CHAPTER 8

Lodging Supply Analysis

¶ 8.01 INTRODUCTION

The lodging supply in a given market area is composed of every facility within that market area that caters to transient overnight visitors, including conference centers, bed and breakfast inns, and health spas as well as hotels, motels, and microtels. All of the transient lodging facilities that operate within one market area are competitive with each other to some degree, but for the purposes of a market study and appraisal, only those that qualify as primary and secondary competitors are evaluated.

An analysis of lodging supply begins with the identification of the market area, generally considered the area within twenty travel minutes of the subject property (see Chapter 7). The market area in which the subject property is located in terms of supply is sometimes larger than the market area as determined by demand. This occurs when demand generators are located close to the outer boundary of the subject property's normal demand market area (usually no farther than five to ten travel minutes beyond its perimeter). These peripheral demand generators may neighbor other lodging facilities that though out of the market area may be to some degree competitive with the subject property. For that reason they are considered part of the supply in the subject property's area.

The analysis continues with the identification of the primary and secondary competitors of the subject property, the number of rooms currently available in the market area, and the number of rooms of proposed projects in the area. Finally, the appraiser must determine the current rate structure of area lodging facilities, their historic occupancy levels, their market orientations, and the amenities that they offer. This information is generally gathered through interviews with competing lodging facilities in the subject area.

¶ 8.02 EVALUATION OF COMPETITION

Primary competition includes any lodging facility that attempts to attract the same transient visitors as does the subject property. Secondary competition generally consists of lodging facilities that attract the same transient visitors as the subject property, but under special circumstances.

The categorization of competitive facilities as primary or secondary depends, for the most part, on subjective judgments. The competitive environment of a market area can be evaluated either by investigating demand and determining the accommodations transient visitors actually select or by examining the local supply and determining the facilities that are similar in market orientation. Interviews with visitors can be helpful in analyzing the criteria that travelers use to select accommodations in the local marketplace, but an experienced appraiser can often evaluate similarities in the market orientation of competitive facilities simply by visiting each property and determining whether the criteria for competitiveness are met. To judge whether a lodging facility represents primary, secondary, or negligible competition for the subject property, the appraiser must answer the following questions:

- Does the facility in question offer a location similar to that of the subject property? Is it quickly and easily accessible for the market area's demand generators? Does it have a specialized location (e.g., airport, convention center, downtown, or resort)?
- Is the hotel similar to the subject property in terms of the facilities it offers? Types of hotels offering specialized facilities include convention, resort, suite, extended-stay, conference center, and casino.
- Does the hotel offer amenities similar to those of the subject property? Distinguishing amenities include restaurants, lounges, meeting rooms, swimming pools, exercise rooms, tennis courts, and golf courses.
- Is the hotel similar to the subject property in terms of quality and price? Classes of lodging facilities include luxury, first-class, standard/mid-rate, upper-economy, and economy/budget.
- Does the hotel in question have an image similar to that of the subject property? Image can be determined by the hotel's brand name, local reputation, management expertise, and any unique or distinctive characteristics (e.g., unusual lobby decor).

To best categorize competitive hotels as either direct (primary) or indirect (secondary) competitors, an examination of the targeted orientation of each hotel's current market capture is necessary. For a hotel to be considered a primary competitor, it must often compete for the same demand pool as the subject property. Two hotels that offer similar services and facilities are typically considered 100 percent—or directly—competitive. Such hotels do not have to be located in the same geographic area. Two five-star resorts located thousands of miles apart may be more competitive with each other than with the standard hotels located in their immediate area. More commonly, two extended-stay hotels located on the opposite ends of a metropolitan statistical are a (MSA) can be considered directly competitive with each other and indirectly competitive with the traditional transient hotels adjacent to them.

Primary competition occurs among lodging facilities that are similar to the subject property with respect to the following criteria: facilities offered, class, and image. Secondary competition occurs with lodging facilities that have similar locational characteristics but share few of the other major qualities of the subject property, particularly class and image.

Properties in the secondary category are considered competitive because they sometimes attract the same customers as the subject property and the subject property's primary competition. However, this tends to happen only as a result of special circumstances, such as when all of the primary competitors are at capacity, so that travelers who would prefer that type of accommodation must settle for one of the secondary competitors. A lodging facility that is not of the same class or image as the subject property might also be a secondary competitor if it has a particularly good location—for example, one adjacent to a demand generator. Because travelers are inclined to stay at the first hotel they encounter, especially during inclement weather, a secondary competitor with a convenient location will attract a certain percentage of the market for which the subject property competes.

In today's competitive hotel markets, franchise affiliation is a strong attraction for travelers, mainly because of frequent guest programs and national corporate room night contracts. Location is not always as important a factor as it has been in the past for guests seeking a place to stay. In many cases, guests will stay at a hotel outside of the immediate market area in order to stay at their preferred franchise. This is most common among the larger hotel chains with properties catering to the different market segments—for example Choice Hotels, Holiday Inn Worldwide, Hospitality Franchise Systems, Marriott, and Promus Hotels.

