



What Does It Mean to Be Investment Grade in the Short-term Rental Market?

Like any other asset class, the goal of investing in STRs is to maximize returns relative to risk. However, with the asset class still in its infancy, few investors have taken full advantage of best practices and reached their true performance potential.

This white paper presents our core thesis for Investment Grade Short-Term Rentals™, based on optimizing four broad drivers of return and risk:

- › Operational
- › Economic
- › Regulatory and Legal
- › Financial Transparency

We estimate that only 3-5% of STRs are operating at their peak financial performance.



The Investment Grade Framework

The guide below is a rough framework that Revedy uses for underwriting and evaluating STR assets and portfolios. This framework is not rigid, and factors vary greatly by region. As such, each STR asset should be analyzed using a comprehensive [first principles](#) approach.

BROAD RATING FACTORS	WEIGHTING	SUB-FACTORS	NOTES
Operational Drivers			
Revenue Management	Up to 40%	<ul style="list-style-type: none"> › Professional revenue manager with dynamic pricing › Full channel distribution 	Most STRs are not fully distributed across all major platforms. Even fewer have quality, local revenue managers.
Operational and Guest Services	Up to 35%	<ul style="list-style-type: none"> › Professionally managed › Ratings / stars › Physical asset optimization, including condition, design and amenities 	There can be a striking variance in cash flow generation between amateur and professional management. Even among professional VRMs, performance can vary greatly across geographies and asset types.
Market and Economic Drivers			
House Condition and Location	Up to 25%	<ul style="list-style-type: none"> › Local environment › Proximity to local attractions 	Location is more nuanced for STRs. Investors must balance proximity to local attractions with neighborhoods that will appreciate in value.
Long-term Market Fundamentals	Up to 40%	<ul style="list-style-type: none"> › Local travel demand › Local Inflation › Supply - STR / hotel competition › Interest rates 	These drivers are some of the hardest to predict, but investing in areas where local inflation is running high can become a larger driver of returns than cap rates. There are currently several cities with double digit inflation rates.
Regulatory and Legal			
Regulatory	Up to 100%	<ul style="list-style-type: none"> › Existing regulations › Risk of future regulations › Level of enforcement › Insurance management 	Short-term rental regulations are going through tremendous changes at the city, county and sometimes state levels. Enforcement can range from \$20 fines, to over \$20k per incident, and even jail time at the extremes!
Financial Transparency			
Quality of Financial Reporting	Up to 25%	<ul style="list-style-type: none"> › Reporting and transparency › Operating history 	STRs are a new asset class. Financial literacy and operating track records can build a significant amount of value



Investment Grade STRs: Operational Optimization

PRICING IS STILL THE LOW HANGING FRUIT

Most STR assets are self-managed, which means they are not fully optimized for full channel distribution, owner holds or capturing pricing spikes from certain single events, seasonal or other secular travel demand drivers.

At this stage of the short-term rental industry's development, simply optimizing pricing and listing distribution is still the most impactful cash flow driver that a new owner can execute.

For example, a mom-and-pop owner may list their property on one or two channels and update pricing monthly. In contrast, a professional VRM will manage listings across 50+ distribution channels, using dynamic pricing technology that adjusts several times a day to optimize revenue and occupancy.

Listing on multiple platforms and moving to a professional revenue manager typically uplifts revenue by 30%+ compared to a self-managed property.

REVIEWS MATTER

While achieving the coveted Superhost ranking on Airbnb can often literally filter out your competitors, it's equally important to manage negative reviews—especially while a property is ramping up. While bad experiences happen, prompt, courteous communication can mitigate the effects.

We've seen an early one-star review drag revenue down by over 30% relative to projections and comparable properties.

DESIGN & AMENITIES BOOST PERFORMANCE

One of the bigger functions that falls on STR investors, and not the VRM to manage, is deciding and executing the level of physical asset optimization, which we define as strategically designing the look and experience of your property to maximize returns.

