

Too many rooms at the inn

With little new construction, hotel chains turn to acquisitions for growth

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Hotels have money to buy, money to renovate but no money to build. And that's great news for the industry. Instead of growing by building new hotels, hotel chains are growing by buying, and often renovating, other hotels.

The lack of new hotel construction is giving demand a chance to catch up with the supply of hotel rooms. As supply and demand come more into line with each other, it will become easier for the hotel industry to recover from nearly three years of sagging rates and revenue, according to people in the industry.

"There has definitely been a slowing of new supply to the industry, particularly in the last couple of years," said Alan Tallis, executive vice president and chief development officer with La Quinta Corp. "That's certainly been good for the industry, particularly in the economic environment in which we've been operating the last couple of years."

Business travel, which is the mainstay of the hospitality industry, started to drop off as the economy began to slow in 2001. Then came 9-11, which quickly dropped the hotel industry into the tank.

"The common perception is that we have essentially hit the bottom," said Richard Barrett-Cuetara, hospitality lawyer with Cowles & Thompson in Dallas.

As business slowed, development capital from institutional lenders dried up, slowing hotel construction.

But the industry still has plenty of equity, which is being used to fund acquisitions. And there are plenty of potential acquisitions as hotel companies unload properties that don't fit their brand. The properties that are sold then get a makeover from their new owners, including renovations, upgrades in technology and a new brand, usually making them more competitive.

The result is that the the hotel industry's outlook is starting to get brighter.

"What we're looking for now is new equilibrium," Barrett-Cuetara said. "Supply and demand is starting to get equal. Hotels are starting to see average daily rate increase."

Although occupancy rates and room rates are down for the year to date, according to Smith Travel Research, both have been rising in the last few months.

"It's a slow boat turning," said Bill Duncan, vice president of brand management for Homewood Suites by Hilton. "We've been partially trying to convince ourselves that it's turning. We're starting to see the signs that it is turning. I'm not going to say it's very rapid."

John Keeling, senior vice president of PKF Consulting in Houston, said the industry is probably looking at 18 to 24 more months of less than 2 percent growth in the supply of hotel rooms -- atonement for the mushrooming of limited-service hotels at the end of the 1990s.

"In the late '80s we saw the implosion of the hotel industry," Keeling said. "All through the '90s, we saw very little hotel construction. In '96, around there, we saw it start to come back. We had a pretty large increase in room supply during the latter part of the '90s and the early part of this decade."

And that created somewhat of a supply hangover, compounded by the economy heading south at the start of 2001 and 9-11.

"One thing that's important to remember is that the hotel industry is a very fixed-cost industry," said Mark Jones, director and senior partner with Bain & Co. in Chicago. "You put capacity in, and it's there. If demand shrinks, that capacity is still there. If it shrinks more, that capacity is still there."

Even with the current oversupply of hotel capacity, however, two years is a long time for hotel companies to wait to grow.

Hotel companies measure growth by the number of new rooms and, in the past, this meant new construction. As operators are aware, travelers, by and large, prefer new hotels.

But if the demand for more hotel rooms is not there, and neither is the funding, the hotels turn to acquisitions for growth.

"We see a number of the clients that we work with talking acquisition," said Rick Garlick, director of consulting and strategic implementation for Maritz Research Hospitality Group. "Growth through acquisition seems to make a lot more sense than opening new boxes."

Real estate investment trusts are selling off chunks of their portfolios. Irving-based FelCor Lodging Trust has sold 16 hotels and has 17 more to go. Wyndham Hotels and Resorts, which was once part of an REIT, Patriot American Group, has been selling properties that it says don't fit the Wyndham mold.

"A lot of hotels are being sold and are in the process of being sold now," Barrett-Cuetara said. "Owners of hotels are retuning their portfolios."

That is helping fuel what Barrett-Cuetara called the hot trend of hotel renovation.

"The projection, according to PricewaterhouseCoopers, is \$3 billion in renovations in 2004 versus \$2.4 billion in 2003," he said. "This reflects plans of hotel companies that have deferred capital projects or need annual expenditures for their properties. Mixed in the pot are owners who want to retool their properties or people who have bought hotels and want to get them renovated."

The renovations allow the hotels to stay viable with a chance to recast them as another brand. While freshening up the rooms they usually also upgrade technology, with such amenities as high-speed Internet access and other features for business travelers.

Locally, a string of renovations -- large and small -- have been announced in recent years.

This year, Fort Worth city officials agreed to work with a private developer to turn the aging Ramada Plaza into a luxury hotel with a new name.

In Arlington, Brandon Jackson, interim director of sales for the Arlington Inn, said that property is in the process of becoming a Crowne Plaza hotel by Holiday Inn.

"We were bought by a new owner June 23," Jackson said. "From that day on they were trying to find a different flag to fly. They are still working out a few minor details."

Jackson said there are plans to renovate all the rooms, the bar area and meeting space. The front desk and landscaping will also be redone. "It's a full-blown renovation," he said.

Earlier, Patriot American Group/Wyndham International announced a \$4.6 million renovation of the Arlington Marriott after it officially became the Wyndham Arlington DFW Airport South.