Hotel companies have realized the importance of national brand recognition. Rather than having new companies enter the market and develop a new national franchise, many of the larger hotel companies have developed new franchise divisions. For example, Marriott has its Marriott brand for its full-service hotels and resorts, Fairfield Inn for upper-economy limited-service properties, Courtyard for first-class commercial properties, and Residence Inn for extended-stay properties. Brand segmentation has been a strong tendency in the hotel industry over the past decade, and the process is continuing as other hotel companies continue to develop new brands to compete in today's complex marketplace.

Some hotels in the market area offer no competition to the subject property and would not be considered in the competitor analysis. Such properties are generally so dissimilar to the subject property that any crossover of demand would be highly unlikely. For example, a five-star hotel will rarely compete directly with an economy property.

¶ 8.03 FIELDWORK

Hotel appraisers must rely on fieldwork to produce information that is essential for a complete market study. For example, two key elements—the definition of the market area for lodging supply and the identification of competition—can be determined only by talking to a number of people in the local area.

Whenever a hotel appraiser goes into the field to gather information, he or she will find local parties interested in having a new hotel enter the market as well as other parties interested in keeping any new competition out. Each party usually wants to advocate its position; consequently the appraiser should anticipate an individual's viewpoint on the subject before undertaking any interviews. The local visitors' and convention bureaus and Chamber of Commerce usually welcome a new lodging facility, whereas the general managers of existing hotels and the local hotel association can generally be expected to oppose a new entry into the market. Local government (e.g., building and planning departments or assessors) typically take a neutral stance.

¶ 8.04 BENCHMARK INFORMATION

Before an appraiser conducts competitor interviews (see the following section) he should first collect some pertinent data that is verifiably accurate. The appraiser can use this information as a benchmark to determine whether data that is gathered during the interviews, such as occupancy or room rates, is biased in any way. The most useful piece of information is an actual occupancy percentage for a competitive hotel in the market area under consideration. The following is a list of possible sources of actual occupancy information:

Hotel association. Local hotel associations often monitor occupancy levels of member hotels, either individually or on a composite basis.

Local assessor. Local assessing departments sometimes receive financial information pertaining to hotels in their jurisdictions. If a hotel appeals its assessment and a public hearing is held, the financial data generally enters the public record.

Rooms tax collector. Many jurisdictions collect a hotel rooms tax, which is usually based on a percentage of gross rooms revenue. The collector of this tax will sometimes make this information available to appraisers. However, the data may be available only on a composite basis, which is not very useful when the occupancy level of an individual property is required. Sometimes the collector provides this data on a property-by-property basis without identifying the properties by name. In such cases, if the market is small, the appraiser can often identify the property by the amount of tax paid.

In Texas, the hotel rooms tax by individual property is considered public record; in fact, appraisers can subscribe to a monthly publication from the Comptroller of Public Accounts, State of Texas, Austin, Texas 78774. This publication contains the names of all the hotels in the state and gives the amount of rooms tax paid by each facility in the past month.

If the rooms tax paid is a known quantity, total rooms revenue can be calculated by using the rooms tax rate. Then, if the average room rate can be determined, actual occupancy can be calculated by dividing total rooms revenue by the average room rate. Experience has shown that general managers of lodging facilities are less apt to inaccurately report average room rates than other information. Therefore, when rooms tax data for an individual property can be obtained along with an average room rate, the appraiser can usually produce a useful estimate of the occupancy rate for the property.

For example, if a 200-room hotel pays $10,416 in rooms tax for the month of January and the rooms tax is charged at a rate of 4 percent, the average room rate of the hotel can be fairly accurately estimated to be $60.00. The occupancy rate for the month can then be estimated as follows:

$$\text{January rooms revenue} = \$10{,}416 \div 0.04 = \$260{,}400$$
$$\text{Rooms revenue per day} = \$260{,}400 \div 31 = \$8{,}400$$
$$\text{Rooms revenue per room per day} = \$8{,}400 \div 200 = \$42.00$$
$$\text{Percentage of occupancy} = \$42.00/\$60.00 = 70\%$$

Lodging 400 survey. Every August, *Lodging Hospitality Magazine,* a leading trade journal, publishes the results of a survey of the operating results of the top 400 hotels in the United States. The magazine ranks each hotel by total revenue and occupancy, and lists the name and location of each facility, its room count, total sales, total sales per room available, total guestroom sales (rooms revenue), total food and beverage sales, total other revenue, and number of employees. It could be argued that information provided in the Lodging 400 survey contains exaggerated data because the reporting hotels are interested in achieving a ranking that is higher than it actually should be. History has shown, however, that the data reported is generally accurate. It must be remembered that the IRS has an interest in the data reported, as do franchisors who base their fees on a percentage of rooms revenue. Average room rate can be calculated from this information by dividing total guestroom sales by the product of room count and occupancy rate and multiplied by 365.

For example, if a 300-room hotel is listed as having room sales of $5,435,000 and an occupancy rate of 73 percent, its average room rate is calculated as follows:

$$\$5{,}435{,}000/300 \times 0.73 \times 365 = \$68.00$$

Because most major hotel markets have at least one hotel that is listed in the Lodging 400, it is fairly easy to find the one piece of accurate occupancy data that is necessary to verify the answers given during competitor interviews.

