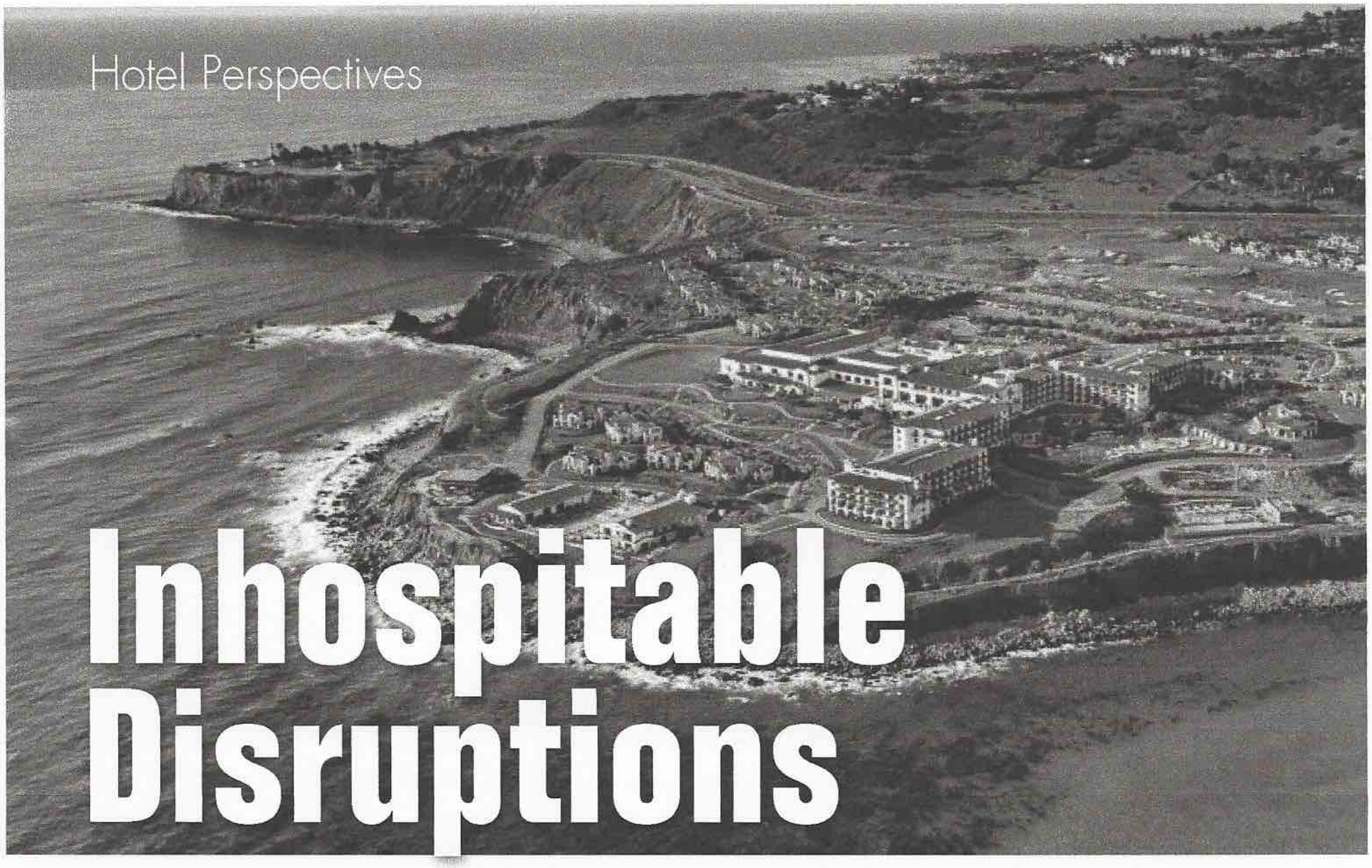
Hotel Perspectives

Inhospitable Disruptions



FOLLOWING SEVERAL YEARS OF RECORD-SHATTERING PERFORMANCE, THE PACE OF THE HOTEL SECTOR'S GROWTH IS EXPECTED TO SLOW DUE TO A VARIETY OF FACTORS

By Rayna Katz

It's no secret that the hospitality sector has been riding an epic wave of success in recent years. Occupancy has reached historic highs while profitability has skyrocketed. Plus, soaring economic indicators and expected increases in metrics for hotels bode well for the future.

But all good things must come to an end and hospitality executives know that a downturn is likely to happen. The good news is that while growth is expected to slow, the decline won't be seismic.

Supply growth, while a concern, is relatively in check and, perhaps in preparation for the inevitable, hoteliers have kept their costs low. However, several trends—including shifts in technology, demographics and inventory options—promise to disrupt the industry, for better and for worse.

"The US lodging industry achieved growth in all top line operating statistics, and every significant metric completed 2016 at a record level," states LW Hospitality Advisors' Q1 2017 Major US Hotel Sales Survey.

