

Summary of the Extended-Stay Lodging Industry in the United States - 1999

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This is a summary of a detailed 1999 survey of the extended stay lodging industry in the United States. The full report is available for sale from The Highland Group (404) 872-4631 or e-mail highlandgroup@mindspring.com. The Highland Group prepared an in-depth report on the status of the extended-stay lodging industry in the United States as a service to the industry. We are grateful to the extended-stay hotel chains and owners that contributed information to this report and trust that the results will be useful. While accurate to the best of our knowledge, we do not warrant the accuracy of any information presented, nor do we warrant that any projections will be achieved. This information should not be relied upon to make any investment or management decision without further research and analysis.

Summary

Extended-stay hotels, and extended-stay guests, have been part of the lodging market since its inception. Niche targeted extended-stay upscale hotel concepts were rolled out in the early 1980 s. These chains, particularly Residence Inn, dominated the extended-stay market for some 15 years. About five years ago, emerging economy chains began to gain momentum, and drove the rapid growth in extended-stay supply documented in this report. As the major franchisors entered the sector, mid market products were introduced, reflecting the franchisors interest in higher gross revenues, and products requiring reservation systems. The mid market hotels have significantly effected the figures for 1998, the first year in which a substantial number operated.

The market for extended-stay hotels has been under served for many years. However, the degree to which demand exceeds supply has been hotly debated. In 1998, the first year in which a number markets have had a full range of product, answers to the question of how many extended-stay hotels can be absorbed are starting to emerge. As expected, the answer is "it depends".

- Extended-stay hotels represent 4% of the hotel rooms in the United States, but some markets have more than 30% of supply in extended stay hotels, which operate at strong occupancy levels.
- Markets with rapid population and employment growth, high-tech industries, and high rates of in-migration tend to have the strongest extended-stay demand.

Slower growth markets with non-high tech industries can often also support extended-stay hotels, but fewer rooms.

- Extended-stay hotels in all segments accommodate transient guests, but transient business generally increases with price. Transient demand contributes 15% in the budget segment, while upscale extended-stay hotels derive 44% from transient guests. Extended-stay hotels have proven desirable to a wide range of customers.
- Extended-stay demand continues to increase nationally due to population, training and employment trends. This will continue, but will fluctuate. For instance, Y2K is a significant generator of extended-stay demand currently, as is real estate development. Other trends generate demand at other times. Extended-stay demand is also increasing as national marketing programs for these products take effect, and as people get used to the product's convenience. The leisure and personal markets are growing fast, particularly at the economy level.

Overall, the product has been extremely successful. Returns on investment have been high at most price points. However, the fundamentals of the extended-stay business remain the same. First, extended-stay lodging generates strong returns because it operates at above average occupancies with below average hotel operating costs. Second, extended-stay lodging is still a price buy. These hotels offer strong value to guests to sustain high occupancies. Finally, brand is a factor. Several extended-stay brands have now reached critical mass. As their marketing and brand recognition gain momentum, they can be expected to draw above average revenues.

Highlights of this Research

- 49,000 new extended-stay hotel rooms opened from November 1997 to year-end 1998, yielding a 46 percent increase in extended-stay supply over the period and a 197 percent increase from 1995.
- Extended-stay hotels averaged 74% occupancy in 1998. Average occupancy for all US hotels was 64%, a 10 point extended-stay occupancy premium.
- Extended-stay demand accommodated increased 36% in 1998 over 1997 while supply increased 46%. Since supply increased faster than demand, occupancy dipped 6 points. However, this includes the ramp-up period for 28% of the inventory. As the new hotels stabilize, demand accommodated will increase.
- Mid-price extended-stay hotels, which had virtually no representation two years ago, now represent 24% of extended-stay supply. Their one-year supply increase of more than 200% resulted in a year-end 1998 average occupancy of 65%,

including the initial ramp-up period for the great majority of these hotels.

- We project that extended-stay room supply will increase by 45,000 rooms in 1999 and total rooms will top 300,000 rooms, or 8% of total lodging inventory, at the end of 2002.
- Overall extended-stay average rate was \$61 percent in 1998, compared to the lodging industry average of \$78.62. Gains in economy and budget market share drew the average down from \$67 in 1997, but every extended-stay segment increased in rate from upscale, which posted a 1% gain, to economy, which posted a 30% average rate gain in 1998.
- Average length of stay in hotels priced under \$200 is 35 nights compared to 20 nights at hotels priced between \$200 and \$300 a week, 13 nights for mid price hotels and 10 nights for upscale hotels.
- Unleveraged returns averaged 12% for economy and mid priced extended-stay hotels, 13% for budget and 15% for upscale properties. High returns continue to draw investment interest in extended-stay lodging.