

of slides and sleeping

tough times, bright future in the water park hotel/resort industry

by Dan Martin

2011 may be the lightest year for waterpark hotels in more than a dozen years. Only two indoor waterpark hotels were opened – one large and one small - while six southern properties added outdoor waterpark features to their properties. The high water mark was 2007 when over 30 waterpark hotels opened.

Before the Recession

Just a couple of years ago, the waterpark hotel market was rapidly expanding across the US. Well over a hundred independent properties were built while six players with bigger ambitions – Great Wolf Lodge, Kalahari Resorts, Wilderness, Sage Hospitality, Schlitterbahn, and Focus Hospitality -- had begun moving on bold expansion plans.

Before the recession, Great Wolf Lodges had five new properties in the pipeline to add to its 12 existing properties. Kalahari Resorts was adding its third mega-resort near Washington, DC to its inventory of existing properties in Sandusky, OH and the Wisconsin Dells. Wilderness had been successful in Pigeon Forge, TN and was adding even more rooms across the Wisconsin Dells property that just kept growing, while planning a Pigeon Forge expansion.

Sage had a dozen Coco Key indoor waterparks

that it had added to its stock of generally underperforming metro area hotels from Omaha to Boston with plans for a total of 17 to 20 properties altogether. Focus had two successful properties in Shipshewana, IN and Dundee, MI with plans for more.

Schlitterbahn, the Texas waterpark giant – with three strong outdoor parks– had plans for waterpark hotels in Kansas City, KS and Austin, TX. Their New Braunfels, TX flagship outdoor property was just named best waterpark in the world for the 14th year in a row and already was a waterpark hotel, and they owned many small lodging properties in the vicinity.

Dozens of single location independent players planned on cloning their location into a brand.

As the Recession Crept in

By the time the recession arrived, the market leaders had honed their concepts to maturity.

Kalahari Resorts had giant properties and indoor waterparks to match. They prospered in the meetings market with substantial convention centers and properties themed with broad age appeal. Large waterparks allowed them to pack in an array of rides and target an all-ages market. The number

of visitors at any time was large enough to support an array of restaurants.

Great Wolf added the addictive Magicquest game on site while taking service, theming and programming to Disney heights. Their target was clearly younger than Kalahari Resort. At between 300 to 400 rooms they were less than half the size of the Kalahari Resorts. Going public and taking on partners gave them the capital to spread a new design quickly to the East, and to Texas and Seattle.

The Wilderness' home property sprawled in every direction but a new one in the Smokies was a tight package. They offered a lot of indoor waterpark space, stayed with the idea of having an outdoor waterpark too and offered a diverse set of accommodations from basic rooms to deluxe cabins and condos. In the Dells they teamed with others to build the nationally recognized Sundara spa.

While both Sage and Focus were experienced hospitality companies with many non-waterpark properties to their credit, they took different paths. Focus did new-construction properties with their Splash Universe brand in small family destination markets without competition, while Sage, with capital from partners, moved quickly and bolted



The waterpark at the Blue Harbor Resort in Sheboygan, Wisconsin shortly after its opening. File photo from InPark Magazine.

waterpark boxes on to a varied package of underperforming suburban metro area hotels. Their target was raising revenue on weekends.

The Recession Hit Hard

The twin terrors of dropping ADRs (average daily rate) and occupancy hit the hotel industry broadly as occupancy dropped 20%. Waterpark hotels felt the pinch in different ways. Some destinations did okay; they were close enough to metro areas that they became the substitute for a trip to Florida. But price competition drove rates down for most. Independent waterpark properties across the country suffered most. The ones in metro areas didn't offer enough of a getaway feel. The impact was considerable. The most heavily themed properties, including Great Wolf, delivered on that feel and suffered less. Great Wolf occupancy reportedly dropped by only 5%.

Large, well designed and equipped indoor waterparks held onto rates and occupancy better than thinly themed and equipped properties. The smaller, less amenitized, first generation Great Wolf Lodges suffered along with many independents. Facilities with broader age appeal could target a broader range of families. Facilities that could afford them added dry play areas such as indoor amusement areas (on the scale of old pier beach casinos on the coast) as they were less expensive than new water features, generated income, and weren't just more water. This was a very popular move in the Wisconsin Dells but easier to do in locations like the Dells or Gatlinburg which draw millions of visitors in addition to a property's guests.

Some failing properties tossed the keys to lenders as revenue dropped and their actual property value dropped below loan values – mirroring the housing market and echoing the fate of early generations of waterpark hotels in the Dells whose value was plowed under when the first Great Wolf Lodge, Kalahari Resort, Wilderness and others were built.

