CHAPTER 5

Market, Product, and Site Selection

¶ 5.01 Long-Term Trends 5-1
¶ 5.02 Trends in the Budget and Economy Segments 5-3
EXHIBIT 5-1 Hotel Industry Segments 5-3
EXHIBIT 5-2 Typical Economy and Budget Segment Hotel Brands 5-3
EXHIBIT 5-2(A) Budget Segment 5-4
EXHIBIT 5-2(B) Economy Segment 5-4
[1] Regional Performance 5-5
EXHIBIT 5-3 Performance of the U.S. Regional Budget and Economy Lodging Markets 5-6
[2] Hotel Valuation Index 5-6
EXHIBIT 5-4 Per-Room Values for Budget and Economy Rate Categories 1998–2000 5-7
EXHIBIT 5-5 Economy Hotels: Replacement Cost vs. Value per Room 5-7
EXHIBIT 5-6 Budget Hotels: Replacement Cost vs. Value per Room 5-8
[3] Challenges Facing the Budget and Economy Segments 5-8
¶ 5.03 Market Potential 5-9
¶ 5.04 Market Overview Study 5-11
¶ 5.05 Product Selection 5-11
[1] New Hotel Products 5-12
[2] Success Factors for Unique Hotel Products 5-12
¶ 5.06 Matching the Product to the Market . . . 5-13
¶ 5.07 Hotel Site Selection 5-14

¶ 5.01 LONG-TERM TRENDS

Hotel development or acquisition begins with three basic steps:

1. Identifying market areas that show long-term potential for hotel investment.
2. Choosing a lodging product that will take best advantage of the local supply and demand characteristics.
3. Search for an appropriate site.

When looking at market areas in which to develop or acquire a lodging facility, the investor should first focus on long-term economic trends and on future supply-and-demand characteristics rather than historical factors. A knowledge of the economic history of a market area is useful, but the ability of a new hotel (whether recently constructed or acquired and renovated) to survive and succeed depends on the long-term supply and demand conditions in the market area. The economic life of a lodging facility typically ranges from twenty to sixty years, with a median of thirty-five to forty years. A long-term evaluation is necessary to determine whether the current economic characteristics of the market are likely to continue or whether some development could take place that would alter the economic climate.

For example, one of the trends presently affecting the economy of the United States is a gradual decline in manufacturing industries and a concurrent increase in service-oriented businesses. This trend has negatively affected the regional economies of many of the major manufacturing centers in the country. One aspect of a decline in a local economic base is that the lodging market in the area is apt to experience a loss in room-night demand. The reverse takes place, however, when an area is able to grow by attracting service-oriented industries.

Other long-term trends that may have a significant effect on both the lodging industry as a whole and on individual market areas during the next thirty to forty years include:

- Decline in the manufacturing and production industries may have a negative affect on market areas that are dependent on this business activity.
- Increase in the service and technology industries will benefit market areas that attract these businesses.
- The aging of the population will result in a greater number of senior citizens who have both the time and the money to travel and to make use of transient lodging facilities. Resort-, leisure-, and tourist-oriented markets should benefit the most from increased travel by the retired population.
- Greater family income, generated by two wage-earners, coupled with generally smaller family size, will stimulate increased leisure travel. Resort, leisure, and tourist markets should prosper from this business.
- The deregulation of the airline industry has reduced the cost of travel to many destinations, with the result that more people can now afford to travel greater distances and patronize more lodging facilities. Technological advances should further increase the speed and range of travel, thus making it easier for people to reach their destinations.
- Faster transportation will, however, in some ways reduce lodging demand. New technology will enable commercial travelers to reach their destinations more rapidly, and thus reduce the amount of time it takes to conduct their business and then return home. At present, for example, a trip from New York to Los Angeles involves five hours in transit, which means a business trip from New York almost always includes one night in a Los Angeles hotel. With the inevitable introduction of supersonic air travel between the coasts, trips to Los Angeles and all points in between will require only one day; consequently, lodging facilities in markets served by this form of high-speed transportation will lose commercial demand.
- Video communication technology is rapidly approaching the point at which businesses will be able to eliminate some of their face-to-face meetings by substituting live video communications, or "videoconferencing." This may reduce the need for people to travel to hold meetings, conferences, seminars, and conventions when the same activities can be accomplished from each party's individual office. However, people still value face-to-face meetings to measure or develop personal "chemistry" for business transactions and to network during larger gatherings. In addition, people report that they enjoy experiencing new places. Therefore, videoconferencing is expected to supplement but not replace business- and meeting-related travel; the potential negative impact on such travel is not expected to be significant.

- It is likely that an increasing percentage of the world's population will be free to travel to more destinations and will also have the financial ability to do so. This trend could benefit lodging facilities, particularly those located in tourist-oriented destinations.

