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Examining Select Service Hotels: A Unique Alternative Investment Product

In 2023, the U.S. economy demonstrated its resilience by recording positive GDP growth each quarter, despite the elevated interest rate environment that has increased borrowing costs for businesses and consumers. However, some economic forecasts indicate the situation could change in 2024 and a recession might occur. The fluid nature of the economic situation makes this an ideal time for investors to consider a product that has the potential to generate attractive risk-adjusted returns and consistent cash flows. A unique alternative investment product that meets these criteria is "upscale" select-service hotels.

Features and Attributes

The leading hotel research firm, STR, categorizes hotels by "chain scale." Chain scales are based on the average room rates of the major hotel chains and are divided into luxury, upper-upscale, upscale, upper-midscale, midscale, economy, and independent segments. Hotels are then classified further into budget, extended-stay, limited-service, select-service, and full-service segments. Select-service hotels are positioned between limited-service and full-service hotels. They are generally upscale or upper-midscale and are distinguishable from full-service hotels by having smaller and fewer rooms (which leads to lower fixed costs), fewer food and beverage options, and fewer amenities. Select-service and limited-service hotels share some features, but traditional limited-service hotels offer fewer amenities than select-service hotels, cater to guests seeking a lower price point, and typically lack a revenue-generating food and beverage component, such as a restaurant or café.

Travelers like select-service hotels because the standards franchisors such as Marriott and Hilton require of them give guests a high degree of confidence that for a reasonable price, they will be staying at a well-maintained property, with well-kept rooms, and limited, but attractive amenities; such as light food and beverage options, a fitness center, business center, pool, and a modest amount of meeting space. Investors like select-service hotels because having fewer rooms than full-service hotels allows them to avoid heavy discounting solely to build a customer base, their fixed operating costs are lower than full-service hotels', and they possess a unique ability to capture demand from "move-up" guests when the economy expands and "move-down" guests when the economy contracts. The ability to attract both sets of travelers during different economic periods gives select-service hotels a higher floor on room demand during recessions and a higher ceiling on room demand when the economy expands. Examples of select-service hotels include Courtyard by Marriott, Element by Marriott, Hilton Garden Inn, Homewood Suites by Hilton, Residence Inn, and Hyatt Place.

The Outlook for Select-Service Hotels

The U.S. hotel industry, which was severely impacted by pandemic-era shutdowns on travel and movement in 2020, has recovered in several respects since then. In 2023, occupied room nights are projected to exceed 2019's for the first time since COVID-19 emerged, while average daily room rates and RevPAR are also projected to exceed 2019's figures. The hotel segment's recovery from the pandemic is further supported by NCREIF's property index, where hotels have recorded the highest returns of any of the major real estate asset classes during each of the last four quarters. Within the hotel segment, select-service hotels are well positioned for growth because of their strong fundamentals and limited new supply due to financing constraints for new construction. Investors who are seeking a product with the potential to produce attractive risk-adjusted returns and consistent cash flows should strongly consider allocating capital to this segment of the commercial real estate market.

ABR Capital Partners, LLC

ABR Capital Partners (ABR) is an independent real estate investment manager specializing in core-plus, value-add and opportunistic investments. ABR takes a focused yet flexible approach regarding market, property type, and capital structure, with a goal of maximizing risk-adjusted returns at the asset and portfolio level. Visit abrcapital.com for more information.

Debo Ayeni
Director of Research and Data Analytics
debo.ayeni@abrcapital.com

Thomas Burton
Senior Managing Director/Chief Investment Officer
tom.burton@abrcapital.com