EVOLVING HOSPITALITY: HOTELS *in the* Internet era

By having creative concepts that cater to each corner of the market, big brand hotels are well-positioned to withstand changing consumer tastes and the threat of Airbnb.

By Peter Laskey, Barclay Fellow

Recently, my wife and I sat down to plan a weekend getaway to the East Coast. We eased our way through buying flights to Washington, DC and moved on to the task of choosing accommodations. As a seasoned hotel revenue manager, I was confident. I consider myself quite adept at booking lodging: I know the tricks to find good deals and I have the wherewithal to recognize them.

However, much to my chagrin, I was dumbfounded by the plethora of different lodging options that have sprung up over the past few years, which made my usual tactics of finding hotels a bit more complicated. There seems to be a dizzying array of options, from new brands to professional vacation rentals, hotel/multi-family hybrids, rental arbitrage hosts, micro-hotels and hostels. Even as an industry professional, I felt a little out to sea in finding the best accommodation for us due to the vastly different options available.

Just as travelers like myself might feel overwhelmed with what seems like endless and confusing hospitality options, investors now face the same dilemma. The concept of a lodging asset has been expanded in the sharing economy. Although this definitional shift has allowed intrepid developers to push creativity, it has also caused a lot of confusion among both those in the industry and on the periphery. Cities have struggled to categorize their tax codes. Hotel franchisers seemingly introduce a new brand each year. And operators find it difficult to determine both their target audience and their main competitors.

Despite all the changes occurring within the lodging sector, big brand hotel owners have enjoyed a decade of relative prosperity and stability. Let's examine how we got here, the hotel landscape in 2020, and where we are headed in the short and long term.

What has changed? The brand takeover

Traveler appetites changed over the past decade and the standardized and admittedly tired concept of a hotel was

1 Julie Weed, "Independent Hotels Are Disappearing As Chains Grow," *New York Times*, October 21, 2019.
2 US Lodging Industry Overview Year End 2018, Cushman & Wakefield Valuation & Advisory.
3 Ibid.
4 TE forecast further slowing for US hotels, *STR*, August 15, 2019.
5 US hotel RevPAR projected to flatten in 2020, *Hotel News Now*, January 28, 2020.

not enough to meet those needs. Consistent with larger societal trends, consumers began to crave authenticity and unique experiences, which they found in Airbnbs and "lifestyle" hotels. To ward off further market share loss, big brand hotel marketing and development teams strategized. The response was to build a hotel portfolio that catered to each corner of the travel market through creative new concepts and acquisitions. Whether it be price point, design, market or room type, big brand hotels now have an option for everyone.

As we enter a new decade, the fruits of hotel brands can be seen in every American skyline, airport and beach. The five biggest American franchisors now have a total of 97 brands: Marriott 30, Hilton 18, Hyatt 15, IHG 15 and Wyndham 19. These 97 brands, and many more not mentioned, sprawl out to cover the needs and desires of almost every kind of traveler. Micro-hotels (Motto by Hilton, Moxy by Marriott), wellness resorts (Miraval by Hyatt, Six Senses by IHG), and independent brands (Two Roads by Hilton, Kimpton by IHG) have all fallen victim to the brand takeover. Many boutique hotels have joined via "soft brands" (think Autograph Collection by Marriott or Unbound Collection by Hyatt), or those hotels that attempted to keep the appearance and environment of an independent establishment but have the structure and marketing engine of a brand. Even the veterans of hotel brands have been significantly altered; for example, Residence Inn by Marriott has tried to remove the tired, lonely aura of extended-stay hotels with strategic locations and fun design choices.

Over the past decade, brands have quietly consolidated, resulting in a current state where the selection of hotel brands has never been greater, yet the backbone behind the proliferation remains solidly within the same handful of names. In fact, 30 years ago about two-thirds of hotels were true independents, whereas today, only about 40% are independently owned and operated.[1]

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This begs the question: in a decade when the hotel industry began in more or less an existential crisis due to the Global Financial Crisis (GFC) and the Internet propelling the new home-sharing industry, how did it end with more brands than ever? From 2010 to 2018, US hotel demand increased 24%, according to Cushman and Wakefield.[2] More travelers led to higher NOIs, lower cap rates and a development surge, thus increasing total keys by 8% in the same time frame.

For a brand, however, adding keys to an urban market is tricky: in order not to dilute their demand base, existing owners usually have covenants with brands limiting the number of products in certain neighborhoods. But franchisors recognized that competitors and boutiques were capturing excess demand in these neighborhoods. This issue then became a pattern in multiple cities and, thus, helped to instigate the creation of a new brand.

In short, the introduction of new brands enabled umbrella organizations to cover more real estate within a city without endangering existing products or alienating ownership groups.

