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# 'CapEx Conundrum' requires balancing act

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## Story Highlights

- CapEx spending is anticipated to increase for the first time since 2008.
- There is no easy answer or quick fix to the CapEx Conundrum.
- Brands have signaled that new owners will be expected to fund not only deferred CapEx but new brand standards to keep the flag for the next 10 years.

Cautious optimism surrounds the industry as owners and operators look to 2012 as a recovery year fueled by average daily rate, providing long-awaited profit growth and a collective sigh of relief. But while we would like to remain focused on better years ahead, hoteliers now face the ramifications of significant deferred capital expenditures and a hefty price tag to catch up.

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This issue impacts all facets of the industry, and the consequences are far more reaching than dated carpet in the corridor. Deferred improvements stand to impact not only product and positioning, but also investment returns and pricing, as owners grapple with the multi-million dollar questions: "How much?" and "Who's going to pay?"

According to a recent industry study, CapEx spending is anticipated to increase for the first time since 2008. In short, time's up, and the industry is now forced to deal with the "CapEx Conundrum," which impacts all stakeholders, each with varying issues and objectives.

**The operation**
The industry has long speculated that the 4 to 5% of total sales, historically reserved for renovation, is not enough to cover growing capital costs and mounting brand standards even during the best of times. Enter the recession and the combination of significant decreases in revenue, which forced owners in some instances to draw on reserves to cover debt service, leaving many hotels with insufficient funds. Competitively, now is the ideal time to hit the market with a renovated product to take advantage of prospective rate gains. Those that do not likely will lose market share as we move through the economic recovery.

**The brands**
Brands recognized owners were operating largely in survival mode the last few years and, as a result, brands allowed owners to defer many projects as debt service took center stage as the main priority. Today, from a brand perspective, it is time to dust off the capital plan and reinvest. Not only are brands looking to owners to play catch up and fund deferred projects, but many are looking to implement new projects aimed at differentiating product through enhancing brand standards and improving market share. New lobby designs, enhanced technology packages and concierge lounges are just a few of the new brand initiatives underway that owners will be expected to fund during the coming years.



**The owner**
We might have survived the economic collapse, but the costs to recover are significant. Just as profits are expected to come back, the capital cost and potential business interruption associated with renovations looms heavy in 2012. There will be increasing pressure to spend in order to comply with brand standards and remain competitive, which for many owners likely will necessitate a dreaded "out-of-pocket" experience. For those owners looking to hold on to assets, the investment possibly will garner a return as the hotel industry moves further along the recovery track. However, funding in the short run could be problematic for many owners still recovering from the cash crunch.

**The investor**

Prospective buyers will be looking much more closely at a property's condition and anticipated brand-property improvement plan before determining a fair price in today's investment climate. With depleted furniture, fixture and equipment account balances and several years of deferred capital spending, sellers can expect a larger price deduct for capital improvements that will impact returns. Further, buyer risk associated with performance impact of a renovation could deflate pricing or transaction activity.

**The answer?**

There is no easy answer or quick fix to the CapEx Conundrum. This issue will be a balancing act between all stakeholders to enhance product, gain market share, capitalize on rate growth and replenish reserve balances today and for the future. However, the brands have signaled that a "CapEx true-up" can be expected when a hotel is transacted, with a new owner expected to fund not only deferred CapEx but also new brand standards to keep the flag for the next 10 years.

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