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HOTELyearbook 2010

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How the crisis will affect luxury in 2010

Editorial input from 25 hotel industry CEOs

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The Ecole hôtelière de Lausanne (EHL) is the co-publisher of The Hotel Yearbook. As the oldest Hotel School in the world, EHL provides university education to students with talent and ambition, who are aiming for careers at the forefront of the international hospitality industry. Dedicated to preparing tomorrow's executives to the highest possible level, EHL regularly adapts the contents of its three academic programs to reflect the latest technologies and trends in the marketplace. Since its founding in 1893, the Ecole hôtelière de Lausanne has developed more than 25'000 executives for the hospitality industry, providing it today with an invaluable network of contacts for all the members of the EHL community. Some 1'800 students from over 90 different countries are currently enjoying the unique and enriching environment of the Ecole hôtelière de Lausanne.

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Boutique DESIGN New York, a new hospitality interiors trade fair, will coincide with the 94-year-old International Hotel/Motel & Restaurant Show (IH/M&RS). Designers, architects, purchasers and developers will join the hotel owners/operators already attending IH/M&RS to view the best hospitality design offerings as well as explore a model room, exciting trend pavilion and an uplifting illy® networking café.

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Bench Events host premier hotel investment conferences including the International Hotel Investment Forum; the Arabian Hotel Investment Conference and the Russia & CIS Hotel Investment Conference. Bench Event's sister company, JW Bench, is a benchmarking company that has launched the Conference Bench and the Productivity Bench. An industry first, the Conference Bench, measures performance data for conference space in hotels throughout Europe.

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Founded in 1922, Cornell University's School of Hotel Administration was the first collegiate program in hospitality management. Today it is regarded as one of the world's leaders in its field. The school's highly talented and motivated students learn from 60 full-time faculty members – all experts in their chosen disciplines, and all dedicated to teaching, research and service. Learning takes place in state-of-the-art classrooms, in the on-campus Statler hotel, and in varied industry settings around the world. The result: a supremely accomplished alumni group-corporate executives and entrepreneurs who advance the industry and share their wisdom and experience with our students and faculty.

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With an exclusive focus on global hospitality and tourism, Hsyndicate.org (the Hospitality Syndicate) provides electronic news publication, syndication and distribution on behalf of some 750 organizations in the hospitality vertical. Hsyndicate helps its members to reach highly targeted audience-segments in the exploding new-media landscape within hospitality. With the central idea 'ONE Industry, ONE Network', Hsyndicate merges historically fragmented industry intelligence into a single online information and knowledge resource serving the information-needs of targeted audience-groups throughout the hospitality, travel & tourism industries… serving professionals relying on Hsyndicate's specific and context-relevant intelligence delivered to them when they need it and how they need it.

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The « new normal » in 2010 : five trends to watch

Following the severe drop in demand that the industry has been living through for the past year, what should we be expecting in 2010 ? Is recovery around the corner – and if so, what shape will it take for the US hotel business ? JAN D. FREITAG, Vice President of SMITH TRAVEL RESEARCH, describes the outlook.

By now the battle cry of the « new normal » is ubiquitous, but what exactly does this mean for specific sectors of the US hotel industry ? We will contemplate, in detail, each of the following five aspects of the market, recall the common wisdom, and define what a « new normal » looks like for 2010 and beyond. Specifically we will discuss :

- RevPAR recovery
- easing supply
- contraction in the middle
- group rates vs. transient rates
- the new value definition

RevPAR recovery

Common wisdom : *Fine through '09*
New normal : *Back in heaven in 2011* (with credit to Jim Burba, BHN)

The unprecedented drop in demand, coupled with strong increases in new hotel supply which were funded before the financial meltdown, has hurt occupancies across the board. Trough August 2009, US occupancy declined by 10.3 %, a function of the demand decline of 7.4 % and an increase in new rooms by 3.2 %. For an industry that is characterized by around 51,000 individual players, the reaction to the bad news was remarkably uniform. Rates were slashed across the board, by around 9 % through August 2009.

Domestic GDP growth is not expected to make a sustained recovery until the beginning of 2010, and we do not estimate that demand will recover until the latter part of 2010, either. And while certain chain scales may see more pricing power than others, the industry as a whole should not experience sustained rate increases until the end of 2010 and then in 2011. This then should lead to the first RevPAR gains after three consecutive years of losses. It will remain interesting to see if pricing power, which has so eluded the industry in 2009, will return with the same speed with which it so rapidly disappeared. We highly doubt that it will, as we will discuss later on.

Easing supply pipeline

Common wisdom : *If you build it, they will come*
New normal : *Ice age in the debt markets*

The heydays of 2006 and 2007 were characterized by prolonged RevPAR increases and exuberance in the real estate markets, with low interest rates and plenty of lenders ready to step up and commit capital at historically high Loan-to-Value ratios. And as STR continued to report phenomenal growth data on the US and global markets, owners, developers, funds and high net worth individuals were ready to take part.
At the top of the market, around late summer of 2008, some 200,000 rooms were under construction in the US, the highest numbers we reported since we started tracking pipeline numbers in 2002.

A year later, there are still around 130,000 rooms under construction, but more importantly the Active Pipeline (i.e. rooms in the phases of under construction, final planning and planning) have declined by around 30 %. As hotels are being opened and move out of the pipeline, few new projects are announced, as funding is hard or impossible to obtain. With the CMBS (Commercial Mortgage Backed Securities) market in turmoil and no clear way of unwinding the existing, underperforming assets, this source of funding is likely to be handicapped for years, if not gone forever. It will take some years and creativity to ease the flow of funds into the development community, but as hotels are perceived as one of the more risky real estate asset classes, a general thawing of debt financing may not influence the pipeline until well after 2010.