Short-term outlook

The uptick in hotel development since 2010 has largely been well-absorbed, with occupancy rates increasing from 57.6% to 66.2% in 2018, despite the added keys.[3] Nevertheless, alarm bells have started ringing, indicating a tip in the supply/demand scale.

In 2019, hotels posted their most stagnant year since the recession, with only 0.9% revenue per available room (RevPAR) growth. STR predicts supply will outpace demand in 2020 — 1.9% supply growth versus 1.6% demand growth — applying downward pressure on occupancy rates, leading to stagnant RevPARs.[4] The following year, 2021, is forecast to tell a similar story: 1.9% supply increase yet only 1.7% demand increase.[5] As the industry knows all too well from 2002 and 2009, tourism is swiftly affected during recessionary times as families and businesses tighten budgets. Although no signs point to a -16.5% RevPAR decline like in 2009, owners should be aware of the revenue challenges that lie ahead and prepare to tighten their operations.

Despite the cloudy forecast, premium-branded hotels should provide stability to owners through the next downturn. Although franchise fees for brands are generally 8% to 10%, the

[6] Dror Poleg, *Rethinking Real Estate: A Roadmap to Technology's Impact on the World's Largest Asset Class* (Cham, Switzerland: Palgrave Macmillan, 2019).
[7] Short-Term Rentals, A Maturing US Market and Its Impact on Traditional Hotels, CBRE, 2020.

backing of a brand cuts travel agency commissions from online travel agencies (OTAs) like Expedia and Booking.com from roughly 20% to 15%. And with tech giants Google and Amazon quietly diving into the hotel booking game, OTAs will inevitably become more aggressive with commission structures, potentially leaving independents as vulnerable. The brands also provide a certain reach with global distribution systems, meeting planners and corporate chain codes, as well as provide a marketing engine that is nearly impossible to duplicate as an independent.

Of course, independents will still endure, especially in the luxury and resort segments, and their bottom line will benefit from reduced franchise fees. But as we move into a potential recessionary period over the next 24 months, the backing of a brand seems to be especially prudent. In the recessions of 2002 and 2009, independents saw a greater RevPAR decline than many of their branded competitors. Economy, midscale, upscale and upper-midscale hotels all fared better than independents. While all segments of travel see immediate and dramatic effects from turndowns in the economy, business and convention travel tend to stay afloat better than leisure, and the backing of a hotel brand helps enormously when chasing business accounts or convention groups.

Long-term outlook

Moving beyond the next few years, the traditional premium-branded hotel model will prove to be viable and stable in the long run. It is true that much of the gains reaped by hotels since the GFC can be attributed to general macroeconomic growth, but credit is also due to hotel operators, owners and franchisors for the creative work done to ward off the threat of home-sharing. Hotels have become so "cool," for lack of a better word, that vacation rentals and Airbnb seem like much less of a threat than once thought. Ten years of growth and a record-setting 2018 indicate that mainstream travelers, both domestic and foreign, still prefer the safety, comfort and amenities of traditional hotels.

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As Dror Poleg indicates in his book, *Rethinking Real Estate*, it seems that even Airbnb themselves have recognized the limited growth of their home-sharing platform. In recent years Airbnb has invested heavily to diversify its business: incorporating hotels and even flights into its booking engine and continued experimentation in multi-family development partnerships. In fact, as Poleg points out, a Merrill Lynch study in 2017 indicates that shared lodging "could be more niche than previously thought."

Taking it a step further, Poleg contends that the 2020's iteration of Airbnb could potentially disrupt multi-family development more so than hotels.[6] CBRE points out that the growth of short-term rentals available has slowed dramatically from exponential growth in the early part of the decade to 39% growth in 2018 and 26% growth in 2019. They are forecasting only 19% growth of short-term rentals available in 2020, with a large chunk of that in rural and suburban markets.[7]

The moral of the story is: Airbnb did not do to the hotel industry what Netflix did to movie rentals or what Uber has done to taxis. Despite the expected economic slowdown over the next two to three years, the hotel industry is not facing an existential threat like once thought and will continue to delightfully serve the world's travelers.

Conclusion

As my online search of accommodations in DC showed, the lodging market has undoubtedly changed over the past decade. However, hotels have landed in a comfortable spot post-Airbnb and GFC. The products of big hotel brands have proven to be stable investments, friendly to lenders and investors alike, and more recession-proof than their independent counterparts. More importantly, they are still the preferred choice of most travelers, as the expanded offerings match modern tastes. The short term might see some casualties as supply outpaces demand, but days like those in 2009 are far in the rearview mirror. It's not all roses — it never is in hospitality — but it increasingly appears as though hotels have survived the threat of home-sharing and will continue to push the envelope on creativity, authenticity and comfort that travelers enjoy. ◆

Peter Laskey is a 2019–2020 Barclay Fellow and an MBA candidate at the Graaskamp Center for Real Estate, Wisconsin School of Business at the University of Wisconsin Madison.