Yet the analysts maintain a cautious outlook for the sector, due in part to increases in new supply in major US markets, the rise of alternative accommodations and the softening of income growth and property values. The upside is that US consumer confidence is at a 16-year high, surpassing pre-2008 levels and rivaling the heady days of the dot-com boom.

US hoteliers are coming off of seven consecutive years of rising profits, reports CBRE Hotels' Americas Research in its recently released 2017 trends report. In response to the threats of stagnant or declining occupancy and slow ADR growth, operators controlled expenses. "The 3.7% increase in profits is the lowest we've observed since the Great Recession, but it's a commendable accomplishment given rising labor and distribution costs," says the firm.

So while there is reason to exercise caution, some analysts say there's no need to worry. "We're clearly at the peak of the cycle; we've been hovering there for the past two to three years," says R. Mark Woodworth, senior managing director and

Two Roads Hospitality offers unique experiences at each of its hotels to foster a sense of place. At Terranea Resort, guests can participate in whale watching and coastal guided hikes along the Palos Verdes Peninsula and California cuisine and wines dominate the menu.

head of lodging research, PKF Hospitality Research, a CBRE company.

"But hotel profit is durable," he says. "From a macro perspective, there are no threats to the continued attractive balance between the supply and demand for rooms. Year-over-year profit increases should be sustained for the foreseeable future."

Many hoteliers are taking such forecasts to heart. "We're very bullish on the next 12 to 18 months," states Russ Shattan, SVP, acquisitions and development, MCR Development. "We were up about 5.5% on RevPAR last year and the country was up 1.5%, so there's still good growth."

Nevertheless, supply growth is still worth keeping an eye on. Gateway cities, particularly those that attract international visitors, "will experience some negative impact in terms of RevPAR," asserts Jamie Lane, senior economist, also of PKF's hotel research group. "Miami is seeing strong declines in RevPAR this year, while New York will be negative again in 2017 and San Francisco will be flat or negative. Los Angeles will experience low growth over the year and Oahu is seeing some weakness."

Evan Weiss, executive managing director and principal, LW Hospitality Advisors, amplifies the point. "Though Miami is fundamentally an excellent long-term market, in the recent past it's experienced its fair share of less-than-positive news, with the Zika outbreak and a declining South American economy, along with domestic uncertainty in group travel and Airbnb."

The market has also experienced significant supply increases and is slated for even more rooms to come on line in the next 24 to 36 months, he adds. Ultimately, Downtown Miami, Wynwood and Miami Beach are good long-term investments, "but short term, headwinds certainly exist."

Contends Lane, "Common themes for several of the markets is substantial new supply, the impact of the strength of the dollar on international travel and weakened economies in Central America. There also could be a slowdown due to the supposed travel ban or its connotation."

Woodworth takes that notion a step further: "If you say, 'we don't want you to come visit,' or you make it more difficult, that's not good. Visitors who don't feel as welcome as they used to will go elsewhere."

The Lightstone Group's president and COO, Mitchell Hochberg, is even more definitive on the effect of the recent rhetoric. "We've already seen a negative impact of the immigration policies. We're opening a number of hotels in gateway cities and those markets have been impacted—no question. Foreign travel is down."

Since it opened, Two Roads Hospitality's Thompson Seattle has been at the forefront of creative partnerships that tie in local culture to culinary adventure. Its signature restaurant, Scout, highlights locally sourced items such as shellfish from the Puget Sound.

Yet he expressed a more positive tone on supply growth. While the product from the development surge of 2010-11 is coming to market this year and next, he points out that the number of rooms scheduled to open beyond 2018 will decrease significantly.

Meanwhile, factors both low- and high-tech could undermine the industry's success or alter how hoteliers do business. For example, Uber, and similar on-demand taxi-cab services, have turned real estate's most fundamental maxim—location, location, location—on its head.

Notes Ernest Lee, VP of development and investment management for citizenM Hotels, "In the pre-Uber age, business travel decisions were made based on how close a hotel was to a company's office building or a meeting. Now, the radius is much wider and hotels that you never would consider as business hotels are having a stronger weeknight performance."

But the impact isn't all positive, he warns. "Hotels in periphery locations, or those that don't really provide an experience, are more vulnerable now after getting away with just their location for years."

Providing that experiential stay is crucial to attracting and retaining guests, particularly for boutique hotels, counters Mark Hickey, EVP, acquisitions and development for Two Roads Hospitality. In fact, it's a fundamental component of the firm's offerings. "With an emphasis on local events, restaurants and nightlife, we can tailor the hotel experiences to customers of our different brands," he says. "The ability to tap local insiders to give us their recommendations, allowing guests to feel like locals, adds to the credibility of our story."

Hickey adds, "A certain age group may want a different service experience, or a business group or leisure guest may have a different need. It's about being relevant and delivering the right experience."