Across the hotel industry properties became cheaper to buy than build, but it seemed worse for some waterpark hotels where the indoor waterpark was seen by some as an operating albatross. As property values plunged, the loan to value ratios shifted. If

value dropped below the loan, you could only hang on if you had the deep pockets or the cash flow. If not, the property was sold to someone else for substantially lower current market value, or simply closed. Dozens of individual properties across the US went through this. The result is that the fleet of waterpark hotels across the US is now a bit smaller – but more importantly, the total value of the industry's assets got a buzz cut.

Sage Hospitality Leaves the Category

Of the market leaders, Sage was hit the hardest, but in its downfall taught the industry a lot. Before the recession it had been criticized for an operations approach that ran the hotels and waterparks separately. Add the dual identity – business and leisure hotels all-in-one plus the cost of branding with a flag, and the result was unusually high cost. The need to be a business hotel through the week meant the hotel itself wasn't themed -- there wasn't a true overall experience and welcome feel for families. The indoor waterparks themselves were not very highly regarded as experiences. As was the case with many independents, they seemed to be value engineered too much. Also challenging: each property had already been an underperforming business hotel and many weekday business travelers could sense that occupancies were low.

Sage Hospitality, which still successfully operates about 60 hotels without waterparks in 26 states, got out of the waterpark hotel business. Eleven properties were sold. One, a Chicago area Sheraton, sold for an astonishing \$7.7 million – under \$18,000 per room. By contrast, two other sales by Sage over the last year of hotels without waterparks demonstrate how outrageously low this figure was. The two Denver area properties Sage sold were a Marriott Courtyard for approximately \$260,000 per room and a JW Marriott for \$370,000 a room – many times more per room than they received for their waterpark properties.

Sage's other ten waterpark properties, scattered across seven states, were also sold at shocking discounts. The adjacent Fairfield Inn North Cincinnati and Crowne Plaza North properties, which share a Coco Key waterpark, received winning bids of \$1.8 million and \$2.2 million, respectively. Even now, a single family house in many parts of

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The advertisement features a large, colorful water slide named 'CONSTRUCTOR' at Wet 'n' Wild Waterpark in Phoenix, AZ. The slide is yellow and red, with a blue and white spiral design. A family of four is shown enjoying the slide. The text 'The tightest and most spine-tingling spirals in the industry!' is written in a playful font. A starburst graphic says 'Brand-splashing new for 2011'. The White Water Waterpark logo and contact information are at the bottom.

California sells for more. A third Ohio property, a 200-room conference and waterpark hotel went for \$4.97 million or \$24,500 a room. A fall 2010 recession-era appraisal had valued the property months earlier at \$36 million.

It's hard to miss the conclusion that the addition of the indoor waterparks to these properties may have lowered their value. Still, the most successful asset in the sale - the Coco Key brand - survived, still used by the buyers of the properties that are still open.

Other Market Leaders Survive

Focus took some hits but has, thus far, made it through with its two properties. This is true of Wilderness as well. Their astonishing sprawl of properties in the Dells continued to grow through the recession and the Wilderness in Pigeon Forge, TN is generally regarded as a success, breaking the barrier for what had been presumably lower-yield Southern family destination markets like Pigeon Forge, Myrtle Beach, Branson, the Florida Panhandle and others.

Kalahari Resorts, on the verge of a well-conceived development deal in Fredericksburg, VA, was caught in the revolving door of the recession. This was a breakthrough deal for them in many ways as it was more sophisticated in several key areas. It was a public-private venture with a lot of community support. The approach to

financing was new for them too. Instead of the farmer's approach of selling a crop (in this case - a crop of condos) to finance the next round of work, this deal had a more sophisticated financing package with a major lender. The design was also a notch above what they had done previously.

Kalahari Resorts wants to try this model again and most likely will when capital flows. The recession has given them time to work out operational wrinkles and become more like the Gaylord hotel chain (enormous meeting-driven properties in Grapevine, TX, Washington, DC, Orlando, FL and the original in Nashville.) Gaylord has become more like Kalahari Resorts with its new outdoor waterpark features at the Texan in Grapevine (a stone's throw from a successful Great Wolf).

If Kalahari Resorts is successful with a third property, they will have the scale to support a full development team that can move on to develop additional properties or convert flagging resorts into Kalahari Resorts. They are less likely to switch to the business model that Great Wolf has chosen as the much larger Kalahari Resort model will not be as easy to franchise.

Schlitterbahn is still planning an entrance into the fray. They've been building an outdoor park in Kansas City in stages over several years.

