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Hoteliers Face a Flat Market in 2010 California

Hotel owners and operators continue to push room rates down but see increasing occupancy and some higher revenue this year

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After devastating declines in occupancy, room rates and revenue, California hoteliers are looking forward to a year of relative stability in 2010.

Hotels in the state saw revenue per available room, or RevPAR, drop by almost 19 percent in 2009 as they lowered average daily rates to fill empty hotel rooms. They're still cutting prices this year, but hotels are reaping the rewards of promotional partnerships and marketing campaigns with occupancy on the rise and revenue for some properties coming in higher than expected when 2010 budgets were developed last year.

Hendersonville, Tenn.-based Smith Travel Research reported 60.1 percent occupancy for California hotels in 2009, down 8.8 percent from the prior year. The state's average daily room rate was \$109.75 per night, down 10.9 percent from 2008. RevPAR was down 18.8 percent to \$66. California had a 2.2 percent increase in its supply of hotel rooms in 2009 while demand was down 6.8 percent.

Nationally, Smith Travel Research expects the supply of and demand for hotel rooms to increase 1.8 percent this year. U.S. hotel occupancy is forecast to be flat in 2010 at 55.1 percent with 3.2 percent declines anticipated for both average daily rates and RevPAR.

"I think we are definitely looking at a much more stabilized situation for 2010," said Ingrid Summerfield, president of San Francisco-based

Joie de Vivre Hospitality. "We have a very cautiously optimistic outlook."

Joie de Vivre anticipates that its revenue will be flat in 2010 compared with last year, even with an uptick in occupancy, because of lower rates offered to fill rooms. Some markets are performing better than others, such as the Silicon Valley, where businesses are hiring and traveling again. But Sacramento and some San Francisco neighborhood hotels are having a tougher time keeping occupancy and room rates from slipping.

Occupancy for Sacramento hotels dropped 11.4 percent on a year-over-year basis in 2009 to 50.9 percent, average daily rate fell 9.8 percent to \$91.37 and RevPAR plunged 20.1 percent to \$46.51, according to Smith Travel Research. The market's supply of hotel rooms increased 2.8 percent while demand dropped by 8.8 percent.

In January, the San Francisco/San Mateo market saw a 7.5 percent decline in RevPAR on a year-over-year basis, but Joie de Vivre's hotels saw 4 percent and 8 percent RevPAR growth in those markets last month.

"Southern California is showing small signs of growth, which is good news for Los Angeles and Orange County," Summerfield said. "The majority of our properties - Hotel Maya in Long Beach, Shorebreak Hotel in Huntington Beach and Hotel Erwin in Venice Beach - were either not open last January or under renovation, so I can't give you good comparisons. However, we are pacing well to our forecasts."

Slowing the Slide

While U.S. hotel occupancy dropped to 46 percent in January from 46.4 percent in January 2009, California's major hotel markets showed improvement last month, according to Smith Travel Research.

Occupancy increased from 53.9 percent to 55 percent in Anaheim-Santa Ana, from 58.9 percent to 62.8 percent for Los Angeles-Long Beach, from 53.8 percent to 54.4 percent in San Diego and from 57.8 percent to 61 percent in San Francisco-San Mateo.

Room rates dropped by 9.3 percent in Orange County, 2.8 percent in Los Angeles County, 11.5 percent in San Diego and 8.6 percent in the Bay Area. RevPAR was down 7.5 percent in Orange County, 10.6 percent in San Diego and 3.5 percent in the Bay Area, but up 3.7 percent in Los Angeles County.

"I think what we saw in the month of January was finally a slowing down of the continuous year-over-year decline in occupancy and rate," said Joe Long, executive vice president of acquisitions for San Francisco-based Kimpton Hotels & Restaurants. "What had been happening until the end of last year is that every month's year-over-year decline was worse than the month before."

"We are seeing RevPAR slightly below where we were in January last year, but it's in the single digits instead of the high teens. Occupancy is coming back, but average rate is not."

As occupancy rebounds during recoveries from economic downturns, it typically takes a while for room rates to rise.

"It's hard to move that needle," Long said. "With the transparency of room rates with the advent of the Internet, you know in five minutes what everybody's charging. All it takes is for one major hotel to lower their rates \$20 and everybody else has to."

