

# Oil, Economics and the Hotel Industry

This year's Hunter Hotel Investment Conference began like many of its predecessors, outlining the economic outlook and how that will affect investment in hotels. As operating statistics remain on the rise, the industry itself is well on its way to recovering to healthy levels. At the same time, there are many mitigating variables that remain in flux as the world's economy continues to evolve.

Dr. Rajeev Dhawan, director and associate professor, economic forecasting center, at the J. Mack Robinson College of Business at Georgia State University, focused on macro economic factors and how they've progressed. Even though the U.S. economy is on the upswing of this recessionary cycle, world events such as unrest in the Middle East and continued growth in China have a direct effect on the U.S. economic climate.

Earlier this week, Libya took its oil supply off the market, which is around 2 percent. Though oil prices went up significantly, the stock market did not react... yet. He explained why through the three stages of economic panic, which he explained as:

- 1.) Habit shift: People say they'll save on other things to fill their gas tank, but what actually happens is they spend the same amount of money and stop saving. Nothing much changes in Stage 1.
- 2.) Concern: People actually start cutting back. Businesses are dealing with higher cost and surcharges, hotels get surcharges on deliveries. At first, they eat those costs, and after a while they pass along the cost, it becomes inflation, and it slows down the economy.
- 3.) Panic: People become worried about the future and panic. Will oil stop at \$147 or run to \$250? They pull back on expansion plans, and defeating proposition becomes recession.

"We are now in the middle of Stage 1, and Stage 2 *can* begin if oil stays high until the end of April," Dhawan said. "Stage 3 happens when Saudi Arabia gets into trouble. So far they have kept their population under control, and I am banking on the fact that they will maintain that."

Other than the Middle East unrest, why does oil continue to skyrocket? China's demand. In 20 years, China's oil consumption has gone from 2 million barrels a day to 10 million. For reference, in the last 15 years, U.S. oil consumption has remained constant around 20 million barrels a day. Other emerging countries have also contributed higher demand.

So why is oil so important to the health of the hotel industry? Because it is tied into consumer confidence. Though home prices seem like they have been overcorrected, Dhawan says that they're still 20 percent overvalued. Of course individual homes, like any other form of real estate, will be valued depending on their particular situation, but in general, your average homeowners are still losing money on their assets, shaking the foundations of the U.S. economy. Home ownership has long been a barometer of success, but when houses become a burden, consumer demand and confidence decline. This, of course, has a direct effect on their willingness (and ability) to travel. Coupled with the potential of \$4 gas prices all summer, there's still risk on the horizon.

This is not to paint a gloom and doom scenario. Dhawan himself says to take with a grain of salt an economist's projection; they are by trade charged with the task of analyzing all factors affecting the world's potential economic fluctuations. However, it's an important point to keep in mind: even as the top markets recover and the face of the news for the hotel industry is optimistic, there's still a long road ahead. It's ok to be patient and make sure that the industry recovers the right way. More on that as coverage of the Hunter Conference continues here.

— Dan Marcec

During the President's Panel at the Hunter Hotel Investment Conference, Choice Hotels President & CEO Steve Joyce made a comment that perhaps sums up the mood surrounding hotel development in the U.S.



"When someone asks about U.S. development," Joyce said, "the response is 'let me tell you about what we're doing in China.'"

There is nothing but truth to this statement. Hotel demand — and economic demand, for that matter — is growing exponentially in China as its middle class swells. Most, if not all, of the major U.S.-based franchise companies are ramping up development and making moves to ensure their footprint in China as its domestic travel continues to grow. The same certainly is true of India, as well as Brazil and Russia — "BRIC", as they've been commonly referred to.



While U.S. hoteliers may tire of hearing about the demand for hotel growth in any other country but our own, these developments are incredibly important to the U.S. hotel industry. As these international traveling classes begin to grow, capturing their business as they progress from increased domestic to increased international travel will be an imperative to gaining market share going forward.

"International travel to the United States is imperative for our industry," said Nancy Johnson, executive vice president, business development, for Carlson Hotels Worldwide, during a panel at the Hunter Conference. "Right now we have five consulate offices in China, and even France has ten — we're constantly working with the State to help them understand that travel is a business and an important aspect of the U.S. economy."

So as the franchise companies try to do their part by creating brand awareness in these countries, and industry associations and the U.S. government work together on the Travel Promotion Act, international travel visa reform and other initiatives to attract foreign travelers, there leaves another point of potential business that a hotel has to work into its distribution mix.

Beyond the brand level, the state level, and even the local level, what is a property owner, GM or revenue manager to do? They need to source the right data to capture exactly what business is coming to their

markets. By working with their brands (if they have one), analyzing outside data, and yes, partnering with OTAs, hotels can leverage their international reach if they want to try and expand their guest base.

Because every hotel doesn't have a revenue manager, doing all these things in the midst of day-to-day operations is easier said than done. Especially for independent hotels that don't have brand support and awareness, taking into account the global footprint of online travel agencies can provide additional perspective into guest booking trends.

"Right now, leisure consumers are spending less by booking shorter trips at the last minute away from the city center, which all lead to lower rates and less overall revenue," said Melissa Maher, global vice president, strategic accounts & industry relations for Expedia, in a presentation given at the Hunter Conference.