Designed to include a very large hotel and an indoor/outdoor waterpark, the waterpark has done better every year. Back in Texas, Schlitterbahn is still looking for the right deal in Austin is likely to do an outdoor waterpark project with lodging on North Padre Island near Corpus Christi, and just purchased the hotel adjacent to the South Padre Island property with plans to renovate and add to the existing waterpark. The group is renowned for its creativity and just debuted a set of one-of-a-kind treehouse cabins at the flagship in New Braunfels, TX that they hope to roll into all of their locations as premium lodging.

Great Wolf Lodge emerged with its portfolio intact at 11 units but without its development division. The company sold a waterpark hotel property it had developed as a second brand for a fraction of its development cost - The Blue Harbor on Lake Michigan in the unlikely destination of Sheboygan, WI. It reportedly sold for \$4.2 million. Great Wolf also reportedly has a negative loan to value ratio on at least two of its older properties. This year the company reportedly will emerge with their highest EBITDA ever.

What saved Great Wolf Lodge was smart strategy. Doubling down on the branding reaped benefits, but what mattered the most was that they had rolled out a smarter new prototype just before the recession. First used in



The entrance to the Great Wolf Lodge near King's Island in Ohio. On page 14, the waterpark for this Great Wolf Lodge features a hydro-magnetics coaster slide from ProSlide. File photos from InPark Magazine.

Tannersville, PA, then Concord, NC, Grapevine, TX, and Grand Mound, WA, the prototype featured better and larger waterparks, more rooms, and more ways to play at the property. Great Wolf began a successful foray into the meetings and events business, forged an alliance with a national cheerleaders group to do events at their properties, and slimmed down headquarters staff while keeping nearly all disciplines in house except the one that got them to the top: they jettisoned their development capabilities and converted to a franchise and operating business model.

Overall, Great Wolf struck a new corporate balance. The challenge with centrally run hospitality and entertainment companies with dispersed assets is to centralize rationally so that the cost of headquarters and operations are less than any franchise fee. They appear to have met that challenge.

Today, Great Wolf Lodge still has expansion plans but, as others must do, their success rests on how well they can find and persuade developers to build properties for them. As the most sophisticated brand in the pack and a successful hotel and waterpark operator, they have a product to sell and have already set their sights on working with developers in several states, including projects in California and reportedly a site near Pittsburgh. Their existing portfolio originally focused on family destinations now it succeeds wherever they can effectively serve a top-20 metro area. Once dependent on family destinations to draw customers, Great Wolf is now the magnet.

Great Wolf Lodge's franchise/operator approach means that they've turned the steering wheel over to prospective developers. While the prospective developer will rely on Great Wolf Lodge for market advice – driving directions – the developers will go where they're comfortable developing. When they build, the sources of financing will want large exclusionary zones around their new investment. This may direct where Great Wolf Lodges will be built in the future.

Because a Great Wolf Lodge hotel and indoor waterpark today can cost \$150 to \$200 million, the company will have to persuade developers that they are smarter than the more fungible Sheraton or Hilton. Here, Great Wolf Lodges has an argument: The US is full of large major brands competing with one another. Almost

all new large hotel construction starts are overseas. But to overcome the development cost hurdle, Great Wolf may be open to the prospect of rebranding an existing hotel. They're smart enough not to fail with this approach as Sage did and would bring their brand. Ironically, raising capital is no longer their problem under the new business model, but partnering with developers can be key. Great Wolf Lodge remains the biggest name in the business and hopes to add several properties a year moving forward.

Looking For Money

Financing new hotels is easier than for most other types of commercial real estate properties. However, financing most other property types is nearly impossible. Financial sources would prefer more typical franchised facilities like Hampton Inn over waterpark hotels. There are 1,800 Hamptons and their performance is pretty well known in advance.

Since the waterpark hotel has a foot in the hospitality and entertainment world it is a step behind all other hotels. Financing a great pool and slide package addition to an existing branded hotel in a southern tier state from California to the Carolinas will be easier than financing a new waterpark hotel from the ground up. Notwithstanding the Sage story, which many lenders may never be aware of, adding this package would be seen as adding revenue-enhancing amenities to a hotel that already has a cash flow – not building a waterpark hotel.

The larger market leaders have a different problem -- the price tag for developing new properties has gotten quite high. A new Great Wolf could cost \$200 million and a Kalahari even more.