Kimpton anticipates that room rates will flatten out in San Francisco, Los Angeles and San Diego this year as occupancy stabilizes or improves slightly with RevPAR flat to 2 percentage points higher by the end of the year.

"Even if the economy improves this year, [revenue] will still be down because corporations negotiated their room rates last fall. The consumer feels they've got the negotiating power and they're just not going to pay," Long said.

While international travel to the United States is strong, leisure travel overall still is soft. Also, Long said, the number of conventions hasn't declined in major convention destinations like San Francisco and Los Angeles, but

attendance at those events and associated hotel room bookings are down.

"We think that San Francisco will probably come back quicker because there's been very little new supply," he said. "San Diego has had a number of hotels open, so that's a concern. Los Angeles has always been a target for us, but it's hard to get into. It's an expensive market."

Cheap Rooms for Investors

The hotel market got less expensive in California for investors who wanted to buy hospitality properties last year.

While Bob Eaton, executive managing director at PKF Capital in San Francisco, said capitalization rates are not great indicators of hotel values in unstable markets, PKF is predicting that hotel capitalization rates will top out at 10 percent when final 2009 data is in and drop to 9.9 percent this year, 8.7 percent in 2011 and 7.7 percent in 2012.

Among the hotel transactions taking shape this year was the recent \$12.3 million sale of the 170-room Sheraton Hotel in Pleasanton. PKF Capital in San Francisco represented the seller, a Southern California-based fund manager. The buyer was Pleasanton Lodging LP, a partnership involving principals of Sethi Enterprises and Kapoor Enterprises.

The number of hotel sales in California dropped 52 percent and the dollar volume of transactions fell 75 percent from 2008 to 2009, according to Irvine-based Atlas Hospitality Group. The median price per room was down 30 percent - 40 percent in Southern California and 24 percent in Northern California.

The \$90 million acquisition of the 404-room W Hotel San Francisco by a Chinese investment fund was the largest hotel sale in California in 2009. The highest price per room was the \$260,000 paid per key for the 15-room Carmel Wayfarer Inn.

Atlas Hospitality is forecasting 150 to 175 California hotel sales in 2010, an increase of more than 50 percent from the 92 transactions in the state in 2009. The firm expects dollar

volume to be double the \$525 million sold in 2009, despite a 10 percent to 20 percent decline in prices.

Meeting Demand

With hotel fundamentals and property values in decline, there is little new hotel development in California this year.

The largest hotel opening in the state in 2010 is in downtown Los Angeles, where the 54-story high-rise at L.A. Live, built for a reported \$970 million, was scheduled to open this month. The project has 1,001 JW Marriott and Ritz-Carlton hotel rooms with 224 Ritz-Carlton condominiums that will be released next month at the top of the tower.

At Hollywood Boulevard and Vine Street, the \$350 million W Hollywood Hotel & Residences opened on Jan. 28. It has 305 hotel rooms and 143 W-branded condominiums.

The project was developed by Dallas-based Gatehouse Capital and is owned in a joint venture between Norwalk, Conn.-based HEI Hotels & Resorts and Gatehouse Capital, in affiliation with the Los Angeles County Metropolitan Transportation Authority.

Jim McPartlin, general manager for W Hollywood Hotel, said he never expected the response the hotel has received. It has done twice the business that was expected for its first month. Room rates for weekend stays were increased after just a few weeks because of the strong demand.

"Unfortunately, we're opening at the end of a bad cycle," McPartlin said. "It's a long-term game. We build hotels for 20 to 25 years or longer. All signs point to a first great step out of the gate."

With its W brand and its location at the iconic intersection of Hollywood and Vine, the hotel already has capitalized on the entertainment industry in Los Angeles. The hotel hosted a Grammy Awards "after party" following the televised awards ceremony on Jan. 31, with 1,500 attendees, including many of the program's nominees.

"We have a lot of that kind of pizzazz working for us," McPartlin said.

In San Diego County, leisure travel demand this year is expected to be on par with 2009, according to Bob Rauch, general manager and co-owner of the Homewood Suites and Hilton Garden Inn in San Diego's suburban Carmel Valley submarket and president of hotel consulting firm R.A. Rauch & Associates Inc.

