Photos: Nick Koutoufas

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Singing a New Tune

Though there were striking similarities to last year's discussion, such as talk of Airbnb and the need to court millennial guests, this year's Hotel Power Panel had some stark contrasts, too. Unlike the bullish tone struck in *Real Estate Forum*'s 2015 gathering, participants this year—who gathered in June during the NYU International Hospitality Industry Investment Conference, held at the Marriott Marquis in New York City—could see the beginning of the end.

RAYNA KATZ: Last year, forecasts said 2016 would be when the sector could start falling off. What are you seeing?

CHAD CRANDELL: A deceleration of growth.

CHRIS PFOHL: We've only had a 2.7% RevPAR gain. May could be the first month since 2010 when you see year-over-year decline. However, we expect positive NOI growth this year.

JAMIE LANE: In our latest numbers we revised our RevPAR forecast downward by about 130 basis points. We thought the numbers would be soft, but not this soft. But we think the second half of the year will perform better and end at around 4.5% or 5% RevPAR growth. In overall growth, we'll be much lower than 2015. We're seeing softness in the East Coast and many oil-driven markets, along with occupancy and rate declines.

Next year RevPAR growth will be a little higher than this year. We have 2017 at 4.9%, versus 4.2% for 2016. The strong dollar is impacting manufacturing and exports while GDP and employment growth are below expectations. If we get above 2% GDP growth for 2017, that will bode well for lodging demand.

JP FORD: A lot of the deceleration we've seen has to do with supply. However, in an election year, there can be market uncertainty. Hotel development slows down and demand is hurting. But after the elections you typically see acceleration. So from a new supply perspective, we're forecasting a healthy 2017.

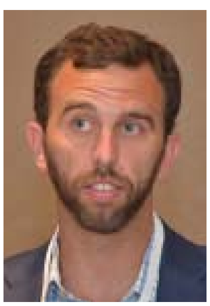
PFOHL: There are many headwinds: the dollar, new supply, Zika and the election. Plus there's global economic uncertainty.

CRANDELL: Cheap gas might give us a little boost for the summer travel season. There's concern for people traveling abroad about safety and the dollar's value. We have seen many more Americans vacationing in the United States this year.

FORD: When gas prices were high, people still traveled during the summer, even if it cost an extra $50 to $100. Although we think gas prices have a direct effect, it's difficult to measure.

LANE: When oil prices get to $150 a barrel, you see pushback. So far, oil and gas prices haven't been low enough to induce travel demand or create big airfare declines. We've seen an uptick in US travelers going abroad because Europe is the cheapest it's been in a long time, and we've seen a flat trend in international visitation to—and spending in—the US.

We've seen incomes increase, though, and that should result in lodging demand. It also negatively impacts the industry's bottom line, in terms of wages.



"Just because we're at the peak doesn't mean we're going to start declining."

JAMIE LANE
CBRE HOTELS

KATZ: What do you expect for ADR?

LANE: A 4.3% increase.

GREGORY MOUNT: Have you seen occupancies return to the highs we reached before the last downturn?

LANE: We're well above it; most major markets are at record highs. But just because we're at the peak doesn't mean we'll start declining. We expect a plateau and—unless we see a major shock—we'll be able to ride the top for a bit.

FORD: We could stay at the top for two to four years, provided there's no outside factor that prompts a change. People talk about supply, but it's been disciplined.

PFOHL: Even in New York City—the poster child of new supply— demand continues to increase or remain stable. This year and next will be tough, in terms of RevPAR decline due to supply, but off of a mid- to high-80s occupancy. However, the long-term forecast for New York City's demand looks solid.

KATZ: Despite "disciplined" supply growth, and demand remaining strong, some investors fear an oversupply situation. What do you expect?

FORD: We're forecasting about 900 properties, or about 102,000 rooms, to open this year. That's a 1.9% to 2% supply increase, which is stronger than last year but not greatly concerning.

There was a deceleration in the pipeline during the first quarter over the last quarter of 2015. Late last year, we added about 355 projects, or about 42,000 rooms. In the first quarter of 2016, we only added 58 projects, or a little over 5,000 rooms.

PFOHL: Many planned projects have stopped because lenders are much tougher.

