Hitting the Hotel Industry Tipping Point

By Scott Donald, Irvine

Nationwide, hotel properties are riding a wave of positive momentum. At the end of the third quarter, more than 750,000 rooms were under construction in the U.S., an increase of 23% over the same time last year.

There’s a fine line between healthy construction in a robust market—and too much construction that can lead to over assessment.

HOTELS ARE HOT

With the exception of the multifamily sector, hotel operations are outperforming other commercial property types and are commanding attention from investors, according to Marcus & Millichap. The flow of capital into hotels drove up transaction and dollar volume over the past 12 months.

Rising demand pushed room revenue to a record of more than $71 billion in the first seven months of 2013, 6.5% more than the level recorded in the same period in 2012. Average daily rates (ADR) and revenue per available room (RevPAR) are projected to be higher for the year as a whole. (See chart, next page.)

TOO MUCH OF A GOOD THING

Speakers at the 19th annual Lodging Conference expressed concerns about hotel overbuilding, especially in some markets and segments.

“Everyone is on the way up on the roller coaster and they only see blue sky. Nobody seems to be looking where the top of that roller coaster will be,” explained Fred Grapstein, senior VP of Vornado Realty Trust.
Grapstein told the conference his main worry is oversaturation in mid-scale hotels. That’s because the vast majority of the new construction is hotels with 200 rooms or less. An oversaturation in the mid-range of the hospitality market will lead to more competitive rates and declining bottom lines. There are only so many travelers and unless they target the appropriate growing segment for their location, some assets could revert back to what they experienced in 2010 or earlier.

When a specific segment overpopulates and struggles for survival, it causes collateral damage throughout the hospitality industry. The effects extend into other market segments, both upper scale and budget properties.

**CHART: HOTEL TRENDS**

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<th>2012</th>
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<tbody>
<tr>
<td>ADR</td>
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*Source: Marcus & Millichap Research Services, Smith Travel Research*