Public partnership in hotel financing is one possibility. Communities will issue public bonds to facilitate new projects that serve local economic development goals. This arrangement has been going on for decades. Large new Hiltons, Marriotts, Westins and others have been built to support publicly-owned convention centers across the US. The demand for these large properties is typically not strong enough throughout the year, but a lot of short-term capacity is needed when the radiologists or, in our world, IAAPA, WWA, or AZA come to town. Unfortunately, some of these properties have been financed this

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way because it “was possible” not because they were truly needed.

Some well known waterpark hotel and waterpark properties already have been financed or had their development supported this way. Schlitterbahn in Kansas City was enticed, in part, by favorable STAR bonds issued in Kansas. Kalahari’s Fredericksburg (Washington, DC area) development would also have been built with tremendous local support. The development that included a Great Wolf Lodge across the interstate had similar support. The Denver based developer of the new Great Wolf in Garden Grove, CA is relying on a substantial bond sale by the local government there to help build the large property on a small site near Disneyland. The small site requires a parking structure that would not be economical without public support.

This approach to financing may distort the marketplace where new waterpark hotels are built. Large new waterpark hotels will need to guard against going to communities or sites that might not be the best locations for business but are selected because they can get the public financing there. Communities eager to do the deal or are fiscally capable of it are not necessarily the best places to build a new attraction.

Great Wolf Lodge’s unsuccessful Blue Harbor project development in Sheboygan (mentioned previously) may be an example of this. The waterpark hotel was to be a key part of the redevelopment of an industrial area on the shore of Lake Michigan and along a cleaned-up river. Although the effort was spearheaded

by a local economic development group that worked the deal several ways to make it very favorable for Great Wolf Lodge, it wasn’t enough. No one in the market took Sheboygan seriously as a destination when source markets like Milwaukee, Madison, and Chicago could choose the Wisconsin Dells as easily.

In these ways the larger waterpark hotels have become increasingly like other large mainstream properties – it also opens more metro areas with the possibility of public financing to the large waterpark hotel players. Kalahari’s bid to go to metro Washington DC would have taken it to a very different location than its earlier family resort destinations in rural areas like the Wisconsin Dells and Sandusky, OH. If the meeting facility that would have been a part of Kalahari’s property would have been owned by the public sector, the deal would have been a new version of the large convention center hotel deals done in dozens of places across the US – but this time with a property that can fill rooms when the convention center is dark.

Using condo sales to finance development has been how most waterpark hotels have expanded over time, but the pool of potential buyers – and their ability to get financing themselves – has shrunk. Additionally, this approach is limited to family destination areas.

Looking Ahead

The waterpark hotel/resort industry is now thriffter and wiser. It has lost a number of smaller players and one large player, although most of its properties remain. Key players continue to sift through the evidence to see what happened and what can be learned.

The next few years will see more Great Wolf Lodges, Schlitterbahn’s entry and probably another property from each of Kalahari Resorts, Wilderness, and Focus. Ski resorts near metro areas or in summer tourism areas have begun to reconsider the idea too.

The largest new market is the southern half of the US from the Carolinas to California. Texas will be a market to watch. Wilderness has done well enough in Pigeon Forge, TN to get attention for its southern strategy. Existing, but generally smaller southern properties are already adding small outdoor parks. They should read the Sage case study first, but there is a development cost difference. Most of this action will be existing properties adding less-expensive “starter” outdoor-only waterparks. But even considering the Sage story, they would be wise to hold aside a spot for an 80,000 square-foot air-conditioned indoor waterpark for when they can afford it and need to make a move on their competition. An indoor waterpark could work well in Arizona where summer temps can stay over 100 degrees for months. Dallas had record temps last summer but Houston and Atlanta summers are also characterized by uncomfortable hot humid summers. The five million people of DFW, six million in Houston, and the five-and-a-half million in Atlanta might be very interested in this type of property. In general, the sweet spot appears to be lower to middle market.

At the top of the market waterpark hotel is not a new idea. The enormous Gaylord Texan near Dallas just added one. Also in Texas, two upscale Hyatt resorts and a JW Marriott in the hills around San Antonio have extensive outdoor waterpark features but have been less successful than expected. But in the capital of higher-than-100-degree-days -- Phoenix/Scottsdale, AZ -- several successful upscale resort properties have extensive outdoor waterpark features.

Overall, there are still plenty of places for some version of the idea to go, but to do that, capital must flow. To realize its potential, the waterpark hotels industry still needs more capacity in development skills, and people that realize that they are in the entertainment industry as well as hospitality.

Dan Martin is the Managing Principal of Market & Feasibility Advisors, Chicago, Austin, and Los Angeles. He and his colleagues have had the honor of working with great minds at Kalahari Resorts, Great Wolf Lodge, Schlitterbahn and others.