¶ 5.02 TRENDS IN THE BUDGET AND ECONOMY SEGMENTS

Budget and economy hotels offer lodging without the extra amenities typically found in full-service hotels, such as restaurants and bars, and depending on their location, their price for a guestroom usually ranges from $30 to $65. The customer groups that use these products are normally business travelers, families, and value-oriented vacationers and seniors.

Exhibit 5-1 Hotel Industry Segments

Source: Smith Travel Research

Segment	Range	Average Rate
Luxury	85%–100%	$129
Upscale	70%–85%	88
Mid-Price	40%–70%	68
Economy	20%–40%	52
Budget	0%–20%	42

Exhibit 5-1 segments budget and economy lodging products on a market-by-market basis by average rate.

Exhibit 5-2 Typical Economy and Budget Segment Hotel Brands

Source: Smith Travel Research

Economy Segment	Budget Segment
Amerihost Inn	Best Inns
Budgetel	Budget Host Inn
Days Inn	Econo Lodge
Fairfield Inn	Extended Stay America
Hojo Inn	Inn Town Suites
Homestead Village	Knights Inn
Howard Johnson	Microtel
Ramada Limited	Motel 6
Red Roof Inns	Super 8
Rodeway Inns	Red Carpet Inn
Shoney's Inns	Suburban Lodge
Signature Inn	Thriftlodge
Sleep Inn	Villager Lodge
Suisse Chalet	
Travelodge	
Vagabond Inn	
Wellesley Inn	

Exhibit 5-2(A) Budget Segment

Source: Bear, Sterns & Co. Inc., Smith Travel Research; Coopers & Lybrand L.L.P.

Brand	# of Hotels	# of Rooms	Brand	# of Hotels	# of Rooms
Super 8	1,580	96,873	National 9	52	1,935
Motel 6	746	83,183	Thriftlodge	37	1,884
Econo Lodge	735	47,849	Good Nite Inn	14	1,692
Knights Inn	229	19,552	Select Inn	14	1,364
Howard Johnson Express Inn	173	13,174	Budget Inn	16	1,264
Sleep Inn	154	11,426	Admiral Benbow	10	1,163
Red Carpet Inn	129	7,774	Motel Orleans	13	844
Budget Host Inn	186	7,500	Friendship Inn	18	685
Scottish Inn	140	7,010	Ha' Penny	6	631
Microtel	66	5,502	Passport Inn	13	607
Travelers Inn	35	4,256	Cricket Inn	4	598
Masters Inn	32	3,828	Wynfield Inn	3	578
Excel Inn	27	3,013	Sixpence Inn	6	577
Cross Country Inn	25	3,009	Roadstar Inn	7	576
E-Z 8	27	2,728	Hometown Inn	5	332
Economy Inns Of America	22	2,474	Great Western	7	323
Wilson	15	2,405	Thrifty Inn	4	315
Family Inns Of America	26	2,291	Travel Inn	4	204
Little America	6	2,276			
			Segment Totals:	**4,586**	**341,695**

Exhibit 5-2(B) Economy Segment

Source: Bear, Sterns & Co. Inc., Smith Travel Research; Coopers & Lybrand L.L.P.

Brand	# of Hotels	# of Rooms	Brand	# of Hotels	# of Rooms
Days Inn	1,738	155,795	Vagabond Inn	49	3,419
Travelodge	443	35,089	Best Inns Of America	33	3,129
Fairfield Inn	345	33,231	Innkeeper	23	1,903
Red Roof Inn	259	29,725	Country Hearth Inn	30	1,755
Ramada Limited	218	16,065	Jameson Inn	37	1,659
Budgetel	153	15,930	Mcintosh Motor Inn	12	1,410
Rodeway Inn	210	13,331	Nendels	16	1,072
Shoney's Inn	87	8,836	Key West Inn	13	590
Americinn	90	4,177	L-K Motel	5	190
Susse Chalet	33	3,714			
			Segment Totals:	**3,794**	**331,020**

The average rates of budget hotels typically fall in the 20th percentile range and lower in a given marketplace, while the average rates of economy properties typically range from the 20th to 40th percentile.

Exhibit 5-2 outlines the hotel brands that are typically found in the economy and budget segments of the industry.

Presently, construction and supply-side increases are more prevalent in the limited service segments (economy, budget, and mid-scale without food and beverage) in select markets across the United States, as compared with other price tiers. This situation differs from the hotel construction boom of the 1980s where over-building of lodging properties occurred in a more or less simultaneous manner across most segments of the hotel industry. This current trend of overbuilding in select markets is expected to result in varied performance across the segments, and in individual markets across the country.