Market research statistics. Numerous organizations, like Smith Travel Research (STR), the Rocky Mountain Lodging Report, and Source Strategies gather hotel market information from hotels and make it available for purchase. There are some limitations to such data, as some hotels are added to and removed from the sample, and not every property reports statistics in a consistent and timely manner. Nonetheless, STR provides the best indicators of aggregate growth in existing supply and demand in U.S. hotel markets. The statistics supplied by STR—which include occupancy and average rates—are useful in reviewing market trends and determining a hotel's position and level of penetration in the market, as illustrated in Exhibit 8-1.

Exhibit 8-1 Subject Property's Market Position

	1990	1991	1992	1993	1994	1995
Subject Property						
Occupancy	67.0%	68.0%	68.4%	69.3%	70.1%	72.1%
Percent Change	—	1.5	0.6	1.3	1.2	2.9
Occupancy Penetration	102.0%	102.4%	104.0%	103.9%	98.9%	94.4%
Average Rate	$54.67	$56.78	$57.50	$62.23	$63.46	$66.44
Percent Change	—	3.9	1.3	8.2	2.0	4.7
Average Rate Penetration	106.6%	104.2%	99.3%	98.8%	95.9%	94.8%
RevPAR	$36.53	$38.61	$39.33	$43.13	$44.49	$47.90
Percent Change	—	5.4	1.9	9.7	3.2	7.7
RevPAR Penetration	108.7%	106.7%	103.2%	102.6%	94.8%	89.5%
Areawide (STR)						
Occupancy	65.7%	66.4%	65.8%	66.7%	70.9%	76.4%
Percent Change	—	1.1	(0.9)	1.4	6.3	7.8
Room Rate	$51.29	$54.48	$57.92	$63.00	$66.16	$70.05
Percent Change	—	6.2	6.3	8.8	5.0	5.9
RevPAR	$33.70	$36.17	$38.11	$42.02	$46.91	$53.52
Percent Change	—	7.4	5.4	10.3	11.6	14.1

The exhibit shows that the subject property's market rate has been experiencing increases in both occupancy and average rate during the past few years. It also shows that the subject property, whose penetration was once greater than 100 percent in both occupancy and average rate, is now below that of the market, showing a decline in its market position.

Previous studies performed on existing hotels. Other hotel appraisers who have evaluated existing hotels in the area are often willing to share information.

¶ 8.05 COMPETITOR INTERVIEWS

Having defined the market area for lodging supply, identified the competition, and secured the benchmark piece of information, the appraiser can begin a series of interviews with selected staff members of the competitor hotels. The primary purpose of these interviews is to identify all of the competitor hotels in the market area and to determine as accurately as possible their occupancy percentages, average rates per occupied room, and market segmentations. The primary use of this information is in the performance of the competitive room-night analysis. (For a discussion of room-night analysis, see Chapter 10.)

Competitor interviews should also be used to obtain the following additional information:

- Date of opening
- Physical condition
  - —Recent and planned renovations
- Access and visibility
- Identification of franchise and management company
  - —Past and present
- Room count
- Amenities
  - —Restaurants
  - —Lounges
  - —Meeting and banquet rooms
- Room rates
  - —Published
  - —Special
- Effectiveness of reservation system
  - —Number of fill nights
  - —Number of turnaways
- Seasonality, including monthly and weekly occupancy trends
- Average restaurant and banquet checks
- Local food and beverage market capture
- Union contracts
- Area generators of transient visitation
  - —Demand generators leaving or moving into area
- Area economic trends and market outlook
- Local hotels for sale
- Proposed hotels and hotels under construction
  - —Expected opening dates
  - —Current status of each project

The interviews generally involve the general manager or other high ranking personnel of the hotel (e.g., assistant manager, front office manager, or director of sales). The information gathered is, of course, confidential and somewhat sensitive, particularly when it may be used to justify constructing a new competitive property. As a result, the interviews are often difficult to conduct and the information elicited less than accurate (e.g., occupancy rates may be stated as lower than they actually are).

The interviewees at competitor lodging facilities generally tend to be fairly candid about their average room rates and market segmentation, although an appraiser should be aware of the hotel's published room rates before the interview so that the average rate that is quoted can be checked for accuracy. In addition, when asking for information about the market segmentation of a competitor hotel, the appraiser must be sure that each segment referred to is clearly defined and that the sum of all segments mentioned is 100 percent.

As discussed previously, in order to achieve the desired results from an interview and to be able to adjust the data for any bias on the part of the person interviewed, the appraiser must possess at least one reliable piece of information regarding one of the competitive properties, preferably an accurate occupancy rate. The procedure for detecting bias and adjusting data to reflect it is fairly simple. For example, if the appraiser knows that a particular property has an occupancy rate of 80 percent, and the general manager of the property claims during an interview that it is 75 percent, the appraiser can assume that the other data given by the interviewee is likely to be overstated.

When all the competitor interviews are complete, the data should be compiled on a spreadsheet that identifies the interviewees and their responses. From this information, the upward or downward bias for individual questions can be adjusted and final estimates determined.