Contraction in the middle

Common wisdom : *Puttin' on the Ritz*
New normal : *New frugality*

Luxury hotels produced some of the more memorable performance statistics in the most recent past. In 2006 the RevPAR increase for the roughly 300 hotels in this scale was 11.7 %, added to in 2007 by another 7.7 %. The ADR for properties in the scale was $268 in 2006 and $289 in 2007,

but anecdotally some hotels we are able to charge over $1,000 per room on a nightly basis. New York City, Miami Beach and Beverly Hills continued to lead the way and with the number of global millionaires and corporate incentive meetings increasing there seemed no end to rate increases in sight. These ADRs aided NOI and with it valuations and ROI calculations produced ever more frothy prices per room.

Through August 2009, RevPAR for luxury hotels has declined 27.3 % percent, driven by a drop of 4.9 % in demand. As corporate groups shied away from meeting in high end resorts (what some have called the « AIG effect ») and travel managers became enforcers of corporate spend thrift, avoiding another front page article admonishing excesses in corporate spending, suddenly upscale and mid-scale hotels are en vogue. Although all chain scale had to endure decreases in demand, hoteliers in the mid-scale without F&B sector only reported demand declines of around 4.7 %. Upscale hotels' demand decreased 2.1 % in the same period – the best in a sea of poor performances. As these more modest accommodations become the new darlings of the corporate travel buyers, they will undoubtedly garner even more attention from the development community. And as their building costs are more manageable, they can easily be financed by local banks without the need for Wall Street syndication.

Group rates vs. transient rates

Common wisdom : *Group ADR < transient ADR*
New normal : *Group ADR > transient ADR*

Since the year 2002 we have not only collected the three standard metrics (rooms available, rooms sold, rooms revenue) but also asked upper end hotels for their segmentation data. Hoteliers report the rooms that were sold in increments of ten or more (what we refer to as « Group ») or between one and nine (what we term « Transient »). We also track « crew or long term stays » as the Contract Segment but their small numbers make them less important for this discussion.

Historically, the following trend emerged : As group rooms were sold in bulk and with longer lead times, hoteliers posted ►

Group ADRs which were well below the Transient rate with its shorter booking window. We observed this pattern both on a hotel and market wide basis. This makes intuitive sense as Group rooms are used to bolster occupancies, allowing yield managers to extract more money for the now scarcer room commodity in their hotel.

An interesting trend emerged as the world, and the country, slid into a recession. The lesson from the 2001 downturn seemed to have been to « cut early, cut often » when it came to room rates. And exactly this pattern played out again towards the end of 2008. As Online Travel Agencies (OTAs) re-emerged as the channel of choice for distressed inventory, STR reported on ADRs in a free fall. And as group rates were supported by legal documents setting them practically « in stone » the variability of those rates was somewhat limited. The convergence of yield-managed (or rather « yield-minimized ») Transient rates and fixed Group rates produced the interesting phenomenon that during July of 2009 we reported higher Group ADR than Transient ADR in 17 of the top 25 largest lodging markets (excl. Las Vegas).

The unintended consequence of this trend was that group attendees, when checking online prior to attending a conference, found a cheaper room rate, canceled their more expensive group room reservation and re-booked outside of the room block. This phenomenon, dubbed « cancel-rebook », potentially led to rather uncomfortable discussions between the group organizer – showing good meeting attendance – and the hotel sales manager – insisting on minimum room pick-up that was contractually guaranteed. Anecdotally, sales managers honored the sold rooms, in or outside the block, but this pattern is nonetheless of concern.Higher Group rates are of course easily reversible as demand recovers and Transient rates increase. However, in the meantime sales managers need to be aware of this potential pitfall.

The new value definition

Common wisdom : *It's a seller's market*
New normal : *365 days of sales*

In the US, the chain of events that drive room rate is sufficiently transparent. Two consecutive quarters of positive GDP growth spurs positive room demand. And room demand in excess of 2 % brings with it pricing power and ADR growth above the level of inflation. As the last few years had produced GDP increases, room rates also increased at a healthy clip. Room supply growth for the nation was almost negligible, even turning negative as a large number of hotels closed in the wake of hurricane Katrina. Hoteliers could almost set their prices at will and in some instances did so. But in the post-recession, post-AIG effect world of curtailed demand, the customer is firmly in the driver's seat and demands more value, often characterized by deep price cuts.

At STR we observe this environment with some trepidation as the industry in effect redefines what the « value » of a room is. In the past up market, hotel yield and sales managers taught customers what to expect in terms of amenities and price points, but the current pricing strategies are resetting this definition to a much different, i.e. lower, level.

It took the US hotel industry six years to make up the rate cuts that occurred post-9/11. So it was only in 2007 that the achieved ADR equaled the inflation-adjusted ADR of 2000. We are fully expecting the deep rates cuts of 2008/2009 to be felt for an even longer time. On an inflation-adjusted basis year 2007 rates will probably not be reached again until sometime after 2017.

These five high-level trends will shape parts of the US hotel industry through 2010. We will continue to monitor the performance of the US and global hotel markets and comment on the emergence of trends and fads that shape the definitions of the « *new normal.* » ■

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