This optimization can be a huge driver of returns. While even bare bones STRs can be successful, the highest returns can come from hot tubs (~40% ROIC), managing sleeps per bedroom (10-35% ROIC), EV chargers (12% ROIC), putting greens (30% ROIC), and other key factors that vary across markets. These can comprise a large part of the overall return in an STR.

Hiring a professional STR interior design firm like [Showplace](#) to furnish your rental can increase your nightly revenue by 25%.



Investment Grade STRs: Market and Economic Optimization

Local travel demand, interest rates, inflation and supply of new STRs and hotels typically dictate the majority of returns for an STR investment. While most of these are extremely challenging to predict, investors can further mitigate risk with the right strategies.

MANAGE SATURATION

Supply risks can still be mitigated by investing early in lower saturated markets. However, even within highly saturated markets, STRs that are fully-optimized to investment-grade may be able to outcompete.

GET TARGETED

Tailoring an STR's appeal towards a particular demand demographic can result in more stable returns. Examples include STR assets geared towards business travelers near a corporate headquarters, sports-themed STRs near stadiums, bachelor/bachelorette amenities, themed decorations to match locales such as beach themes or even kid-themed.

DIVERSIFICATION

As with any asset class, investors can mitigate risk by building a diversified portfolio. This includes varying your assets across the following factors:

- › Geographic region
- › Seasonality
- › Market type (destination, urban, etc)
- › Target audience
- › Pricing tier (budget - luxury)
- › Level of optimization



Some of the highest performing STRs are fully-optimized from a design standpoint, even going so far as theming to appeal to a specific target audience.

Investment Grade STRs: Regulatory and Legal Optimization

STAY COMPLIANT

It doesn't matter if you have the best STR in the world if it's illegal. The regulatory landscape for STRs is constantly evolving. Most regulations are set at the city council level. The policies of local politicians tend to be more volatile and unpredictable. Investors would be wise to consider what regulations currently exist, risk of new regulations and what are the penalties for enforcement before purchasing an asset.

We have seen fines as small as \$20 on one end of the spectrum, to criminal charges for multiple violations on the other extreme.

REGULATORY-INFLUENCED MARKET SELECTION

While some perceive the regulatory landscape as a risk, others see opportunity. Many investors are incorporating regulations into their acquisition strategy, including:

- › Buying in low or no-regulation markets
- › Buying in environments where regulations are strict but stable
- › Buying "scarce assets" in markets where STR permits are limited or capped
- › Buying in unincorporated areas adjacent to highly-regulated cities
- › Diversifying a portfolio across regulatory regimes



MONITOR FORWARD-LOOKING RISK

If landmark STR decisions in cities like San Diego or Las Vegas have taught us anything, it's that regulations can change at any time. Investors should stay abreast of changes in their markets and conduct thorough research before investing in others. In fact, Revedy actively monitors sentiment and activity in key markets to evaluate the risk of future regulations.

Investment Grade STRs: Financial Transparency

Lack of institutional capital in the space means that the operating histories and track records for most STRs are poorly recorded. Most reported financials are based on cash accounting and finding a transaction with clean, quality accounting is rare (we estimate in <1% of STR transactions).

Investors and owner-operators looking to scale a portfolio for eventual sale should start today to implement:

- › Trust accounting
- › Clear divisions between the operating company and property company
- › Accurately categorized and documented expenses



How Many STRs Operate at the Investment Grade Level? Very Few

We estimate that there are only 3-5% of STRs that are operating at their peak financial performance. We call these properties Investment Grade. These properties compete at the top end of their local markets and maximize cash flows while minimizing risks. It takes a tremendous amount of investment, knowledge and effort to operate STR assets at this level.

Many Mom-and-Pop operators don't aspire to reach this level and prefer to run their STRs for some balance of investment return, personal use, investment capital and effort. However, as larger investors enter the space, they will demand that returns on capital will be maximized and new standards set. Over time, we believe this will push the STR renting experience much closer to hotels, while also proving out the true potential of STRs as an investment class.

To get learn more about investing in short-term rentals with Revedy, contact our advisory team at 401.307.1325