By Rick Swig

Some Stability Has Returned, But Its Staying Power Is in Question

Stability is returning to the hotel sector, yet it is a steadiness that real estate investors do not embrace. National occupancy trends may not be headed down, but little growth is forecast for the next year. There is still downward pressure on room rates due to the lack of demand, operational strategies to capture market share and growing consumer awareness about discounted pricing and alternative channels for attractive purchasing.

Nationwide hotel occupancies have huddled just below the 60% level for the past year, according to Smith Travel Research, versus the 65% pinnacle in 1996. Meanwhile, average US daily rate levels have declined to just below $84 from a peak of $87 in 2001. Coincidentally, there have been significant increases in operating and fixed expenses.

All market segments continue to be muted. Conventions are not only falling short of attendance expectations, but many attendees find overnight accommodations with heavy discounts outside of reserved convention housing blocks. Behemoth convention centers, such as Las Vegas, New Orleans and Chicago, may also be concerned about the immediate future of mega-trade shows, which have traditionally attracted thousands of attendees with proportionate hotel room sales.

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The top 20 major markets with the greatest room inventories have been most vulnerable to aberrant market conditions and will continue to be so. Large upscale hotels are using a variety of strategies to sell excess inventory and capture market share from the reduced existing demand.

In the short term, the battle for market share is the name of the game. The greatest competition will exist between higher priced segments and their previously lower priced rivals. These latter players will face the continuing challenge of fending off their more upscale competitors, who are poaching customers through aggressive room-rate incentives. This activity has already created an impact, with mid-scale hotels and economy chains exhibiting greater downward occupancies on a national basis than their upscale rivals, which have mitigated their declines or even experienced slight increases during the past year.

However, this plundering of lower market tiers has cost upscale hotels a 3.5% average decline in ADR during the past year. In major markets such as New York City, Chicago, Boston, Miami and San Francisco, there has been significantly greater impact, with downward ADR pressure manifesting itself in double-digit percentages during the past 24 months.

Larger upscale hotels have diluted or even destroyed the value proposition between themselves and their previously lower priced competitors. Although consumers have become more aware of prices, in many cases they are not shopping for the lowest absolute rate, but for the best value based on their individual hotel rate price cap. Consequently, customers have moved into more upscale products, while not necessarily paying more money.

Hotel customers do seem to have price tolerances for specific markets; they expect to pay within a certain rate range for specific destinations. With newly adjusted pricing models, business travelers can comply with corporate spending tiers and still stay in an upscale format. Additionally, even though leisure travelers still exhibit price resistance, reduced hotel room pricing has enabled segment customers to move from a mid-scale property to a higher quality product for the same cost and with greater satisfaction.

The urban boutique hotel segment has been especially impacted by slow market conditions. The contemporary urban boutique success story has been based on a value proposition versus larger upscale hotels. It compared the more expensive and larger full-service hotels to the smaller boutique format, where comparable product benefits could be realized at a lower price and with minimal comfort compromise. As a result of current market dynamics, large upscale hotels with surplus inventory have quashed this value differentiation by pricing their excess rooms at reduced prices, while the boutiques with less inventory to place at risk have been forced to choose between reducing prices or yielding enough revenue to be profitable. Even with further discounting, the boutiques have not been successful in stimulating lost demand or capturing market share.

It is obvious that the larger upscale hotels have realized some short-term gains, but there will be some long-term side effects because they've shed significant ADR percentages in order to achieve market penetration goals. Due to recalibrated customer pricing expectations for upscale products, recovery from previous pricing thresholds will be a long and arduous journey. ■

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