For example, under Two Roads' Destination Hotels brand, the Cliff House Maine offers lobster excursions while the Carolina Inn provides moonshine tastings and a furniture-making demonstration. The firm's eclectic boutique brands of Joie de Vivre Hotels and Thompson Hotels feature a wide variety of off-the-beaten path activities, including a denim fitting in Nashville, a "bee experience" class in Carmel Valley, CA or a "Tattoo Dinner" in Seattle.

There are some hotel brands that provide a unique experience through in-room technology, a tool that might especially lure coveted Millennial customers, opines Hochberg. "Some rooms now allow guests to stream content from their own entertainment providers—such as Netflix or Hulu—from their smartphones to the television in the room. There are also virtual check-ins as well as virtual concierges where, through an iPad, you can arrange a ticket to a local attraction or a restaurant reservation."

He asserts, "These changes are about being responsive to how consumers look to do business. It's a more efficient way of doing things, which is particularly important for younger consumers."

Other players in the space see such tools as both a blessing and a curse. "Everyone thinks of technology in terms of getting people in their doors but it's also a way to control costs," suggests Geoff Davis, founder and senior principal of Davis Hotel Capital. "Cost control of hotels is going to become more prevalent." But, he argues, "We're in the hospitality industry—we should enjoy being hospitable. Yes, hotels are very labor intensive, so if there's a way to create efficiencies, the industry will embrace it. But there should be a way to deliver both customer service and technology."

Many hotels look to technology in terms of social media or phone applications, both when managing properties and in their customer offerings. Information collected on guest preferences allow properties to deliver personalized service, while the online property tours and reviews give would-be guests an inside look. Add to that the use of social media and marketing, which are taking a more prevalent role.

That personalized service, and experience, stands to whet the appetite of investors, Hickey asserts. "The ability to reach customers is important," he insists. "If you're able to target the right customers, drive superior market performance and provide a high-level of experience, you can create strong financial performance."

Prism Hotels & Resorts' Steven Van, president and CEO, put it more directly when he spoke with Real Estate Forum's sister publication, GlobeSt.com, last year. "Online reputation has become as important as brand perception. Owners must pay attention to how their management company handles online reputation or they will lose value. And that loss could be significant, with a tangible and persistent impact on the bottom line." To emphasize his point, he cited an announcement by JLL that it would use guest sentiment analysis gathered from over 150 review sites in evaluating asset performance and investment opportunities.

Meanwhile, Airbnb and online travel agencies are still giving hoteliers and investors pause. Airbnb certainly needs to be monitored, notes Davis. "There are people who buy blocks of condominiums and rent them out like a hotel, so that's a threat," he says. "Hoteliers are just looking for the hosts to have to play by the same rules as them in terms of labor, taxation, safety, etc. Eventually all the third-party accommodation platforms will be regulated and taxed."

On the flip side, some industry players see Airbnb's impact as positive. Woodworth, for one, feels the sharing economy is "one of the best things to happen" to the industry. "While traditional hotels were running at record-high occupancies, Airbnb doubled in size in last year (in terms of rooms), so clearly there are more people traveling than ever. If you're in the travel industry, you have to say that's a good thing."

And though OTAs and their punishing commissions have been a thorn in hoteliers' sides for years, they're becoming more of an issue lately. "There's been a pretty substantial increase in the use of OTAs year-over-year," Lane explains. "The ease of use of booking online has become a factor," particularly among Millennials and their ubiquitous mobile devices.

With the proliferation of mobile phones come apps, the use of which is increasing. "Phone apps will continue to be an important part of the customer and service experience," states Lee. "Their use and application within hospitality will be broad."

Adds Weiss, "For booking, apps can be both a boon and a nightmare. They can assist with filling need periods, last-minute bookings and driving revenue. But they can also re-book rooms at lower prices, allow for lower pricing through comparisons and make the process less personalized."

The wave of the future, he declares, are operational apps that allow guests to interact with management and make requests in real time, enabling management to respond quickly and to better deploy employees, increasing customer satisfaction and efficiency."

Despite disruptions, ample opportunities are on the horizon for hotel investors, according to several industry players.

"For well-capitalized buyers who aren't afraid to get in early, there will be terrific opportunities for quality hotels in need of recapitalization," insists Van. "As the world continues down the path to globalization, a dramatically expanding middle class population in countries like China will continue to add to a growing pool of travelers—many of whom certainly will want to spend time and money in this great country of ours."

And while REITs have been pretty quiet the past 18 months, in part replaced by offshore investors, they won't remain that way for very long. REITs, says Davis, "are amassing capital for opportunities in 2018 and 2019. They'll come back in another year in a bigger way, possibly embracing more risk by forming more joint ventures, entering more turnaround situations or matching offshore investors in terms of price and accepting more yields." ◆