

UNDERSTANDING HOTEL REAL ESTATE INVESTMENT

Part 4 – Implications to Consider

Introduction

This is Part 4 of a four-part series intended to provide an overview about the hotel industry. This article will address a variety of other matters that impact the business of hotels.

Ratings & Ratings Services

Though there is a great deal of "noise" about hotel ratings, industry insiders shy away from using them, other than those conferred upon recipients by the two long-standing and well-recognized "rating agencies" – Forbes Travel Guide and the American Automobile Association. Both Forbes and AAA have a history of widespread recognition as rating services in the hotel and broader hospitality arena. Forbes is global in scope, and AAA is mostly domestic (Canada, Mexico, Central America, and the Caribbean).

Forbes Travel Guide (formerly known as Mobil Travel Guide) originated in 1958, and it became a standard for rating hotels. Having undergone several changes over the years, including a name change in 2009 and adopting an exclusive focus on the higher-end hotels globally in recent years, Forbes Travel Guide Ratings have become both an industry benchmark and its annual pronouncements, an industry event.

AAA Diamond Ratings are published annually by the American Automobile Association for hotels and restaurants in the US, Canada, Mexico, the Caribbean, and Central America. AAA evaluations have been published annually since 1937 and ratings, ranging from 1 to 5 Diamonds, since 1963.

Forbes publicly identifies its Standards Advisory Committee, a broad and deep

hospitality expert group with hundreds of years of combined experience. It uses professional inspectors to apply a rigorous list of standards developed over the years and constantly being modernized for changes in the hotel industry itself. AAA identifies its standards publicly in a comparatively voluminous booklet (available online), applies both physical standards and operational standards, and utilizes professional and trained inspectors to assess hotels according to those standards.

Claims of "five-star" status that are not supported by a Forbes rating at that level are simply claims. Yelp, TripAdvisor, and similar online providers offer "star" ratings by accumulating consumer ratings and presenting them to the public, along with comments by individuals posting their impressions and experiences. These ratings may have value for consumers, but they are not rating services. For example, hotels operated under Marriott's Luxury Collection may not be – and for the most part, are not – recognized by the rating services as "luxury." Claims of "luxury five-star" may sound good but, if applying Chain Scale and Forbes ratings, might be neither.

Accounting Methodology

The hotel industry, like many other industries, has its own accounting system, broadly in use in the United States, called the "Uniform System of Accounts for the Lodging Industry ("USALI")." USALI 11th Revised Edition

became effective as of January 1, 2015. Published originally by the Hotel Association of New York and now jointly published by the Hotel Association of New York, the American Hotel & Lodging Educational Institute and Hospitality Financial and Technical Professionals (the international association of, well, hospitality financial and technical professionals), USALI is the "bible" for hotel accounting; changes to it are greeted with interest and, occasionally, enthusiasm or dismay. However, as its Introduction states, *"The information . . . in this uniform system is based on a consensus of [industry participants, including] academia and certified public accountants, and is intended to be consistent with accounting principles generally accepted in the United States of America (GAAP)."*

There is no requirement (except, perhaps, those imposed by lenders) to utilize USALI in any hotel property or group of properties. However, as with any "standard," the more consistent the reporting, the less confusion created for one trying to understand hotel operations. Transactions today require (nearly universally) financial presentations consistent with USALI, and it indeed has become the gold standard for hospitality industry financial reporting.

Asset Management

Institutional investors typically have either a dedicated in-house asset management function or an outsourcing relationship with one of the specialized asset management firms serving the hotel industry. In the case of hotel asset management, one refers to property level oversight and operational and capital expenditure decision-making by the management company, whether brand or third-party management, rather than only an overall portfolio approach. Hotel asset managers understand both investment rationale and hotel operations and provide

their investment company employers or clients an expert to act on the owner's behalf in dealing with the management company and its day-to-day operational functions.

Third-party asset managers offer granular service to their owner clients. They regularly interact with on-site management in every aspect of the hotel's operations, from engineering/maintenance to human resources to sales and marketing and the hotel's broad utilization of brand resources. They offer a valuable monitor on the daily operations, and they are experts in poring over the various reports generated from a hotel. As mentioned in **Part 2**, the asset manager with a broad portfolio of brands can bring best practices and benchmarking capabilities to bear across all the brand families to benefit their clients. A qualified hotel asset manager is a valuable addition to the investor's team. The industry association, Hotel Asset Managers Association, has become an industry force, with its membership (numbering about 200) limited to individuals and not their employers.



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