Because of the recent construction activity within the budget and economy segments of the lodging industry, supply in these segments is currently outpacing demand. This trend has changed somewhat from 1994 and 1995, when the opposite was true: at that time, demand for these lodging products outpaced supply. On a macro level, supply is currently outpacing demand in the budget and economy segments of the lodging industry. However, on a micro level, some regions of the country are more affected by the oversupply than others; there are regions where it is still appropriate to build new budget and economy facilities.

[1] Regional Performance

As previously mentioned, performance in the budget and economy segments of the lodging industry varies by market and by region. Exhibit 5-3 illustrates recent historical occupancy and average rates for nine regions.

As shown in Exhibit 5-3, the New England markets of Connecticut, Maine, Massachusetts, New Hampshire, Vermont, and Rhode Island recorded both the strongest demand and resulting revenue increases in the nation for the year ended October 1997, while supply in this region is estimated to have decreased by approximately 0.04 percent for the same period. The Middle Atlantic region, which includes New Jersey, Pennsylvania, and New York, posted demand increases of 1.1 percent for the year ended October 1997, which exceeded the 1.01 percent increase in supply for the same period. These increases resulted in a 10.30 percent increase in revenue over the same period in 1996.

The areas that posted the greatest increases in supply include the Mountain, East North Central, and West North Central regions of the country. The Mountain region's 3.54 percent increase in supply was coupled with a 0.3 percent increase in demand. The East North Central and West North Central regions posted supply increases of 3.13 and 2.42 percent, respectively, with a zero and 0.1 percent respective increase in demand. While each of the nine census markets posted positive revenue increases for the year ended October 1997, the market that recorded the lowest revenue increase was the East South Central market, where a 1.07 percent increase in revenue was reported.

Overall, as compared to the previous years, the budget and economy segments achieved a 1.70 percent increase in supply for the year ended October 1997, but they experienced no demand growth. This trend of supply surpassing demand is expected to continue for the foreseeable future, until such time when the construction of new properties in the budget and economy segments is no longer feasible. This occurs when the per-room construction costs exceed the values per room of these products. Simply put, new construction occurs when the value of a new hotel is higher than the cost to build it. This positive feasibility draws capital into lodging development; as more and more hotels are built, occupancies fall and values begin to decline. Feasibility becomes negative when it costs more to build a new hotel than to purchase an existing property with the same utility. At that point, the supply of capital evaporates and new construction ceases.

Exhibit 5-3 Performance of the U.S. Regional Budget and Economy Lodging Markets

Sources: HVS International and Smith Travel Research

	Occupancy		Average Daily Rate		Percent Change		
Region	Year Ended Oct. 1997	Year Ended Oct. 1996	Year Ended Oct. 1997	Year Ended Oct. 1996	Demand	Supply	Revenue
New England	61.6%	59.4%	$54.68	$50.88	3.7%	−0.04%	11.49%
Middle Atlantic	64.4	64.3	66.66	61.09	1.1	1.01	10.30
Pacific	64.1	64.0	50.66	46.84	0.6	0.32	8.80
East North Central	56.8	58.6	45.52	42.62	−0.0	3.13	6.80
West South Central	57.8	59.1	39.50	37.41	0.1	2.42	5.67
West North Central	56.5	57.7	41.38	39.49	−0.1	2.04	4.66
South Atlantic	60.5	61.9	43.56	41.28	−1.1	1.20	4.33
Mountain	62.4	64.4	41.74	40.59	0.3	3.54	3.16
East South Central	56.2	58.1	38.79	37.56	−2.1	1.17	1.07
U.S. Total	60.3%	61.35%	$46.53	$43.76	−0.0%	1.70%	6.34%

[2] Hotel Valuation Index

A method of measuring these cyclical changes in hotel values has been developed. Through the use of a valuation model known as the hotel valuation index (HVI), hotel value trends in major markets and in various average rate categories can be monitored. Hotel values change over time as a result of differing capitalization rates and earnings expectations. The HVI was designed to illustrate these changes and to quantify the value attributable to movements in earnings and changes in the costs of debt and equity capital. The HVI also enables hotel investors to compare values among different market areas and product types. By considering historical development cycles and projecting values through the application of the HVI, investors can determine their entrance and exit strategies and take advantage of the inevitable fluctuations in market values.

The HVI is a sophisticated hotel valuation benchmark that covers 47 individual markets, the United States as a whole, and five industry price tiers. The index is calculated based on actual occupancy and average rate data supplied by Smith Travel Research, along with local P&L operating performance, projections of supply and demand, and capitalization rates derived by HVS International. The HVI, which was initiated by HVS International in 1986, reflects trends in market value over time, and assumes a willing buyer and a willing seller rather than a distressed, liquidation-type transaction. It gives the greatest weight to the income capitalization approach, and secondary support is provided by the sales comparison and cost approaches.

