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Feasibility Studies: Fact or Fiction

Recently, the trade press has been buzzing with articles addressing the topic of hotel feasibility studies and whether they accurately portray the future operating results of a proposed hotel. As a provider of feasibility reports, I feel compelled to provide my point of view on this hot issue.

Hotel developers typically use feasibility studies to support their predetermined conclusion that a proposed hotel, if built, will be an economic success. These studies are necessary to provide third-party confirmation, along with the necessary credibility, to secure both debt and equity financing. Most feasibility studies include an analysis of the local market demand and competitive supply. The contain a forecast of income and expense and an economic valuation to justify the feasibility conclusion.

Are feasibility studies accurate? They probably are at the time they are performed. But hotel markets are highly dynamic, and unforeseen changes such as the addition of new rooms, a downturn in the local economy or changes in the transportation patterns can have a devastating affect on a hotel's future operating performance. With all these interrelated factors (positive and negative) occurring in a highly random pattern, predicting the future income and expense of a hotel is like determining the Dow Jones average three years from now. Many hotel chains have difficulty budgeting an existing operation one year into the future; how accurate can you expect the pro forma of a proposed hotel to be several years from now?

Why don't you see negative feasibility studies? Most hotel developers are sophisticated enough these days to direct their energies toward projects that have a good likelihood of success. In addition, most feasibility consultants are experienced enough to spot potential problems during field work and will terminate the assignment before the report writing phase even commences. I have often advised prospective clients that a proposed project will not fly, based on my knowledge of local market conditions.

Developing new hotels can be a high-risk undertaking. The feasibility consultant will provide you with a snapshot of the *current state* of the local hotel market, but attempting to direct blame for unforeseen future events that alter the economic outcome of a project is not justified. Change is a risk that a developer needs to accept.

What should you expect from a feasibility study? Not all hotel feasibility studies are created equal. When commissioning a study, ask for the following:

- A sample copy of the report to determine its content.
- The occupancy and average room rate of each competitive hotel should be researched and documented in the report.
- The study should include a market value estimate performed by a state-certified appraiser so a lender can use it. Many accounting firms will not allow their studies to be relied upon by unidentified investors; this greatly reduces the acceptability of their product. You generally have to pay more to obtain a study from a highly credible, national firm. Consider this added expense a form of insurance that could make the difference when securing financing from investors and lenders who need reassurance that the project is viable. LH

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