ROUNDTABLE SERIES

Mapping out a new year full of surprise and intrigue

Insiders discuss what the change in political leadership, a shifting economy will mean for hotel real estate

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With 2016 in the rearview mirror and jumping full bore into 2017, we convened some of the hospitality industry's brightest to discuss all things hotel development and real estate.

In a year marked by uncertainty, the one thing we now know is that as of January 20, 2017, we will have a new president, one Donald J. Trump.

So, what does the industry have to look forward to amid a changing political landscape, rising interest rates, a spate of M&A, new brand extensions, continued foreign direct investment and disruption from a convoluted distribution environment and home-sharing. These topics and more were all debated during our roundtable.

From left to right: Ryan Meliker, MD of equity research at Canaccord Genuity; John Keeling, EVP of the Valencia Group; Ian Davis, principal at Lodging Capital Partners; Paul Novak, executive director, lodging acquisitions at Whitman Peterson; Mark Laport, CEO of Concord Hospitality; Jon Wright, CEO of Access Point Financial; Mitch Garrett, VP of business development for Trump Hotels; Jalil Mekouar, MD & EVP for CHMWarnick; Michael Kitchen, VP for acquisitions and development for Aparium Hotel Group; Greg O'Stean, CIO of Loews Hotels & Resorts; and Arjun Singh of Michigan State University. Not pictured: Fred Kleisner, independent director at Caesars Entertainment and Aimbridge Hospitality.

Who else but Mitch Garrett, VP of business development for Trump Hotels, could get first crack at what new leadership in Washington means for the economy and the hotel industry. After all, it's his boss who will be in the White House.

While the U.S. stock market suffered a quick drop subsequent to Trump's victory, it was quick to recover, and Garrett remains bullish.

"I think the consensus on the market is they're optimistic," he said. "If you look at what Mr. Trump was able to do in terms of creating a game plan and then executing it, if that's a sign or foresight as to what his presidency will be, everything he had planned was exactly what he did.

"So if you're looking into what he's looking to do with physical stimulus, we're not sure exactly where that will all shake out, but I think all signs point to positivity."

Ian Davis, principal at Lodging Capital Partners, said the near future could be a net win or resoundingly

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bad depending on where your properties are located, but admitted the future is hard to forecast due to the "opaque" nature of Trump's campaign.

"If you look at the [North American Free Trade Agreement]… some of the trade deals he's talking about eliminating, that could be really bad for some Texas properties," Davis said. "1.1 million jobs in Texas come from exports. If you look at the opportunity for deregulation, that could have some really short-term positive impacts as well, so a lot I think is still to come."

Paul Novak, executive director of lodging acquisitions at Whitman Peterson, said Trump's connection to the hotel business could prove to be a boon if he is able to enact legislation to improve tourism throughout the U.S.

"He's very aware of tourism, and the importance of it, not only to his business obviously, but to the whole industry," Novak said. "He could look at tourism on a very favorable note and provide significant funding for the U.S. Travel Association and for other organizations to drive tourism to the U.S., so there could be that positive side."

SHRINKING RATE

Industry figures coming in for the end of 2016 are confusing for operators and analysts, with New York at negative revenue-per-available-room growth while secondary markets continue to see growth.

Ryan Meliker, managing director of equity research for Canaccord Genuity, said the industry is in the midst of suburban RevPAR growing materially higher than urban RevPAR, primarily because urban centers are at peak occupancy.

"What that creates is more compression in these suburban and airport markets where you can run at a lower occupancy number…so you have to build your core occupancy and you can still raise rate at the same speed you're raising them at urban locations," Meliker said. "That's led to outsized RevPAR growth."

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Paul Novak of Whitman Peterson, far left, argues a point. He is seated next to Mark Laport, CEO of Concord Hospitality, and Mitch Garrett, VP of business development for Trump Hotels.

Meliker said New York regularly runs 89-percent occupancy, so if the competition starts slashing rates, everyone's figures are going to drop, something Mark Laport, CEO of Concord Hospitality, agreed with.

"We're seeing another great year, 90-plus at our hotels, but we have no pricing power," Laport said, pointing to hospitality alternatives such as Airbnb and Uber's growing popularity giving more faith to the sharing economy as reasons for smaller returns. "The New York Marathon used to be a total sell-out, huge premium rates. Not anymore. So there's this strange and new dynamic that is making it very difficult in a market like this to regain pricing power. Add to it, of course, the tremendous new supply," Laport continued.

Davis questioned whether any downturn will have a greater potential for economic damage as a result of the success of Airbnb.

"I'm a condo owner and I'm going through some tough times because I just lost my job, I want to rent out my place when the World Series comes to town," he said. "When the market gets tougher, do you expect more people to employ that format to make a rent payment?"

Greg O'Stean, CIO at Loews Hotels & Resorts, said it's a distinct possibility. "We're seeing the inventory in Airbnb go up and up. People will try [renting], and as the market goes down more people will," he said. "It doesn't affect us much…we're mostly group hotels."

