HOTOUR Publication on project development

The ten most serious mistakes in hotel project development

Mistake no.1
Personal vanities as investment drivers

Not only in the game of Monopoly, hotels represent the top asset class of real estate. Project developers, investors and hoteliers are also tempted to make expensive vanity mistakes in real life, as is the case with only a few other investments. Hotels in the four- and five-star category are particularly susceptible to satisfying personal prestige. After all, it is not uncommon for them to serve as a prestigious stage to socially ennoble one or the other career. But it is precisely the particularly capital-intensive and complex hotel that generate the lowest returns in the first four to five years.

Mistake no. 2
The wrong team

The know-how of an investor who - just because he has travelled widely - finds himself to be experienced in hotels is no guarantee for the success of a hotel. This even applies to cases in which he is assisted by architects and a future hotel manager. In order to be able to correctly adjust the decisive set screws - market and location evaluation, hotel concept, size, category, room concept and profitability - already in the start-up phase of the project, a well-founded expertise is required at an early stage, which only an interdisciplinary team of hotel experienced professionals can offer. However, these are often saved due to thriftiness, ignorance or false vanity.

Mistake no. 3
Incorrect assessment of the market

Particularly popular bankruptcy properties can be found in the picturesque location "in the middle of nowhere". With a lot of imagination and naivety, markets are often constructed for locations beyond all agglomerations or holiday regions: Conspicuously often, manors and castles appear to be suitable for the use as seminar and wellness hotels. After all, every investor believes to know a hotel in a "no-name location" that has successfully asserted itself. There is no doubt that there are concepts that also have their market in decentralized locations. But these must be excellent concepts! And this can only be achieved - if at all - by exceptional hoteliers with far above-average commitment.
But even in the city hotel industry, errors in market valuation are one of the most common causes of ailing investments. Here, however, it is usually misjudgements of demand and inadequate research into the current and future competitive situation that ultimately have a costly effect.

Mistake no. 4
Incorrect assessment of the site

At "no-name locations", the business model is determined by the concept. In large and small cities, the location is already the business model. The location and size of the site are the decisive factor - for example, for a small, fine luxury hotel or a large-scale congress hotel.

In addition to the investment ruins in the eastern part of the German republic, there is a conspicuously large number of bankrupt properties in poorly developed industrial areas, unfinished office parks or barely locatable side streets. Even "one-dimensional" hotel concepts that rely exclusively on neighbouring congress- or exhibition halls, for example, are high-risk.

Mistake no. 5
Immature concept

Problem hotels generally have one more thing in common: they lack a well thought-out concept that has been developed strictly on the basis of the correct market, demand and location assessment. The very personal taste of individual project participants is usually given priority over the needs of the market and the expectations of the future guest. This applies to less taste lapses. Although these are annoying, they only reduce turnover to a certain extent and are risky. Rather, it concerns the major conceptual lines - for example, the location in the industrial estate where a first-class hotel with 150 rooms and a conference centre is being built, but where a one-star budget hotel would actually be in line with market requirements.

Mistake no. 6
Too high investments

This fundamental mistake in the conception is now naturally reflected in the profitability: With the low-priced demand at this location, the debt service for a high-priced hotel property cannot be earned. In this case, the statement "only profitable after the third bankruptcy" is fully true in terms of content. This fundamental mistake results mainly from mistake no.1: Many developers cannot or do not want to understand the merciless simplicity of an economy hotel required in simple locations and unnecessarily increase the investment with every planning meeting.

Mistake no. 7
Overrun of the construction budget

But even with properly designed hotels, excessive real estate costs are often the root of all evil due to a lack of expertise, professionalism and discipline in the planning and construction phase. Hotels are already burdened with a high block of fixed costs (above all personnel costs) due to their operation and, in addition, need up to four years start-up time to really achieve stability in the market. If the investment-related costs - rent or debt service - exceed 25% to 30% of the achievable turnover, depending on the concept and location, things become critical.

Mistake no. 8
Selecting the wrong operator

Also the choice of the wrong operator has already ruined many hotel investments. Serious hotel companies immediately recognize critical projects and reject them. In the early 2000s, characterized by stormy project developments and 100% financing, operators with a desire to expand were found even for projects without any chances. Driven by the idea of developing "new" locations and supposedly lucrative earning opportunities, they were willing to enter into risky high fixed leases through so-called technical assistance contracts even in the planning phase.

In the current economic situation these rents can no longer be earned. Unfortunately, renegotiations and changes of operator then bring the market-driven lease to light, much too late.

Mistake no. 9
Incorrect financing

Objects of bankruptcy are - or rather were in times before Basel II - not infrequently also wrongly financed. The most frequent causes: land bought at too high a price, interest rates too high, too low equity share or critical fund concepts.
Some private hoteliers, even if they have exhausted their investment credit for the renovation of the hotel, often use the current account credit for the purchase of loose furniture or small inventory. Thanks to KfW's initially redemption-free promotional loans, many hoteliers have lied in their pockets in the first few years and, when the repayment is due, slide into the first liquidity crisis, which often continues.
Holiday hotels that are sold as partly owned properties or as closed-end real estate funds via KG or BGB company shares often suffer in their development from the "many cooks spoil the broth" mentality of investors from outside the industry. By the time a hundred dentists, lawyers and master butchers have decided on a new wellness facility, hosts of competitors, capable of acting, have already taken the lead.

Mistake no. 10
Underestimating the initial phase

Depending on the location and concept, hotels have an initial phase of up to four years until they have achieved a stable occupancy rate and can retain customers in the long term by means of a sufficient number of occupancy agreements. During these years, the hotelier is usually not yet able to pay the full lease or earn the debt service - a fact that is often not taken into account in the financing concept and business plans. Private hoteliers are often brought into spin by this.

Conclusion

Objects of bankruptcy are mostly based on serious management mistakes of the developer, if one disregards fraudulent intentions. Thus, mistakes 3-10 are automatically eliminated if mistakes 1 and 2 do not even happen.
Since hotels are particularly complex operator properties with comparatively low initial yields and an increased risk in the first years of operation, they only forgive conceptual mistakes in exceptionally good locations.
However, a professional team can set the right course to minimise the risks in the critical start-up years on the one hand and to ensure the value of the hotel on the other. In the long term, a hotel in the right location with the right concept and the right operator will beat any office property in terms of value appreciation.

HOTOUR Hotel Consulting GmbH, based in Frankfurt, was founded in 1970 and is one of the oldest and most renowned management consultancies for the hotel and tourism industry in Germany. The main focus of its activities is on advising banks, institutional investors and project developers on all questions relating to the purchase and sale, development and revitalisation of hotels. www.hotour.de