In 1997, HVS International began projecting the HVI four years into the future. These forecasts are based on our extensive knowledge of local markets and product types. As is the case with any forecast, actual performance may differ from projected performance as a result of events that were unforeseen at the time the projections were made.

Exhibit 5-4 shows per-room values for the budget and economy rate categories nationwide. Values from 1988 to 1996 are based on actual occupancies and room rates; projected figures were used to arrive at values for 1997 through the year 2000. The annual percent changes in each rate category has also been presented.

Exhibit 5-4 Per-Room Values for Budget and Economy Rate Categories 1988–2000

Sources: HVS International and Smith Travel Service

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Economy	$31,003	$33,213	$29,572	$26,245	$27,784	$28,085	$29,498	$35,367	$36,121	$36,411	$37,726	$37,485	$36,241
Percent Change	—	7%	–11%	–11%	6%	1%	5%	20%	2%	1%	4%	–1%	–3%
Budget	$26,944	$26,952	$25,400	$21,818	$22,679	$24,998	$27,498	$33,003	$34,797	$37,168	$33,984	$33,472	$31,496
Percent Change	—	0%	–6%	–14%	4%	10%	10%	20%	5%	7%	–9%	–2%	–6%

In addition to this valuation data, graphs have been developed for the economy and budget rate categories comparing per-room values and replacement costs. These graphs show historical values and cost data from 1989 to 1996, along with projected data to the year 2000.

The market value and replacement cost graphs illustrate the points in time when feasibility was either positive or negative. In addition, these graphs identify when new hotel development is likely to commence and when it is likely to decline. As the market value line moves upward and passes through the replacement cost line, new hotel projects become feasible, lenders and investors gain interest, and development begins. Savvy hotel developers will anticipate this trend and start new construction before the two lines actually cross. On the downside, new development is curtailed when the market value line falls below the replacement cost line. Generally, new hotel development does not begin to slow down until the market value line crosses the replacement cost line. Exhibit 5-5 and 5-6 illustrate these feasibility and development timing concepts.

Exhibit 5-5 Economy Hotels: Replacement Cost vs. Value per Room

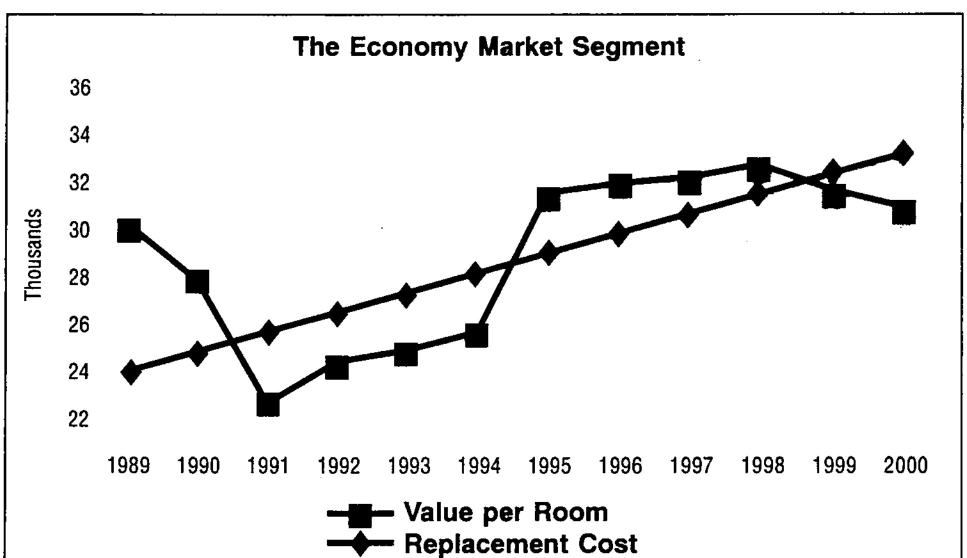
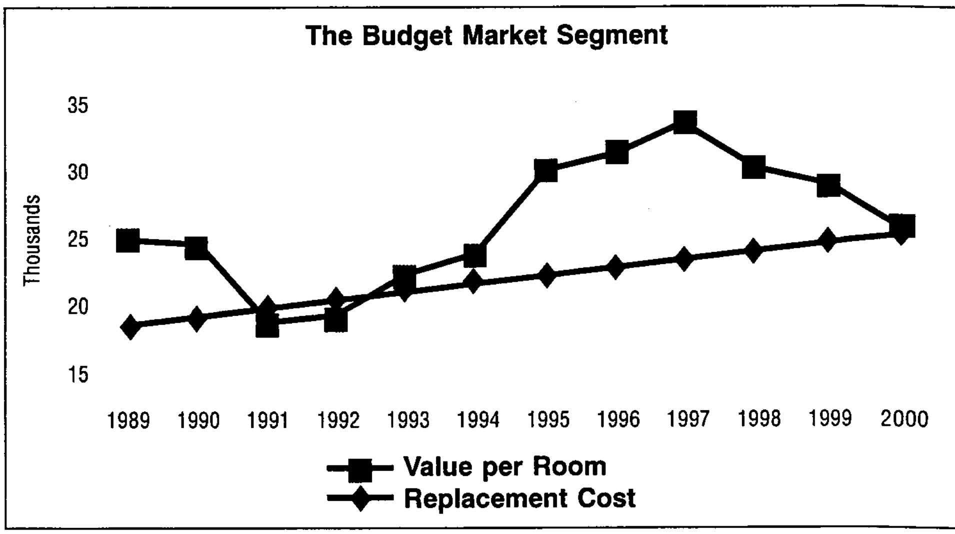