LANE: This is suppressing supply below levels we've seen in past cycles.

CRANDELL: JP, how does it look this year and next?

FORD: Last year, new supply grew at 1.6%. This year we're forecasting 1.9% to 2%, and in 2017, 2.3%.

LANE: We're just below that: 1.8% for this year and 2.3% for next year.

PFOHL: In major markets—in particular Boston, San Francisco, New York, Los Angeles—hotel construction costs are rising as projects try to compete with retail, residential and office development, and land prices have increased substantially.

KATZ: What kind of projects are you working on? Are particular parts of the country of interest, or are there areas you're shying away from?

PFOHL: We have probably seven or eight projects under development. We're building extended-stay product near major universities. We have a 330-room Residence Inn in Berkeley, CA; we're going to build a 200-room Residence Inn at Johns Hopkins Medical Center and one at the University of Arizona, Tucson.

We see the university market as very stable. We just assumed management of AJ Capital's Graduate Hotels and are assisting in growing that brand.

FORD: There only are 52 luxury hotels in the pipeline across the US. Even in upper-upscale segment, there are 180 properties, and many of those are in the early planning stage or scheduled to start in the next 12 months.

PFOHL: To build a full-service hotel with 20,000 to 25,000 square feet of meeting space and 300 rooms on fee-simple land is $350,000 to 400,000 a key. Those projects that are getting done often have a public element or public subsidy to them.

"The seller ask versus the buyer bid is rather large. Sellers have to readjust their expectations if they're going to transact a property in 2016."

CHAD CRANDELL
CHMWARNICK

KATZ: Transaction activity was down a bit in the first quarter and, in April, investment activity reportedly was down 4%. Cap rates have crept back up, hitting 8.5%. What are you seeing?

CRANDELL: The gap between what the seller is asking versus what the buyer is bidding is rather large. Events in 2016—modest increases in the cost of debt and decelerating RevPAR—have historically challenged valuations. Sellers have to readjust their expectations if they're going to transact in 2016.

LANE: We saw the sale of the Waldorf in the first quarter of last year, and a few big portfolios trades, too. Those types of deals aren't happening this year, which has led to big declines in the volume and value of transactions. As the bid-ask narrows, transaction volume hopefully will tick up.

CRANDELL: Buyers are a bit different; REITs are not active. Also, we had a lot of international activity last year from the Middle East, China and more that has slowed down a bit.

"In major markets, hotel construction costs are rising as projects compete with retail, residential and office development."

CHRIS PFOHL
PYRAMID HOTEL GROUP

KATZ: For the next 12 to 18 months, are you net buyers or net sellers, and what's of interest?

MOUNT: We acquire assets with good metrics and a number of them are under branded and under capitalized, thereby creating value.

We'll look at adaptive reuse where fringes of the markets are being gentrified. Particularly in some gateway cities, there are opportunities for acquisitions that can become good hotels at a reasonable basis.

PFOHL: We're net buyers. We have spent a lot of time in the past six months looking at transactions that didn't close last year. We see what's happening and try to do a deal.

We're spending time in secondary markets—where pricing isn't crazy—and we continue looking selectively into major markets.

KATZ: What impact will the recent mergers among major brands have on your business and the broader industry?

MOUNT: It creates uncertainty for owners and creates some opportunity for smaller brands. We took the initiative with Hotel RL to have flat monthly franchise and marketing fees not tied to earnings. That gives owners the ability to grow their RevPAR.

KATZ: Let's talk about financing. Are you finding it, and from where is it coming?

FORD: It's readily available. There has been an uptick in pricing but solid borrowers with a good game plan generally can find financing. It is available with regional banks.

KATZ: What impact is foreign capital having on the market?

PFOHL: It led to 18 hotels getting sold. A fair amount of European and Middle Eastern capital is coming in, particularly from European pension funds. They're getting little or no growth, plus negative interest rates, and they're looking at it on more of a long-term basis. And we opened an office in Europe. There's a real opportunity to grow there.

C0RANDELL: We'll continue to see foreign capital. It tends to have a lower cost, and investors' hold term is usually significantly longer.

KATZ: Are you concerned about CMBS?

CRANDELL: The CMBS performance in the first half of this year has not been nearly as strong as last year, and some balance sheet reserve requirements will start this fall, which could further dampen the market in the second half of 2016.

