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CHMWarnick takes a look at STR's new competitive set guidelines

by *Chad L. Crandell* | May 19, 2016 11:15am

STR has been, and will continue to be, one of the most sought after source of supply, demand and overall performance data for the hotel industry. For the past 30-plus years, STR's core product, the STAR Report, has graced the desks and passed through the hands of many: general managers, revenue managers, asset managers, prospective buyers, brand representatives and legal advisors, to name just a few.

The competitive sets and resulting data in these reports receive a lot of scrutiny over the course of an investment, and serve not only as a comparative measure of performance, but also as the basis for many of the legal agreements surrounding each deal.

In an effort to preserve confidentiality and integrity of client data, particularly in light of recent and widespread consolidation of industry brand companies, STR announced in April 2016 a new set of guidelines for determining eligibility of competitive sets. The new guidelines are summarized as follows:

- No single **property** nor single **brand** can comprise more than 50 percent of the total room count, excluding the subject property and other properties from the same company as the subject.

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- No single **company** can account for more than for more than 70 percent of the total participating room supply of a competitive set, excluding the rooms of the subject property and other properties from the same company as the subject.
- Sets must include a total of **four** properties, excluding the subject, and a minimum of **two** companies, excluding the subject.

Source: STR –Version 1.1. Last updated April 25, 2016.

Chad Crandell, CEO of CHMWarnick

A more complete version of STR's guidelines, STR's Competitive Set/Trend Report Guidelines, goes on to detail more specifically how set sufficiency and composition will be evaluated, along with other requirements regarding location/vicinity (no isolation of properties), multiple set runs and modifications to existing sets. The new guidelines go into effect January 1, 2017.

So, how do you know if your hotel's current competitive set is non-compliant with the new guidelines, and more importantly, what are the implications if they are? STR has indicated that a member of their Client Services team will be contacting those hotels that currently run sets that do not meet the new guidelines.

When it comes to understanding how these new guidelines could potentially impact owners, and in particular our clients, we wanted answers right away. Our asset management team developed a model for testing, at least on a preliminary basis, which competitive sets would be in violation and for what infraction—sufficiency, composition, brand, company...the list goes on. We then assessed what the potential implications would be both to the property teams relying on data to manage day-to-day performance, as well as at the asset management and ownership levels.

Results

We ran 55 competitive sets from our active asset management portfolio. Our sample included 50 hotels (some with multiple sets) comprising approximately 20,000 rooms, evenly distributed amongst major brands and geographically located throughout major markets in the U.S.

We were somewhat surprised to learn that the new guidelines only impacted about one-third of the existing competitive sets tested. However, those that came up as non-compliant, did so on multiple levels. Of the 17 competitive sets that were non-compliant, 10 had issues on the property

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check (meaning one of the competitive set hotels exceeded 50 percent of the supply, calculated exclusive of the subject and other hotels in same brand company); and eight were not compliant with the company check (too many hotels from the same brand "company"). Of those sets that were identified as non-compliant on the basis of having too many rooms from the same brand company, six of them are in violation as a direct result of the Marriott/Starwood merger.

Owner Implications
So, what does all this mean for owners?

- "Comparable Hotels" identified in management agreements serve as the basis for measuring management's effectiveness and are typically tied to performance test clauses. They sometimes come into play in management incentive fee calculations, which incorporate a RevPAR index hurdle.
- Competitive set changes will set into motion a series of challenges for owners who will no longer be able to measure performance and exercise rights with respect to existing "Comparable Hotels" as originally documented in the hotel management agreement.
- Additionally, the new, compliant competitive set may necessitate a revised RevPAR index hurdle that will likely be different than previously negotiated, depending on the quality and degree of competitiveness of the newly comprised set of hotels. We foresee disagreements (disputes), both on the set and performance target, to be a challenge on the near horizon.
- Ultimately, changes will necessitate some level of re-negotiation with the brand/operator of the competitive set and key provisions surrounding performance, resulting in revisions to the hotel management agreement (time and money). Unresolved differences will lead to arbitration or possibly even litigation.
- Even when owners and brands can agree on a new, STR-compliant competitive set, they may be required to add hotels that are not deemed directly competitive, as well as deleting those that may have been preferred, in order to arrive at a compliant competitive set. If settling for a less than optimal set, management will need take that into consideration and adjust accordingly when setting performance targets and analyzing data.
- As it may be difficult to arrive at one compliant competitive set, multiple-sets, historically utilized to gain greater market perspective, may be a thing of the past.
- On the investment side, prospective buyers will also have to heavily scrutinize competitive sets when evaluating deals, to ensure the data is reflective of the true market for which they are buying into, as well recognize that additional set modifications may be required based on the timing of acquisition.

What Should Owners Do About It?

- For starters, you need to know where you stand. Determine what changes, if any, will be required to your hotel's competitive set(s).
- Get in front of the issue and begin strategizing on what changes you would make to the competitive set and proactively engage in dialogue at the property and brand level.
- When evaluating modifications to your set, make sure you consider factors such as location, quality level, size, facilities/amenities, seasonality and mix of business, not just occupancy, ADR and RevPAR.

- Determine your exposure. Understand how changes to your hotel's competitive set will impact consolidated performance and the ability to effectively evaluate management's revenue management strategy for the hotel in future.
- Consult legal counsel as you begin to negotiate with your operator and prepare for amending the hotel management agreement. Likewise, determine a strategy for any properties that already may be in a period of performance failure to understand how these change may impact ownership's ability to enforce a cure (often a two year test) or other remedies.
- Outline an action plan, from analysis through to implementation, keeping in mind the timing of changes.
- Lastly, as with anything, there are many moving parts to this equation. Keep tuned in and consult regularly with experts, particularly as the Marriott/Starwood merger continues to unfold and STR ramps up to roll out their new guidelines.

Our Take

As an industry, we are forced to adapt to many changes and this is just another one along the spectrum. The key is to stay close to the issue, understand the potential impact and proactively strategize to preserve and protect ownership rights and investment returns. As asset managers representing a wide-range of hotel owners, our objective is to make sure whatever changes are made fit into the long-term strategic plan. We also will use this as an opportunity to re-establish expectations with the brand and property teams, while ensuring fair share (and even above) performance is maintained. It is important that management not get complacent in the face of changing metrics and that the brand is fully supporting performance above the property level, providing continued value for the cost associated with having the brand.

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About CHMWarnick

CHMWarnick is a provider of hospitality asset management and ownership advisory services in the U.S. The company currently advises a client portfolio of more than 50 hotels with 20,000 rooms, collectively valued at $10 billion.

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