Exhibit 5-6 Budget Hotels: Replacement Cost vs. Value per Room



The economy segment experienced a significant drop in value between 1989 and 1991. During that period, the market value line crossed the replacement cost line, indicating that hotel investors could buy existing properties at a cost lower than what would be required to develop new ones. This buying opportunity continued until 1994, when the market value line rose rapidly and crossed the replacement cost line, signaling the start of new development. We project values to begin to decline in 1998, as this rate category becomes overbuilt, and we expect the replacement cost line to be crossed again in 1999. At that time, over-building in the economy category is expected to result in negative feasibility, and new development should slow down.

Per-room values in the budget segment declined from 1988 to 1991. The replacement cost line was crossed in 1991, which meant that investors could buy an existing budget hotel for less than the price to construct a new one. As a result, development slowed and investors began to focus on acquisitions. As a result of the low occupancies caused by the recession, prices were very attractive, and the RTC flooded the market with hundreds of foreclosed properties. As Exhibit 5-6 shows, those buyers who could foresee an upturn in the value of budget properties realized a significant amount of appreciation. As values for budget-oriented lodging facilities escalated during the early to mid-1990s (exceeding replacement costs in 1993), it again became feasible to develop these types of properties, and construction in the budget segment rose. Exhibit 5-6 shows that values are expected to peak in 1997 and will begin to decline as over-building erodes occupancy levels. By the year 2000, the market value line is expected to cross the replacement cost line indicating possible over-building, which should greatly reduce new development in this category.

[3] Challenges Facing the Budget and Economy Segments

It appears that there are two additional challenges facing the budget and economy segments of the lodging industry. The first challenge is the introduction of budget and economy-oriented extended-stay products. According to F.W. Dodge (a firm that tracks new construction in markets throughout the country), as of the third quarter 1997, there were approximately 229 budget and economy extended-stay products that were in the "start" stage of development. This is the stage of development after planning and typically is at the point of, or close to ground breaking. These 229 projects amounted to an estimated 28,572 new rooms. Additionally, there were approximately 60 budget and economy extended-stay products in the planning stage. These new additions to supply in the extended-stay arena are expected to magnify the threat of oversupply and erode demand in the budget and economy transient segments.

The second challenge facing the budget and economy segments appears to be posed by the midprice segment of the lodging industry. According to Smith Travel Research, the mid-price segment is comprised of properties in a lodging market with average rates in the 40th to 70th percentile range. This segment typically includes hotel brands such as Courtyard by Marriott, Wyndham Garden Hotel, Doubletree Club, and Hilton Garden Inn. The challenge from this segment is that in 1996, they experienced a 2.9 percent increase in supply, which outpaced their 2.5 percent increase in demand for the same period. It is forecast that this trend will continue through 1999. Due to this supply increase in the mid-price segment, we believe that these properties may have to compete with the budget and economy segments for business by lowering their room rates.

Overall, construction of new hotels is occurring at a moderate pace in the budget and economy segments of the lodging industry, resulting in supply growth that is anticipated to surpass demand growth. It is anticipated, through the use of the Hotel Valuation Index, that as of 1999, it will no longer be feasible to build hotels in the economy segment of the lodging industry due to the per-room construction cost exceeding the per-room value. The same is anticipated to be true for the budget segment as of 2000. The majority of the new construction has occurred in the central and mountain regions of the country, while the Pacific, New England, and Middle Atlantic regions have experienced lower increases to supply. It is, however, important to remember that the lodging industry is a market-by-market business with individual markets often acting in contradiction with overall national industry trends. It is, therefore, imperative for investors to take note of these individual market trends through the use of available information, and to pay attention to the overall state of the economy and budget segments of the industry when forming their investment decisions.

