Gloom Looms for Rooms

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The hotel industry has enjoyed a profitable supplier's market in recent years, but the good times are ending, with lodging demand heading into a potentially deep decline, as the economy continues its tailspin.

The market erosion began earlier this year as the economy started to slow, but September's financial and credit market collapse underscored the economic downturn's severity that had hotel market analysts downgrading already dampened forecasts.

"Our outlook for the lodging industry has deteriorated dramatically in a fairly short period of time," said Mark Woodworth, president of PKF Hospitality Research. PKFHR, which bases its forecasts on indicators by Smith Travel Research, in October had to revise its 2009 outlook released in September, in the wake of the Wall Street crisis. It now forecasts that hotels will average 58.3 percent occupancy for 2009—the lowest in 20 years.

Also, room supply is increasing. PKF-HR expects 275,000 new rooms to come on line in 2008 and 2009. Over the past few years, bullish developers, credit lenders, and hotel companies—which saw steady profitability increases and in 2007 posted their best year ever ($28 billion in profits, according to the American Hotel & Lodging Association)—fueled much of the oncoming expansion.

Now, "with supply and demand moving in opposite directions, the typical hotel manager will not be able to maintain aggressive room rates," said Woodworth.

The market has undergone a fundamental shift, said John Hach, a senior executive at TravelClick, a hotel intelligence and marketing firm based in Chicago, adding that some major markets saw double-digit occupancy declines in October.

The balance of power in group contract negotiations will shift back to buyers for the first time since 2003, according to Bjorn Hanson, the former hospitality research leader at PricewaterhouseCoopers and now an associate professor at New York University.

Hanson said the rates for conventions, conferences, and meetings negotiated in fall 2007 or earlier have buoyed hotels' average daily rates, but rates secured in 2008 were lower, as the negotiating dynamic began to swing in buyers' favor.

While this would presumably place meeting planners in a good negotiating position, other factors, such as corporate budget slashing, will nonetheless conspire to make their jobs difficult. What's more, the window of supplier-side weakness will begin to close by 2010, experts said.

Still, with the current state of affairs, hotels will almost certainly not be able to increase rates at all—as nearly half of them were still able to do in 2008, despite lower occupancy versus 2007—while many will have to cut their rates to some degree, said Jan Freitag, VP of Smith Travel Research, in an October webinar hosted by Hospitality Sales & Marketing International.

Alternatively, "we are suggesting that hotels provide more value rather than simply play with rates," said Freitag, in an interview with *MeetingNews*. "Offering items such as free breakfast, free Internet access, free bottled water, free newspapers, or waiving the resort fee would be preferable options." Yet, Freitag admitted it is unlikely that hotels can hold rates.

Indeed, there already has been a wide-scale roll out of value packages even by luxury suppliers, and a countless number have slashed rates.

But in a recent web presentation, TravelClick's Hach noted that while suppliers are traditionally quick to drop room rates, what mainly stimulates demand is destination appeal and airlift. So hotels, he said, will have their work cut out for them: "The double-whammy is the economic crisis and air carriers cutting capacity."

And that's more bad news for planners. Freitag warned that many cities offering the best hotel deals now are also the most costly and difficult for attendees to fly into. "Airlines have cut seat capacity in so many secondary and tertiary markets that planners will probably refocus on primary gateway cities—and hotels in those cities have done pretty well historically in avoiding big occupancy and rate decreases," he said. But, Freitag said, "Properties might be more willing to say, 'We will give you a discounted room rate if you give us a minimum food and beverage revenue, meeting room revenue, plus spa, golf, and other ancillary spending.'"

Nevertheless, planners will have to weigh any savings they receive from any property against the cost of airfare and greater inconvenience for attendees flying into less-accessible markets. What's more, the credit crunch is going to restrict new room inventory starting in 2010, narrowing planners' window of negotiating opportunity.

PKF-HR's Woodworth, in the HSMAI webinar, showed data suggesting that the presently tight lending situation for hotel expansions and new builds will cause guest room inventory in 2010 to remain nearly the same as 2009. Combined with a probable slight uptick in individual leisure and business travel in 2010, it will result in a rise in occupancy rates and thus average daily rates.

So, if planners can persuade their organizations to execute meetings sometime in 2009, it could prove to be the most affordable time in the foreseeable future.

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