

CEO of apart-hotels operator Kasa diagnoses what went wrong with Sonder's model

Segment sustainable but master leases flawed in hospitality, exec says



Aparthotel company Kasa operates a portfolio of 85 apartments and hotels across the U.S., including the apartment Kasa River North Chicago. (CoStar)

By **Bryan Wroten**

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The apart-hotels segment of the hospitality industry is a small but growing one, and recent news coverage of Sonder Holdings' collapse may have brought more eyes to it.

Even with the negative headlines, the chief executive of apart-hotels company [Kasa](#) said he doesn't believe the fallout from Sonder's closure and stranding of guests will have a negative impact on the apart-hotels space.

"Yes, there was one hiccup that they experienced, but that hiccup probably wasn't widely known, people weren't widely aware of it," said Roman Pedan, founder and CEO of Kasa. "It made a big splash in the industry, but for the average consumer, I would be surprised if it reached their radar."

Kasa operates 85 locations across the U.S., managing both hotel and apartment hotel spaces for travelers, Pedan said. The company works with many of the larger apartment owners nationwide, including Starwood Capital, Toll Brothers Apartment Living and Greystar. Prior to Sonder's bankruptcy, Kasa was the second-largest apart-hotels company in the segment.

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Over the years, Kasa has added 12 former Sonder properties to its portfolio, Pedan said. Kasa has not added any since Sonder started bankruptcy proceedings because of the automatic stay put in place that prevents the property owners from making any changes.

"We haven't taken any over, although we are in very late-stage conversations with many owners," he said.

Prior to its bankruptcy, Sonder had proactively gotten out of some leases, and those owners sought out Kasa to take over operations, Pedan said. Kasa and Sonder operated similar buildings and under similar quality levels, easing the transition process as the aparthotel owners are familiar with the property operation model.

Following Sonder's abrupt closure, Kasa offered codes for its hotel rooms and apartment units to displaced Sonder guests, Pedan said, likening it to times when Kasa has offered accommodations to people displaced by the wildfires in Southern California and refugees from Russia's invasion of Ukraine.

The issue isn't the demand for aparthotels or the operational model, Pedan said. Travelers are interested in the Airbnb-style accommodations available, but they also want the professionalism, the reliability and the consistency in stay that comes with a hotel brand.

Kasa's model is based off of management agreements, just like a third-party hotel management company uses, Pedan said. Sonder signed master leases with apartment and hotel owners. Companies similar to Sonder that have used lease agreements have not survived, and that's been true for decades.

The big hotel brand companies such as Marriott International, Hilton and Hyatt Hotels Corp. use management and franchise agreements, he said.

"You look at companies that don't exist, and they were all leases, and that's because of the inherent misalignment of the master leases with owners and the mismatch between long-term liabilities and short-term revenue combined with hospitality being a cyclical and volatile industry," he said.

The master leases create an illusion of safety for property owners, and it's an easy button for growth for operators, Pedan said. Owners feel like they have security because they have "a guaranteed payment," but the agreement is the worst case for them when things go well and when they go poorly. If the operator is doing

well and bringing in excess profits, they pocket that and pay the amount in the lease agreement to the owner.

“When things go poorly, the operator is likely not going to actually pay, as is happening with Sonder and many others,” he said. “They end up feeling distress, and what felt like a guarantee becomes a bankrupt entity or someone who stops paying their lease payment.”

The owner loses in both cases, even though it feels like they have security, he said.

For aparthotel operators looking to grow, the lease model offers faster numbers when offering the owner favorable terms, Pedan said.

“But it’s an adverse selection signal, meaning those who are resorting to leases likely cannot grow in other ways, in more sustainable ways, and almost by virtue of offering the lease, an operator is signaling they are incapable of growing in other ways,” he said.

Venture capital has fueled the lease model over the past 10 years, Pedan said. Venture capitalists often value and invest in companies based on revenue growth, and the faster a company grows revenue, the more interested the venture capitalists will be to invest. The master lease model allows an aparthotel company to drive revenue quickly due to the attractive lease terms.

“You're sort of incentivized to offer higher rents and more attractive lease terms in order to get owners to agree to partner with you more quickly,” he said.

It leads to a vicious cycle in which investors reward growth that makes companies growing through leases less profitable, Pedan said. Once the interest rate environment changed and increased in 2022, that cycle ended.

“A lot of companies that were fueled by it realized that they were holding a lot of uneconomical leases at the end,” he said.

The management contract model has been sustainable for a long time, and it aligns incentives, Pedan said. Kasa charges a fee more on a property's profit than its revenue. When the owner wins, Kasa wins, he said. Similarly, when times are tough, they share in the downside, but it doesn't put the company's balance sheet at risk, making it a healthier partner for the owners.

The apart-hotels space is still small relative to the larger hospitality world, but it's been the fastest-growing segment of hospitality for the last decade, Pedan said, adding that all signs point to it continuing to grow at a faster pace.

There's a broad accommodations market that also includes vacation rentals and short-term rentals such as Airbnb and Vrbo, he said. Short-term rentals are often not professionally managed, but there is a section of it that is managed and it's growing quickly. It's similar to how hotels evolved, from unprofessional operators who were innkeepers with one or two properties.

Over time, there was a need and benefit for professionalization, branding consistency and reliability and systems consistency, he said. That led to the big hotel brands such as Marriott, Hilton, Hyatt and others.

"The same thing is happening in this [apart-hotels] world, too," he said. "It's growing really rapidly and has been for a decade, but it's the fastest-growing segment of hospitality because it still has so much room to expand from where it is."

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