can be, present their own challenges, however. Deal terms are usually fairly rigid and expectations of the developer relatively unflinching. Compared with those of independents, brand agreements are generally of longer duration, product and service standards are generally less flexible, and fees are usually higher. But, again, there are tradeoffs, because “the top brands will significantly outperform the overall market in a downturn,” says Linnartz. Such proven performance will also make it easier to attract debt and equity—a major advantage in today’s market.

However, after this downturn, there will be hotel and resort opportunities worth a cautious look. Mace points out that the issues plaguing projects today are more the result of timing than of poor products. Because entitlement processes are so demanding and require so much thought and input, the final outcome is usually more thoroughly considered and locations and construction are generally of high quality. When the business cycle turns positive and the economy improves, these products will last, he says. Resort and hotel properties developed very recently “will have a future and will have a life. They will change hands and people may lose money [in the short term], but these assets will come around,” he predicts.

The areas most likely to emerge more quickly are those closest to major metropolitan areas, Mace believes, and even now their numbers are experiencing only a slight downturn. Areas requiring extensive air travel are in a more perilous situation. As travelers forgo their regular vacation spots, such as Mexico, they will turn to Palm Springs, California, which Mace calls the “drive-to destination” for southern California, and Florida, the destination of choice for the Southeast, he says. “It may be a relatively tougher year for harder-to-reach destination resorts in Mexico, the Caribbean, and Hawaii,” he adds.

Even though much of the resort world is wading through uncharted waters, some basics of the business are still important to track, says David Jones, partner in
In Latin America, some hotel operators are focusing on improving existing resorts through enhanced programming and improvements to the beach experience, the bedding, and the food and beverage offerings.

the real estate practice in the Charlotte, North Carolina, office of K&L Gates. Chief among these is understanding the entitlements in place for a site. Developers must assess whether they are able to refocus their projects under approvals already in place or whether new entitlements will be necessary, he says. Developers also will need to determine whether other governmental commitments need to be revisited. Especially in emerging markets, where development may carry incentives, a change in project parameters may affect such agreements and, therefore, project returns.

Keeping close tabs on existing projects and remaining flexible are the only way for active developers to weather this storm, says Dan Ford, development manager in the Asheville, North Carolina, office of DPS Development. His firm has multiple financial and development checkpoints throughout the development process at which it objectively views project performance, he says. “While our phasing plan is drafted as the preferred direction we hope the project takes, the timelines associated with each phase are such that we can quickly shift our focus and development efforts,” says Ford.

While the market abyss is dark and deep, there is a bottom that developers hope will be reached sooner rather than later. Until that bottom is reached, however, a return to the principles and fundamentals of real estate is the best approach to mitigating today’s difficulties. Now, more than ever, resort and hospitality developers need to stay alert, flexible, and proactive. UL

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