It will be interesting to see what happens with CMBS maturities. Many owners may have to refinance into shorter-term capital.

KATZ: Last year we talked about millennials and how hotel brands were working to accommodate them. Is that still happening?

MOUNT: A better term is "the millennial mindset," referring to anyone who carries a smart phone and does not have a house phone. The most successful brands will be those that create an authentic experience. Many brands are trying to contrive one that doesn't exist in their culture.

What's more important is to understand how people shift and how they're booking their businesses. We've brought people in from Apple, Microsoft, HP and others who are taking a different approach to our booking experience.

You could say our rewards program is a millennial mindset. Instead of an expensive points-based program that only rewards you once you've stayed multiple times—and may not allow you to book a room on certain dates—we went to a program about "'surprise and delight." If you stayed with us last night, we may send you an iTunes song, an Amazon gift card or the coffee served in the coffee shop.

"The most successful brands will be those that create an authentic experience. Many brands are trying to contrive one."

GREGORY T. MOUNT
RED LION HOTELS CORP.

KATZ: Are you seeing, or implementing, new products or services?

MOUNT: We're doing a program called the Living Stage, which is like TED Talks. Every day and night, at every hotel, someone gives a talk, and those get rebroadcast on the entire Hotel RL television system. Those types of efforts will create long-term connections and an authentic experience.

PFOHL: The name of the game is to connect to the community—as Airbnb has done. It's much more than having a picture of the Golden Gate Bridge in your room in San Francisco or a picture of Faneuil Hall in Boston.

Maybe it entails sending something to guests after their stay but it's creating Facebook and Instagram moments by deploying food and beverage and different measures to make people talk online about your product.

LANE: Airbnb connects two people who don't know each other and makes that booking experience seamless. It's easier than booking at a major chain. Most people see that it's beginning to impact traditional hotels' market share, especially in large markets.

MOUNT: I don't see the business traveler sharing a room at someone's house. A recent study showed that Airbnb represents less than 3% of new supply in the US,

> We are forecasting a healthy 2017 from a new supply perspective."

JP FORD
LODGING ECONOMETRICS

yet the industry continues to suggest Airbnb has a big impact.
PFOHL: It's created a market. Younger people with our company use Airbnb often. They can't afford to pay $400 to $500 for a room but now when they go to New York or San Francisco, it's more affordable.

Where it will show a larger impact is when there's a downturn and Airbnb supply increases because a couple in a two-room apartment in New York has their variable rate mortgage raised so they start renting rooms.
LANE: The data shows that outside of the top 15 markets, you don't need to worry about Airbnb. But in top locations like New York, 10% of demand in 2015 went to Airbnb. That probably affected rates.
MOUNT: Some of the supply in New York affected rates as much as anything.
LANE: It's hard to prove. Many hoteliers feel they are not able to raise rates because there are 300 Airbnb units around them selling for $150 a night. I'm not saying Airbnb is the be-all and end-all but it probably will impact ADR in US gateway cities.
PFOHL: It's important that the major brands figure out how to connect to millennials. What happens when a millennial couple gets married and moves to the suburbs with two kids? Then they probably are more likely to use a branded hotel.

KATZ: What disrupters in product type do you see on the horizon?
CRANDELL: One thing that our industry hasn not dealt with is the need for a meaningful room cancellation fee. The idea of waiting until six o'clock the day of arrival is ridiculous because there are disrupters out there, such as HotelTonight and tripBAM.
MOUNT: In our revenue management, we are pricing dynamically based on our online reputation at that moment. That's going to be a game changer for the industry.
PFOHL: The living wage is a disrupter the industry has to address. The other thing is that healthcare costs will rise.
CRANDELL: The cost of Obamacare gets fully absorbed into our economy in 2017 or 2018.
PFOHL: The third strike is overtime pay; it's occurred the last couple of years.

KATZ: At this time next year, what will you say in terms of the year past, and looking ahead?
CRANDELL: I'd say 4.2% RevPAR would be a good year. It's going to be a focus on being more efficient and challenging the business model on cost structure.
FORD: People will say it was a good year—though maybe not great—and the future still looks bright. ◆

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