

# Special CapEx Considerations for the COVID-19 Era

Prepare for Inflation on Raw Materials, Logistics



By [Alan Benjamin](#)  
HNN columnist

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As we slowly exit the effects of COVID-19 on our industry, three approved vaccines, pent-up demand and basic personal and business necessity will provide recovery to all segments of travel. As reported in HNN and other industry sources, demand has already begun to return in the leisure segment, to be followed by corporate and group demand.

Meanwhile, many hotels have had a “half year” of wear and tear on the interiors during 2020 – the roof, parking lot, HVAC and other exterior and structural elements of the building all aged normally, regardless of actual occupancy – and now are in need of capital expenditure to resolve those issues.

The guests we are welcoming back will have discerning eyes for anything not up to par. Hotels cannot afford to be physically dated or in disrepair, given the vast sharing of information and rankings on social media.

## CapEx Will Be at an All-Time Peak in 2022–24

- Pre-COVID-19, some CapEx work that was due in 2019 was not completed for various reasons, as owners and asset managers may have been in talks to change brands, arrange financing or sell the asset.
- There is a copious amount of deferred work from 2020-21 due to economic necessity. For the first time, I am aware of some lenders who have even granted permission to use the once “lock-boxed” 4% to 5% CapEx reserve for more immediate expenditures, leaving no available funds for CapEx.
- All of the scheduled CapEx needs from hotels that opened or were renovated in the last five to seven years will be due between 2022 and 2024.
- There will be CapEx demand from new owners tied to change of ownership property improvement plans, finally exercising the massive amount of cash on the sidelines.
- Enforcement of brand standards will come back very strongly and very quickly. In the U.S. alone since 2015, 114 new hotel brands have been introduced. Worldwide since 2015, more than 300 new brands have been introduced. Today there are more than 600 hotel brands in the U.S. — 20% more than six years ago. All these brands must differentiate to remain viable.



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## What Does the New CapEx Environment Look Like?

First and foremost, owners must not be enamored with a low number on a spreadsheet, whether from a vendor or a consultant. The laws of commerce have not suddenly changed. If something looks too good to be true, it is. As one client asked, is there a “30% off sale” from 2019 furniture, fixtures and equipment costs? Well, maybe, but not with any vendor we want to do business with today. Now is a time for a flight to quality and for careful consideration of the risk/reward scale for every purchase decision.

Next, despite what our industry has endured, be prepared for inflation on everything from raw materials to logistics. While I hope the current container cost increase — three to four times 2019 costs — will be balanced, we may not see the pre-2019 costs again. In terms of demand for interior furnishings, construction materials and labor, our industry makes up a very small part of the overall global supply chain. Other sectors, such as residential, multifamily, senior living and commercial

construction, did not hit pause with COVID-19. In fact, they have been accelerating. All of us in the hospitality industry must compete globally for production time, labor and materials.

Rather than a CapEx sale, many costs will actually rise. Also rising are lead times that will be longer than ever. While a great purchasing firm can use its vendor relationships to get an owner to the head of the line, the line will be longer for the A-list vendors that have the best combination of attributes we all want.

### **How Should Owners Navigate This New Environment?**

- The project manager, general contractor, architect, interior designer, purchasing agent and vendors all need time to perform. We do not charge any more to be hired early and we can do a better job the sooner we are engaged; ideally, the same time as the interior design firm. Engaging your purchasing team early allows them to share the most up to date information on vendors to use and more importantly in this cycle, vendors not to use.
- While hiring early, retain the best project team you can find, not the cheapest.
- Have the property improvement plan scope already negotiated with the brand so that the team can start immediately on the project.
- Global sourcing is not going away. Given the recent world events and container costs, we do have clients asking to buy less from Asia, and for many items, we are able to do this with little to no cost increase. However, the entire world today is living with a global supply chain. Lighting that is “Made in the USA” probably has component parts from all over the world, mostly from Asia.
- Maintain the foresight and fortitude that got you and your hotel through the period of record-low occupancy and prepare wisely for a great recovery.

Bring on the recovery and let your purchasing firm help manage your CapEx cycle concerns.

*Alan Benjamin, ISHC, is President and Founder of Benjamin West ([www.benjaminwest.com](http://www.benjaminwest.com)) and is the world's leading hospitality FF&E and OS&E expert.*

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