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Hotel developers, owners and investors are finding the West hospitable despite the national economic challenges.

Rick Takach

From subprime stresses to real estate woes, the national economic landscape has undergone some tumultuous times during the last 6 to 12 months. With the national real estate market trying to keep its head above water, it may seem like a reasonable leap of logic to presume that the hospitality industry would be taking a hit as well. Interestingly, while no industry is ever entirely immune from these large-scale trends, the hospitality industry has proven to be remarkably resilient in the face of challenging economic circumstances. Unlike some other industries, the ripple effects from the subprime challenges and subsequent national real estate slowdown have not had a dramatic negative impact. Taking a closer look at how hotel builders, developers, owners and investors have been able to continue moving forward despite the challenging real estate market provides a revealing glimpse into some of the factors that drive this industry.

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The optimism surrounding the hospitality industry is grounded in positive data. Industry fundamentals are still quite strong, and the overall long-term outlook for the industry continues to be a positive one. Despite the occasional slumping market, the industry as a whole has performed well. In fact, hotel analysts have observed a 5.5 percent increase in revenue per available room (RevPAR) in 2007, which is above the long-term average of 3.5 percent. RevPAR increases for 2008 are expected to be in the 3.5 to 4.4 percent range, though the second and third quarters could be impacted if corporate travel and entertainment expenses are lowered.

The relatively robust numbers paint a portrait of an industry that, while not entirely immune to national financial difficulties, is still generating positive momentum. A closer examination of some of the details and issues behind the headlines can help reveal to what degree — if any — that momentum has slowed somewhat; what industry segments, products and markets have been and will be the most affected; and information as to what lies in store for the industry as a whole.

As well as the hospitality industry has performed in the past several years, recovering well after the trauma of Sept. 11th and even posting record growth, industry observers are seeing some collateral damage filter in from the sluggish financial and real estate markets. There has certainly been some softness within the industry, but, for the most part, that trend has been more of a slowdown than a complete reversal of fortunes. This slowdown has been most evident in some of the major metropolitan markets, first becoming obvious in places like Washington D.C. Interestingly, leisure centers, coastal regions and smaller or niche markets have exhibited little or no slowdown at all, however.

While it may seem counterintuitive to those who would assume leisure and vacation spending might be the first areas to bear the brunt of an economic slowdown, in actuality it is the larger business markets that serve as the proverbial canary in the hospitality coal mine. This is a phenomenon largely due to corporate belt-tightening and cutbacks, benefit cuts, and, in particular, the travel restrictions and cutbacks that so many businesses have imposed in order to trim some fat during leaner or more uncertain economic times. Those changes in travel spending patterns and economic priorities quite naturally impact larger cities and major business travel destinations more so than other markets.

Despite this predominantly smaller-scale collateral damage, however, the question remains, how and why has the hospitality industry been able to perform so well under trying national economic circumstances? A big part of the answer to that question involves a fairly basic concept: supply and demand. In a nutshell, less of the former has been able to offset a general decrease of the latter. Like any other business model, hospitality is fundamentally a supply and demand issue, and with less product coming online recently, any broad-spectrum decrease in occupancies is felt less keenly.

Ironically, the tighter credit policies and higher equity requirements brought on by the real estate slowdown, combined with rising construction and land costs, have made it more difficult to get deals done and have contributed to the slower supply growth — a phenomenon that has actually helped existing hotel portfolios. With the exception of a few notable markets such as Richmond, Virginia; San Antonio and Fort Worth, Texas; and pockets in the Northeast that have a big supply coming online in the near future, this is a trend that looks likely

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conditioned space) and with set backs and step backs," says Mahoney. "Despite the fact that the site encompasses an entire city block, these restrictions in large part dictated the footprint of the hotel."

Another major issue was the development of the property's parking structure. As the site is effectively 100 percent developed, Triyar's only option was to construct an underground parking structure at a cost of approximately $4.6 million per garage level, which became a physical and financial burden for the company, says Mahoney.

The design of the property is intended to surprise guests at every turn. The hotel features hand-cleft Jerusalem stone; custom glass and metal panels; a dramatic porte-cochere entrance; a pool and entertainment deck on the second level, including a swimming pool with 5-inch diameter portholes on the pool bottom, which are visible from the porte-cochere level; a heated and chilled water system in the pool; a 155,000-pound stone and reflective glass art wall in the lobby; and a Brazilian Kumaru wood floating staircase in the lobby, as well as unique petrified wood clusters, candle walls, and water and fire features. The guestrooms feature floating beds, stone accent walls, corner glass features and either a juliette or a full balcony.

Although Triyar typically owns and manages all of its real estate assets, W Scottsdale Hotel & Residences will be managed by Starwood Hotels & Resorts Worldwide/W Hotels.

ALOFT TO LAUNCH IN TEMPE

Los Angeles-based Triyar Companies and Warburg Pincus Real Estate I LP have teamed up to bring Starwood Hotels & Resorts' urban hotel brand, aloft, to the Arizona market. Currently under construction at Tempe Town Lake in Tempe, the five-story property is slated to open in early 2009. The property, which offers 136 rooms, features wood accents, oversized windows and colorful zinc metals. The interior features loft-inspired guest rooms, a hip daytime coffee bar that transforms into a buzzing nighttime bar scene, a convenient grab-and-go café and modern design elements. The Tempe hotel will be among the first 20 aloft hotels to open worldwide; the first United States property opened in June 2008 in Rancho Cucamonga, California. A vision of Starwood's luxury boutique brand, W hotels, aloft is designed to create an urban-influenced, modern and vibrant design, and an energetic guest experience at an affordable price. Triyar is also in discussions to bring an aloft hotel to North Scottsdale, Arizona. ❑

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to continue for now and will probably continue to have a mitigating effect on any negative financial trends that could impact the industry. A weak dollar and the subsequent growth in foreign travel and, to an extent, foreign investment dollars have also helped bolster the industry recently.

Another influential factor is that even though demand has slightly softened, rates have increased healthily in the past few years. Fortunately, the increase in rates appears to be less of a reactionary move and more of a natural growth trend. The year 2000 is still considered by many to be the performance benchmark in the industry, and when rates today are compared to those in 2000, they are still slightly below that level once inflationary increases are factored in. Clearly, there was some room for growth. On the flip side, hotel owners and operators do need to be cautious and not succumb to recessionary pressures to lower rates. That has been a trend for the industry during historical periods of economic hardship in the past, but it is a tactic that has been proven to be ineffective — something that not only does not help the performance of an individual hotel in the long run, but that also exerts downward pressures on competitors and is a net negative for the industry as a whole.

So where does the hospitality industry go from here? While there is no doubt that the hospitality industry has traditionally been a cyclical and potentially volatile business, and that owners and developers have in the past had a tendency to exacerbate nascent problems by enthusiastically and sometimes foolishly outbuilding what the market will bear, there is growing evidence that caution and thoughtful management have begun to generate some long-term stability within the industry. While no one can control what might transpire in the aftermath of a large-scale catastrophic event or major financial impact, the overall industry trend lines are positive, something that is all the more remarkable considering the current overall economic context. Experienced developers who have shown that they have the financial and logistical capacity to get deals done are making it work despite a less than ideal economic climate; something that certainly bodes well for the future of the industry as a whole.

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