¶ 5.03 MARKET POTENTIAL

Any market analysis is based on an evaluation of potential supply and demand. In a hotel market study, supply represents all of the competitive lodging facilities in the area, and demand represents the travelers visiting the area who will use these facilities. When there is a balance between supply and demand, area hotels and motels achieve a sufficient level of occupancy to generate a reasonable profit. The relation between supply and demand can sometimes become unbalanced, causing a low level of profit (e.g., oversupply or decline in demand) or a high level of profit (e.g., undersupply or increase in demand). Most markets experience cyclical changes in the relation between supply and demand, with levels of occupancy and profits rising and falling over extended periods of time.

In their search for hotel development or acquisition opportunities, investors should seek out the following:

1. *Market areas with an undersupply of lodging facilities relative to the amount of available demand.* This situation develops when demand increases rapidly because of such circumstances as the arrival of a major new business in the area (e.g., Disney moving into Orlando, Florida); significant growth of an existing business (e.g., Hughes Aircraft receiving a large government contract); or the improved attractiveness of a city as a destination (e.g., Atlantic City af-

ter the approval of casino gambling). An undersupply of lodging facilities can sometimes occur when existing hotels are withdrawn from the market. An example of this undersupply occurred in New York City during the 1980s, when a number of lodging facilities were torn down and replaced by office buildings.

2. *A cyclical market experiencing an upward trend in occupancy.* Care must be taken not to overestimate the length of the upward trend; such an error could lead the investor to enter the market just as occupancies are peaking before they decline. The best time to develop or acquire a lodging facility is when the cycle is nearing its lowest point. In these situations, prices tend to be depressed and a property can be acquired under the most favorable terms. For example, by the end of the 1980s depressed hotel markets in Houston, Tulsa, and Denver seemed to have hit the low point in their occupancy cycle; consequently, this period was a good time either to acquire an existing hotel or to start developing a new one in these markets. Although this strategy is theoretically sound, it takes both personal determination and strong financial staying power to actually follow such a course.

3. *Markets in which newly-constructed additions to lodging supply have been restricted or inhibited (i.e., where there are barriers to entry).* Barriers to entry tend to favor existing hotels, which benefit directly from a stable supply of competitive rooms. The most common barriers are zoning restrictions, which can sometimes actually bar new hotel development or make it so time-consuming and expensive that developers choose a different use of the property. Zoning can also reduce the feasibility of a hotel project by limiting the number of rooms or by requiring unnecessary facilities such as excessive parking. Other governmental regulations that can restrict development include building moratoriums brought about by a lack of sewage capacity or available water, adverse environmental impact (e.g., traffic congestion), and zero-growth policies. Lack of developable land on a site and proposals of a higher and better use of the land are also forms of barriers to entry. In New York City, the high cost of construction brought about by escalating land values and development costs makes it difficult to economically justify new hotel projects. Investors should be aware of market areas in which barriers to entry are likely to arise in the near future and should look into developing a new lodging facility or acquiring an existing one before the barrier takes effect.

4. *Markets that offer diversity of demand.* Over the long term, hotel markets that cater to a wide spectrum of lodging demand generally suffer fewer significant downturns than areas that are dependent on a small number of demand generators. Cities that depend on one type of industry run the risk that eventually the industry may decline or even go out of business. Markets in the midwest, for example, have suffered considerably when steel and automotive plants have closed. Houston and Tulsa were severely affected by the decline in domestic oil production. In addition to looking for locations with a number of different industries and businesses, hotel investors should also seek areas that attract a variety of market segments. An ideal hotel location caters heavily to all three of the major market segments: commercial, meeting and convention, and leisure. These segments tend to have complementary usage patterns. For example, when commercial demand is weak (weekends and summer months), leisure travel demand is strong, and vice versa. Meeting and convention demand tends to fill the gaps between the strong commercial travel and leisure travel periods. San Francisco, Boston, New York, and New Orleans are examples of cities that have been able to attract strong patronage from all three major market segments.

¶ 5.04 MARKET OVERVIEW STUDY

To identify a market area with the necessary long-term characteristics to support a lodging facility, the prospective investor should conduct a market overview study. Market overview studies are performed either directly by the hotel investor or by an independent hotel consulting and appraisal firm. A market overview study should include:

- *Discussion of the subject area's economic base and generators of transient visitation.* The long-term outlook for the area is the most important consideration in this discussion, although historical trends should also be examined. The study may determine what the economy of the market will be during the next five to ten years, what will attract transient visitation to the area over that time period, and what the expected economic growth trends for the area will be over the long term.
- *An investigation into the supply of lodging facilities and operating characteristics of hotels and motels in the subject area.* Ideally, the study will contain data regarding historic occupancy cycles during the past ten to twenty years, the typical length of such a cycle, and the high and low occupancy levels during a full cycle. In addition, the study should pinpoint where the area currently stands in the cycle, and whether the cycle is likely to change over the long term. If such extensive data is unavailable, typically a five-year analysis is provided. Finally, the study should discuss the short-term outlook for additions to supply and identify any potential barriers to entry in the market area.