Part of the way hoteliers can counteract these trends is to cultivate an international strategy. It's estimated that China will grow to export the most outbound international travelers within the next five years, and that's only one country (though an important one to focus on). All international travelers have a longer booking window, they stay longer, and they provide an ADR premium.

"Even if we keep our current 6 percent share of international travel, we'll need to be preparing for 6 million Chinese tourists," said Liam Brown, COO, select service & extended stay hotels, The Americas, for Marriott International. "We need to continue to work to attract foreign visitors because it creates phenomenal job growth and hard currency."

One of the things individual hotels need to consider as they market to international customers is making sure they have capabilities in different languages, which they can optimize through their websites. Expedia, for example, translates into 33 languages, specifically written by people on the ground in those countries (in other words, not through an Internet translator, but in the actual languages). So when international travelers are shopping for hotels in the U.S. through online travel agencies, if individual properties want to convert those shopping experiences to direct bookings, they need to be sure their guests an easily navigable opportunity to read in their native language.

"Individual hotels need to understand the international demand generators coming into their area," said Maher. "By analyzing that data, they can analyze their opportunities to develop a better distribution strategy."

This just provides a brief overview of what it takes to start developing an international strategy. Though it may not be an immediate windfall for every hotel, understanding where the opportunities to improve overall room revenue are will be crucial in the race for market share as the industry (and the world economy) evolves.

— *Dan Marcec*

LEED construction for commercial properties certainly is not anything new, but certified hotel properties have lagged other real estate sectors. To date, only 40 LEED-certified hotels are open, according to the U.S. Green Building Council.



While a hospitality-specific program from the USGBC is in the works, the Council explains the challenges in creating such guidelines: “Hospitality properties can present unique challenges and opportunities in certain areas of environmental performance, often due to features such as on-site amenities, food and beverage operations, pool and laundry operations, convention facilities, frequent renovation cycles, and transient guest populations.”

With that said, more than 900 hotels are currently registered with LEED and are working toward certification, which shows the incredible amount of interest green guidelines have garnered in a short period of time.

Concord Hospitality is one of the hotel groups leading this charge, as its future development strategy is completely centered upon LEED construction. But even though this has been built into the fiber of its company culture, the shift was recent.

“We actually endeavored into sustainable design about four years ago, and frankly we couldn’t figure it out how to justify the additional investment required,” says Tim Osiecki, executive vice president of development and facilities for Concord Hospitality. “But through our perseverance, we kept pushing for design alternatives to make it affordable. We are doing it for the right social and environmental reasons, but it has to balance with economics and we’ve now found a way to do that.”



The Courtyard by Marriott Settlers Ridge, Pa., the first LEED-prototype Courtyard to open worldwide.

Most of Concord’s new properties are prototypical upscale select service — Courtyard, Residence, SpringHill Suites, Hyatt’s Summerfield Suites — and everything they build from here on out will be designed to LEED standards. With 80 hotels today, the company opened the first of Courtyard by Marriott’s new LEED in Settlers Ridge, Pa. (south of Pittsburgh), and is currently working on another Courtyard in Washington, Pa., and just broke ground in February on a SpringHill Suites in Columbus, Ohio. Both of those hotels are expected to be open in 2011.

## **Beyond Construction**

Assuming an average of 125 rooms — plus or minus — Osiecki says that the investment for LEED-certified construction runs in the \$350,000 to \$400,000 per hotel range. Not for the faint of heart looking at the up-front numbers, but payback comes through the long-term investment in operating costs.

“We know that spending that money is not all going to necessarily come back in savings today, but we’ve been careful to put a heavier weight into energy and water, where we can see a return,” says Osiecki. “One of the huge costs in our business is for electric and water — in totality, our average deal will see about a \$50,000 dollar per year energy savings, in today’s dollars.”

With regards to water simply by using new technology in showerheads, lavatories and toilets — which work

just as well but use far less water, Osiecki says — in a 125-room Courtyard the modeling suggests a savings of 319,000 fewer gallons of water used annually. And that's based on current usage. By working to educate guests on using less water and saving electricity — the things they can control — the savings are incalculable.



“In addition to the physical features, we were able to achieve an innovation point by submitting to the USGBC that we are going to educate our guests so they understand the things we've done to the hotel that conserve energy and water,” says Osiecki. “We put together a video clip and a channel on everyone's TV that explains our culture and some of the high level items we've done to make the hotel more environmentally efficient.”

Some of the other elements that contribute to sustainability include drip irrigation for plants (shown on front page), glazing systems (left), and outsulation in wall cavities (below, right) — in other words, nothing in those cavities but air, with a polystyrene foam on the outside that produces an envelope covering the building.



Furthermore, Concord has converted its pools to saline, which “takes all the chemicals out of our world,” Osiecki says. “We're done with chlorine — it's less harmful to building materials, and we keep it out of water treatment plants as well as out of our customers' eyes and hair.”

Considering the difficulty we're seeing now after a particularly strong development cycle, looking toward the future when new hotels will be in shorter supply and planning to maintain a property for the long run is a sound strategy.

“There are a lot of ways we can get there, and as our company culture, every project going forward will be designed to be LEED-certified,” says Osiecki.

— *Dan Marcec*