Jalil Mekouar, managing director & EVP for CHMWarnick, mentioned a different trend that could act as a deterrent for investment in hospitality: the growing spread between inflation and RevPAR growth. According to Mekouar, hospitality investments are traditionally a good defense against inflation, but new projections show that investing in hotels may become riskier in 2017.

"We look at next year and predictions are 2.2 percent, and then the [average-daily-rate] growth 3.1 percent…that's probably the lowest spread between

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inflation and ADR growth… for quite a few years," Mekouar said. "So why would I want to take a risk in an asset class that's perceived as being volatile and more risky?"

PHILOSOPHY OF VICTORY

If occupancies are at peak levels and RevPAR refuses to budge, logically the problem would appear to have a solution based in revenue management. But Novak said there is more to it than that, and that success during this period will be determined by an ownership philosophy that is resistant to cutting rates in hard times.

"If we could do anything with students coming out of hotel programs, going into the industry, [it] would be to try to teach them that when you get into a difficult time, cutting rate is not necessarily going to create demand," he said. "This industry has to get to the point where it starts to have a philosophy that when things get bad, I'm not going to cut rates, I will risk the occupancy. Granted, that's hard because your perception is when you cut rates, that will hold customers."

Fred Kleisner, independent director at Caesars Entertainment and Aimbridge Hospitality, said the supply-driven growth that precipitated changes in the last cycle is not taking place today. He pointed to the Economic Recovery Act of 1987 for evidence of a cycle ending in 1990, and an atmosphere of supply coming online in early 2001 as another indicator of a slow growth cycle, but the current slow cycle lacks similar signs.

"Right now, if we top 2-percent growth next year, that's not terrible," Kleisner said. "If we start closing in on 3-percent-plus, that's the time to tighten the chinstraps."

John Keeling, EVP of the Valencia Group, said the current lending market is colored by a large degree of discipline driven by banks and credit officers.

"Having been a lender back in the last cycle, I can tell you it's very different," he said. "They're capping out the loan values, they're looking at the cash-outs, looking at all the stuff they should be looking at. It's kind of encouraging."

A DYING BREED

The conversation shifted to the viability of full-service hotels in today's market. Novak said the traditional hotel with a bellman, doorman, 10,000 square feet of meeting space and a full concierge raises more questions about survivability than a 160-room lifestyle hotel with a bar and restaurant that is self-sufficient.

Meliker explained that the margin differential of a traditional full-service hotel versus a limited-service property is huge, meaning developers are skipping right past full-service properties during the planning stages.

"If you've got a margin that might be 1,000 to 1,500 basis points higher, and you have a rate differential that is only 5 [percent] or 10 percent, who in their right mind would ever build a new Hilton or Marriott as opposed to the Courtyard or Hilton Garden Inn?" Meliker said. "When you get into boutique, niche, lifestyle and more luxury-oriented properties that maybe have a demand driver there, it's a whole other ballgame."

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The discussion returned to successful developments in suburban neighborhoods, which Keeling said requires two ingredients: a site in a walkable neighborhood and a market with sufficient demand to sustain it in the long term.

"You can have the coolest site with all kinds of retail and neat stuff. If you put a hotel there, it will die, because there's no demand generators around it," Keeling said. "We've seen a number of those, in a gorgeous site, but who's going to stay there?"

Michael Kitchen, VP for acquisitions and development at Aparium Hotel Group, said it was important to get away from equating the "millennial mindset" to something associated with age. Instead, he considered it a psychographic trend, something other generations are adopting in their booking and travel habits, making it a trend hotels can capitalize on.

"There's an overall shift to the urban core no matter where you go," Kitchen said. "When we launched the company, it was in 2012; what we saw in Portland, Nashville, Austin, we knew was going to carry though. It's not post-grad millennials. It's actually now empty-nest boomers. They're the ones actually driving up pricing in the urban core."

The roundtable touched on a variety of hotel industry-related issues. Hospitality students from Michigan State University also were in attendance and were given the chance to ask questions at the end of the roundtable session.

THE NEXT MOVEMENT

In closing, those in attendance were asked about cross-border investment, particularly with regard to international investment from China. Kleisner said it comes down to the cost of capital, which fluctuates and puts different countries in the cockpit for investment at different periods, and China is taking its turn.

"Why did the Japanese get so involved in the acquisition side of hospitality in the U.S. during the 1980s?" Kleisner asked. "It was because the yen bond deal was 1.5 percent; it's really simple. It was a much better deal."

During a question-and-answer portion with the audience, a student in attendance asked what the uncertainty in the market means for those set to graduate with a hospitality degree in the spring of 2018.

Loews' O'Stean said uncertainty has always existed in hospitality, and recalled how he felt before previous downturns—one of which began on the same day as a fire at a local prison, and his reaction to seeing smoke in the sky as the markets went down was to ask: "What have I done?"

"And then it happened four more times," O'Stean said. "It's a roller-coaster ride. You'll get that. Just hang in there." HM