"The corporate side was soft last year," Rauch said. "We haven't seen a lot of group activity, but there is some pickup in small groups. Big meetings have been cut back really dramatically."

Corporate budget cuts remain intact when it comes to booking group activities at hotels and many companies are meeting at their local offices whenever possible.

"I do feel that that will improve in the second half of the year and next year, but it hasn't hit yet," Rauch said.

Room rates dropped about 15 percent in San Diego County last year. This year, Rauch said the goal for his two hotels is to break even.

"If we can hold steady during this time, in a couple of years we'll be sitting pretty," he said. "I've seen the first signs of a third-quarter 2010 turnaround, but I don't think we're going to see a rate turnaround. We'll see a pick up in leisure demand and significantly picked up business demand. I don't see any movement in rate until 2012 or 2013."

From a demand perspective, it's still too early to claim a turnaround, according to Randy Hulce, managing director for hotels at San Diego-based Trigild, which specializes in distressed property management, receiverships and loan recovery.

"We're standing at the bottom of the ocean and looking up," Hulce said. "You're still under water, but at least you're not sinking anymore."

Hotel room demand from convention attendees in 2008 and 2009 was off 5 percent to 10 percent from 2007 levels. The attrition rate from people who were expected to attend

conventions but stayed home instead was high. Hotels in convention markets like San Diego, Anaheim and Los Angeles competed in pricing wars to fill rooms.

"It's very much a buyers' market," Hulse said. "Until jobs come back around, we won't see that uptick in rates."

The State of Hospitality Distress

Hotel owners are giving big, high-profile hotels back to their lenders after very little discussion of the assets' problems because they know it will be years before property values comes back.

"We have quite a few lenders - banks in particular - with a loan that's probably double the value of the hotel in today's market," Hulse said. "We anticipate a lot more going into foreclosure and receivership this year."

Atlas Hospitality reported that the number of hotels in foreclosure jumped 313 percent to 62 properties between the beginning and the end of 2009. The number of hotels with loans in default jumped 479 percent from 53 to 307.

Trigild has about 20 hotels under management or in receivership in California, and the company expects that number to triple by the end of this year.

In an interview at January's Americas Lodging Investment Summit, Alan Reay, president of Atlas Hospitality, said hotel owners had a good 2008, so they had money in reserve, but those reserves were used up in 2009.

With debt payments higher than the revenue available to pay their mortgages and with property values below the amount of debt they owe, hotel owners are more likely this year to give properties back to their lenders, Reay said.

"Any new hotel is hurting," he said. "In the whole country, the only market that was up [last year] was Washington, D.C."

Even if new hotels in markets like Moreno Valley that have a low supply of rooms are keeping occupancies at healthy levels, they are doing so at lower average daily room rates.

Reay noted that RevPAR is off by at least 25 percent in Moreno Valley.

Elsewhere in the Inland Empire, Sun Development & Management Co. opened a 150-room Embassy Suites Hotel in Palmdale and plans to open a 175-room Embassy Suites in Ontario later this year.

The supply of rooms in the Inland Empire increased 9.6 percent in 2009 and is expected to increase by 3.9 percent in 2010 on a year-over-year basis, according to PKF Consulting. Occupancy decreased 2.6 percent in 2008 and 2.3 percent in 2009, but is expected to rise 0.7 percent in 2010. Room rates declined 1.3 percent in 2008 and 12.8 percent in 2009 and are forecast to drop 1.4 percent this year. RevPAR declined 9.3 percent in 2008, 22.2 percent in 2009 and is anticipated to drop 4.5 percent this year.

The Homewood Suites by Hilton in La Quinta reopened on Jan. 19 after closing last fall due to financing issues. LQ Hospitality LLC maintained ownership of the property, which has 129 studio, one- and two-bedroom suites, but the hotel is under new management by Vesta Hospitality.

Brad Poncher, general manager at the Homewood Suites in La Quinta, said the property has performed better than expected since reopening last month. At the rate that rooms are being sold, the hotel is expected to produce 40 percent to 50 percent more revenue in March than was budgeted. Early in February, the hotel was generating about 25 percent more than budgeted.

