



The Hotel Capital Partner's Diligence Playbook

What serious sponsors and allocators review before term sheets, distilled into one practical guide.

Vestara Capital Group LLC

Illustrative guide · Not investment advice or an offer

1. Market & demand fundamentals

Hotel underwriting is not only a real estate exercise; it is an operating business tied to transient demand, channel mix, and brand positioning. Before you debate leverage or exit multiples, the market story needs to read credibly: who travels here, on what cadence, and which competitors truly split share with this asset, not just which flags appear on a STR map.

2. Operating performance & P&L quality

Operating performance is where hotel diligence earns its keep. RevPAR trend lines are easy to print; the harder work is whether ADR and occupancy moves are structurally consistent with the competitive set, channel mix, and renovation or repositioning timing.

3. Brand, management & capital plans

Brand and management agreements shape both upside and downside. PIP schedules, FF&E reserve adequacy, and performance test language can move value as much as a basis point on debt, especially when renovation displaces rooms during a fragile ramp.

4. Capital structure & sensitivities

Capital structure should be legible in one view: sources and uses, tranche purpose, covenants, and what breaks first under stress. Committees forgive conservative assumptions; they rarely forgive opaque tranche logic or covenant headroom that disappears when occupancy dips modestly.

5. Risk register & mitigations

The best diligence memos end with a short risk register: the five outcomes that would genuinely impair the thesis, each tied to an owner or operator mitigation. This is not pessimism; it is the fastest way to align sponsors and capital before term sheets harden assumptions.



MARKET & DEMAND FUNDAMENTALS

Hotel underwriting is not only a real estate exercise; it is an operating business tied to transient demand, channel mix, and brand positioning. Before you debate leverage or exit multiples, the market story needs to read credibly: who travels here, on what cadence, and which competitors truly split share with this asset, not just which flags appear on a STR map.

Serious diligence teams expect seasonality, compression nights, and group or event exposure to be explicit, not buried in a footnote. If new supply is coming online, describe the submarket mechanics in plain language: timing, quality tier, and how your rate and occupancy bridge responds if ramp is slower than the sponsor base case.

Stress-testing should pair demand shocks with rate integrity and channel behavior. A narrative that only slides occupancy while holding ADR flat often understates how competitors and OTAs respond in a downturn. Give your investment committee a small set of replayable scenarios they can remember after the meeting.

Make the competitive set intellectually honest: include the properties a revenue manager actually shops for share, not a hand-picked list that flatters RevPAR index. Explain how the subject's distribution, brand standards, and renovation calendar compare, because underwriting lives in relative performance, not absolute slogans.

Before you leave the section, answer four questions in plain English: What demand segment pays the bills in this submarket? What would make ADR crack first: competition, mix, or rate integrity? Where is new supply in the pipeline, and what quality tier does it represent? What would you tell a skeptical allocator who has seen three similar deals in the last eighteen months?

If you only add one exhibit, make it a simple bridge from trailing performance to underwritten stabilization: drivers named, ranges narrow, and risks called out where your bridge depends on execution you have not yet proven.



OPERATING PERFORMANCE & P&L QUALITY

Operating performance is where hotel diligence earns its keep. RevPAR trend lines are easy to print; the harder work is whether ADR and occupancy moves are structurally consistent with the competitive set, channel mix, and renovation or repositioning timing.

GOP flow-through tells you whether incremental revenue becomes incremental profit, or leaks into labor, utilities, or sales costs. Experienced reviewers look for margin drift, one-time owner expenses, and accounting choices that inflate “normalized” cash flow in diligence but do not repeat in operations.

A clean underwriting narrative separates recurring cash flow from adjustments that belong in a bridge, not in a covenant test. If the operator is new, or the brand is changing, spell out the ramp assumptions and the KPIs you will watch in the first four quarters after stabilization.

Ask for three years of monthly or quarterly operating detail when possible, not because more data always equals truth, but because seasonality and one-offs hide in annual roll-ups. Pay attention to F&B contribution if it matters to the story, and to payroll efficiency if labor is tightening in the market.

Compare distribution health to peers where you can: direct booking growth, reliance on opaque channels, and fee loads that quietly compress net revenue. These items often explain why two hotels with similar RevPAR perform differently where it counts, in cash.

End this section with a management narrative that matches numbers: who runs day-to-day decisions, how fast the asset responds to shocks, and what operational KPIs will be reported monthly after closing, before surprises become emergencies.