The market overview study should be designed to provide a broad view that will enable the investor to identify market areas with the potential for long-term success. Once a market exhibiting such potential has been selected, a more in-depth, short-term study, known as an economic market study and appraisal, is usually performed. The case study elements at the end of Chapters 6 through 14 illustrate the various features of the economic market study and appraisal.

¶ 5.05 PRODUCT SELECTION

Once a market area exhibiting the required long-term characteristics has been identified, the hotel investor should make a preliminary selection of the type of lodging product best suited for that particular market. A preliminary selection is made at this point in the process to provide criteria for selecting potential sites. A final product selection is made later, using the information contained in the economic market study and appraisal.

Like market areas, hotel products tend to go through definite cycles. During the past forty years, there has been a recurring phenomenon in the lodging industry known as "amenity creep." Amenity creep has occurred in several major hotel chains; Holiday Inn provides a prime example. When Kemmons Wilson started this chain during the 1950s, his aim was inexpensive lodging for the traveling public. He provided clean, comfortable accommodations at a reasonable price. Over time, however, the chain has upgraded Wilson's initial concept by adding amenities such as meeting space, large restaurants and entertainment lounges, Holidomes, health clubs, and recreational facilities.

The addition of each new amenity or service required economic justification, such as improved occupancy or average room rate. The general trend became a slight upward adjustment in room rate whenever a new amenity was added. Over time, an economy-oriented lodging chain became a mid-rate chain with some individual facilities achieving first-class status. Other chains, such as TraveLodge, Ramada Inns, and Days Inns also began in the economy segment of the lodging industry, but through amenity creep have become established as mid-rate chains.

Franchise chains tend to encourage amenity creep for economic reasons. Because franchise fees are generally computed as a percentage of rooms revenue, when amenity creep drives room rates upward, franchisors benefit directly by collecting additional franchise fees. A swimming pool added by a hotel in order to match competitive facilities might increase the room rate by $5, and thus could be generating $80 per room per year in additional franchise fees.

Hotel investors can benefit by understanding the cycle of amenity creep and the opportunities it produces. Each hotel chain that succumbs to amenity creep creates a void in the market. For example, Days Inns' strategy of moving up from the economy segment into the mid-rate market has left fewer products available for the economy traveler. However, this void is currently being filled by the proliferation of new development in the economy sector, primarily because of lower barriers to entry.

[1] New Hotel Products

Occasionally, a new product appears in the hotel industry that creates its own market niche and is able to capture market share and fend off competition. The following are some of the unique hotel products that have been introduced over the years.

All-suite hotels. The all-suite product is a hotel with oversized guestrooms containing both a bedroom and a living room area. The all-suite concept includes a limited number of meeting rooms, down-sized food and beverage outlets, and a free breakfast, plus a complimentary cocktail hour in the evening. All-suite hotels attract mostly commercial and leisure travelers. This concept has not created any new hotel demand, but rather has redistributed existing demand over more properties.

Extended-stay hotels. Extended-stay hotels are designed to attract the extended-stay (seven nights and more) market by offering large units with separate living and bedrooms, full kitchen facilities, and dining areas. Their layouts resemble those of garden apartments. This concept has created new hotel demand by attracting extended-stay travelers whose previous lodging options were chiefly limited to renting apartments.

Micro-budget motels. A micro-budget motel room is actually a down-sized motel unit that is usually no larger than 190 square feet in area. A micro-budget motel facility is designed to offer accommodations at prices 15 percent to 25 percent lower than the traditional economy-type motel. A micro-budget motel is able to offer this low price by eliminating such amenities as the restaurant, lounge, meeting rooms, lobby area, and swimming pool. This concept has created new hotel demand by providing price-conscious travelers with a lodging product that meets their particular needs. Micro-budget motels attract patronage from rooming houses, mom-and-pop motels, and campgrounds.

Mega-resorts. A mega-resort is an all-inclusive resort hotel offering a wide variety of activities, services, and amenities. Disney World is an example of a mega-resort on the largest scale. The Hilton Waikoloa Village on the island of Hawaii is a mega-resort without a theme park. This concept has created new leisure demand by attracting people who would not be satisfied with normal resort hotels.

[2] Success Factors for Unique Hotel Products

As with any hotel product, the supply and demand characteristics of the local market are one of the primary keys to success. Other factors that are important to making a unique lodging product economically viable include:

- *Ability to create new hotel demand.* A unique hotel product that merely reallocates existing hotel demand among more hotel rooms is not as competitively viable as one that, like residence hotels, actually generates new hotel demand; and
- *Price/value relationship.* Hotel products that achieve the greatest success in the marketplace generally offer a good price/value relationship. This does not mean that only economy properties fit this criteria; for example, all-suite products offer a good price/value relationship to commercial travelers who may not require such amenities as meeting rooms, entertainment lounges, or room service. With a pricing structure that is similar to that of a full-service hotel, an all-suite product can provide the traveler a larger guestroom unit with the benefits of a separate living area and in-room kitchen facilities.