After the completion of \$70 million in renovations that began in 2007, the Riviera Resort & Spa in Palm Springs, which is managed by Noble House Hotels & Resorts, reopened in October 2008, right around the time that hotel occupancy and revenue began to plunge into negative territory. Karl Kruger, vice president and managing director of the Riviera, said 2009 was difficult for it and all of the Coachella Valley. RevPAR for the Coachella Valley dropped from \$124 in 2007 to \$90 at the beginning of 2010.

"We were battling to win business," Kruger said. "We're seeing things turn around. We were seeing bookings go up in December."

Another Southern California project, \$20 million in renovations at the 462-room Paradise Point Resort & Spa on San Diego's Mission Bay, is scheduled for completion by the end of February. The project spruced up the 48-year-old hotel's 35,000 square feet of meeting space and each of the bungalow-style guestrooms.

Geoff Young, vice president and managing director in San Diego for Noble House, which manages Paradise Point, said the hotel operated under its typical sales and marketing campaign last year, even while renovations took 80 rooms at a time out of the property's inventory.

Managing the Downturn

To keep rooms filled in a tough economy, Young said the first priority should be taking care of existing customers by being flexible and providing good service. Paradise Point also is making contacts with group business and catering customers that have hosted events at the hotel before and not been back in a while.

"We would rather bring a customer back than spend marketing dollars to get a new one," he said.

Hotel managers also are monitoring third-party distribution channels on a daily, and sometimes hourly, basis to make sure room rates are competitive with surrounding hotels.

John Huettel, group vice president for the Americas from JDA Software Group, said that hoteliers use many means for pricing their rooms in reaction to rates available in the marketplace, like JDA's revenue management software.

"You have to understand what price point will drive people to your hotel," Huettel said.

With the ability of consumers to compare the prices for every hotel in the destination where they intend to travel within minutes via third-party Web sites, he said hoteliers must know

how price-sensitive customers are to a hotel's competition.

The Homewood Suites in La Quinta offered special rates when the property reopened last month, but the hotel is still booking future business based on its regular seasonal rates. It also is looking to bring in business related to upcoming special events in the Inland Empire, including the annual tennis tournament in Indian Wells in March and the Coachella Valley Music and Arts Festival in Indio in April.

"We ran almost 60 percent occupancy on Saturday night [Feb. 6] and that was totally unexpected; we forecast 35 to 40 percent," Poncher said. "It follows the trend of what the convention centers are seeing. They're seeing more short-term business going on."

Convention bookings at the Palm Springs Convention Center are flat compared with 2009, but smaller events scheduled months instead of years in advance are boosting revenue.

The Riviera Resort & Spa is reaching out to all market segments, but leisure travel seems to be the dominant segment so far this year with more than 90 percent of those guests coming from cities in Southern California, Kruger said. Group and business travel remain the most challenging segments.

The Riviera, like all other hotels with "resort" in the name, has suffered from the so-called "AIG effect" - corporations shying away from events at high-end resorts after AIG Group came under fire for hosting a lavish conference at the St. Regis Monarch Beach in Dana Point last year after receiving billions in bailout funds from the federal government.

In addition to courting leisure travelers from Southern California and other drive-in markets, the Riviera partnered with area convention and visitors bureaus and convention centers on marketing efforts for the region.

"There are 14,000 to 18,000 hotel rooms in the valley so we are in a battle for business," Kruger said.

One tool in San Diego County's arsenal is the tourism marketing district created by the local hospitality industry in 2007. Hotels in the region collect an extra tax administrated by a private nonprofit called the San Diego Tourism Promotion Corp. to pay for advertising that promotes local attractions in nearby markets.

"I think our region is doing better because we have spent dollars promoting the value of the San Diego region," Rauch said.

Partnerships, special promotions and an effort to drive traffic to its Web site have been important business drivers for Joie de Vivre. The hotel company offered a "Sowing the Seeds of Love" package around Valentine's Day for any of the company's 35 California hotels. Joie de Vivre also has used partnerships with other area attractions to fill rooms, such as an offer for free lift tickets in the Alpine Meadows ski area near Lake Tahoe with a hotel stay.

"Personally, I believe hotels have discounted their rates about as far as they possibly can. Revenues were down last year by 20 percent overall," Summerfield said. "You can only cut costs down so much before it impacts the guest experience. As an industry, we have probably, for the most part, achieved what is feasible."

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