Key takeaways

- ADR, occupancy, and RevPAR trend integrity versus the comp set.
- GOP flow-through and where margin leaks typically hide in operations.
- One-offs, owner expenses, and adjustments that affect “true” cash flow.



BRAND, MANAGEMENT & CAPITAL PLANS

Brand and management agreements shape both upside and downside. PIP schedules, FF&E reserve adequacy, and performance test language can move value as much as a basis point on debt, especially when renovation displaces rooms during a fragile ramp.

Operator incentives should align with the business plan you are actually underwriting. If the plan assumes aggressive rate growth while the contract rewards top-line over GOP, say so openly. Termination rights, cure periods, and replacement operator economics belong in the diligence pack, not only in legal review the week before closing.

Capex sequencing matters: a renovation that overlaps with peak season without a credible displacement model can quietly erode the story. Tie capital spend to revenue management decisions and show how you protect guest experience and channel rankings while rooms are offline.

Be explicit about brand-standard changes in the pipeline: standards affect cost, timeline, and guest perception. If a flag shift is possible, outline the decision tree and the sponsor's historical experience navigating brand relationships under stress.

Map the FF&E reserve to a realistic PIP calendar, then show what happens if the owner defers. A reserve that exists on paper but never funds creates a cliff in year three that allocators spot from a mile away.

If the asset is franchise versus managed, describe how control, fees, and performance tests differ in practice, not just on a term sheet. The goal is alignment on who can move rate, cut cost, and call a default when KPIs deteriorate.

Key takeaways

- PIP timing, FF&E reserves, and contract points that move value.
- Operator incentives, performance tests, and termination realities.
- Capex sequencing alongside revenue management and renovation risk.



CAPITAL STRUCTURE & SENSITIVITIES

Capital structure should be legible in one view: sources and uses, tranche purpose, covenants, and what breaks first under stress. Committees forgive conservative assumptions; they rarely forgive opaque tranche logic or covenant headroom that disappears when occupancy dips modestly.

Sensitivity work should be small enough to fit on one page but honest enough to change decisions. Rate, occupancy, and ADR rarely move independently; show a few coherent scenarios rather than dozens of orthogonal tweaks that obscure judgment.

Refinance and exit windows should connect to brand, market liquidity, and sponsor capability. If the plan relies on a sale in year four, name the buyer universe and comparable trades, even if the answer is uncomfortable. Clarity builds trust faster than precision without context.

Layer in floating-rate exposure with both base-rate moves and cash sweep mechanics; many hotel deals breathe through reserves until they do not. If hedges exist, summarize economics in one paragraph; if they do not, explain why not.

Identify where sponsor equity truly sits beneath fees and promotes. Misalignment between promote hurdles and lender tests is where quiet rescues become noisy restructurings.

Finish with a one-paragraph liquidity plan: sources of cash in a downside year, sponsor support (if any), and the order of operations if covenants need a cure; clarity beats optimism when the cycle turns.

Key takeaways

- Sources and uses clarity; tranche logic and covenant headroom.
- Rate, occupancy, and ADR sensitivities your IC can replay quickly.
- Refinance and exit windows tied to brand, market, and sponsor plan.



RISK REGISTER & MITIGATIONS

The best diligence memos end with a short risk register: the five outcomes that would genuinely impair the thesis, each tied to an owner or operator mitigation. This is not pessimism; it is the fastest way to align sponsors and capital before term sheets harden assumptions.

Early warning metrics turn a risk register into an operating rhythm. Occupancy pace versus ramp, GOP leakage versus budget, and channel mix shifts are examples of signals you can monitor monthly without drowning the sponsor in reporting theater.

Documentation and reporting cadence should match the deal's complexity. Light-touch for stabilized select-service; more structured for heavy value-add or brand transitions. The goal is alignment under stress, not paperwork for its own sake.

Include at least one risk tied to external demand (market), one tied to execution (operations or capex), and one tied to capital markets (refinance or exit). That triad catches most failures sponsors regret later.

Write mitigations as owners and timelines: who acts, by when, with what authority, not vague promises to 'monitor closely.' Committees reward specificity because it converts anxiety into process.

Close with how decisions get made when a downside case begins to materialize: escalation path, decision makers, and what evidence triggers a sponsor-capital conversation before small problems become crises.

Key takeaways

- Top five downside cases with owner/operator mitigations spelled out.
- Early warning metrics to monitor between signing and stabilization.
- Documentation and reporting cadence that keeps everyone aligned.