¶ 5.06 MATCHING THE PRODUCT TO THE MARKET

Before starting the search for sites for a proposed hotel, a preliminary product selection should be made to determine which product would be best suited for a particular market area.

The factors that should be considered in making this preliminary selection include the primary characteristics of the area's existing transient lodging demand:

- Price
- Facility requirements
- Seasonality
- Size, by market segment
- Future growth potential

In making the preliminary selection, the following primary characteristics of the area's existing lodging supply should also be considered:

- Number of competitive hotels
- Current levels of occupancy and average rates
- Orientations to particular market segments
- Analysis of facilities, amenities, and services
- Relative competitiveness, by market segment
- Probability of new additions to lodging supply

Finally, the type of lodging product that appears to be capturing the largest share of the market in the area and the reasons for this product's success must be taken into account. Examples of possible reasons include:

- Superior location
- Superior management
- Superior affiliation
- Superior product (facilities and amenities)
- Lack of competition

If the success factors cited can be duplicated, then two issues remain to be dealt with: (1) whether or not there is sufficient demand to justify another product of this type; and (2) the likelihood that other, similar products will enter the market over the short and the long term, given expected barriers to entry. If there are any market segments that are not being adequately served by area lodging facilities, the following considerations should be explored: the depths of these market segments, their expected growth, and the probability of competition for these segments.

On the basis of an analysis of the factors described, the following list provides, in descending order, the most desirable product traits and market conditions for preliminary product selection.

1. A product that does not currently exist in the local market but for which there is sufficient demand to justify its addition to the market. In addition, barriers to entry limit other new additions.
2. A product that exists in the local market, but that, because of a high level of demand and limited competition, outperforms all other products, and for which there is sufficient demand to justify the addition of more products of this type to the market. The product enjoys the protection of barriers to entry.
3. A product that exists in the local market and that experiences strong and growing demand. Competition within this product is also strong, but because barriers to entry discourage entirely new products, another product of the same type could be readily absorbed into the market.
4. An existing product for which there is strong demand in the local market. Competition within this product is present, but if the competition suffers from poor location, poor quality of facilities, poor management, or a weak franchise affiliation, a new lodging facility (or an existing hotel that has been repositioned) with positive attributes should be able to attract sufficient existing demand away from the underperforming competition.

The markets described in items 1, 2, and 3, while worth looking for, are rarely found. Most market areas exhibit characteristics similar to those described in item 4. While this type of market does not display all the optimum characteristics, it does represent favorable investment potential if a good site can be obtained along with strong management, competitive facilities, and a desirable franchise affiliation.

Markets with more than one negative characteristic, such as a combination of stable or declining demand, no barriers to entry of new competition, overbuilding over the foreseeable future, saturation by all existing products, and unfavorable long-term outlook should not be given further consideration unless there are mitigating circumstances.

¶ 5.07 HOTEL SITE SELECTION

Hotel site selection is the step of the hotel development or acquisition process that follows the identification of a favorable market area and the preliminary selection of a type of hotel product. Generally, the site selection takes place prior to performing an economic market study and appraisal, because this type of analysis is site-specific.

Chapter 7 describes in detail the various characteristics of a desirable hotel site; consequently, only the basic considerations necessary for initial selection are discussed here.

There are three basic locations that are considered suitable as sites of transient lodging facilities:

1. *Locations near transient demand generators.* Most travelers look for lodging facilities that are close to the demand generator that has brought them to the area.
2. *Locations near transportation.* Travelers generally prefer to be accommodated in facilities near the mode of transportation that they use.
3. *Locations near restaurants and entertainment.* Many travelers prefer lodging near the activity center of a market. These areas typically provide restaurants, lounges, shopping, theater, and other types of entertainment.

Hotel sites that are either near or within one or more of these three basic location types are the most desirable, particularly if other positive elements (e.g., easy access and good visibility) are also present. Hotel sites that do not enjoy these basic locational attributes may not be sufficiently competitive to warrant further consideration or the investment in an economic market study and appraisal.

Although this discussion concentrates on potential hotel construction sites, the locational criteria described in the foregoing list also apply to the selection process for existing lodging facilities.

The process of finding a potential market, identifying a suitable product, and locating either a desirable site or an existing facility constitutes the first major step in developing or acquiring a hotel or motel. In most instances, the effort involved in taking this step is made by the hotel investor with the assistance of an outside hotel consultant and appraiser.

The key considerations involved in selecting a consulting and appraisal firm are discussed in Chapter 6.