Hotel Industry Update for DuPage County

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The Building Will Continue Until Morale Improves

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The news this time is the development activity. Because national statistics and top 25 market summaries review growth on a comparative basis and Chicago has exhibited some fairly strong dynamics early in this year the Chicago market was targeted as a growth market. This means that the developers have come out of the woodwork. A lot of the exuberance was based on some aberrations in the statistics. January showed a 28% jump in occupancy, but because it was compared with January 2011 when the east coast was socked in with snow and the Boston, New York and DC airports were closed; and a second aberration in April where there was a spike. Without looking behind the numbers, Chicago became a "hot market."

Downtown Chicago has several projects under development including a multi-property White Lodging project in the River North, the Langham, the Virgin Hotel, expansion of the Hyatt at McCormick, a Park Place hotel and several other active development programs. There are several older projects that have suddenly have achieved new life. When we look at downtown we are beginning to dampen the occupancy growth as a result of the development activity and the uncertainty of the economy both nationally and internationally, but continue to expect some modest growth in rate. In fact our outlook for the downtown market presented in August was a little depressing.   That report is available on our web site or through the IHLA.

That focus on growth also impacts the suburban market area with a lot of exploratory studies at the O'Hare area. An interesting statistic is the closing of 11 DuPage county hotel properties since 2011, many in the budget sector.   However development activity continues. Within the DuPage market these are the projects and updates we have encountered. First the closed projects right in our backyard. The Drake Oakbrook is on track to re-open shortly after a renovation program and application for a CO. The development group is a quasi-religious organization that expects to operate the property without a focus on alcoholic beverage service, catering to organizations with similar beliefs, the corporate meeting market and area sources of business. The property should open in the next several months, probably before year-end. GGP is in the process of finalizing a deal with a potential operator for The Renaissance Hotel, probably as a focused service property, expanding the room count slightly and renovating to bring it up to market standards. The leasehold operation should re-enter the market early next year.

The most significant new development is the announcement of the Riverfront property in downtown Naperville, a 130 room mixed use project with meeting space that could enter the market as early as 2014. Other projects include the Hilton Garden Inn Bolingbrook of 150 rooms scheduled for July of 2014 and a Candlewood also in Bolingbrook; a 101 room property in North Aurora, and two development sites in Joliet, a 100 room Candlewood scheduled for a late 2013 opening and the Center Point development site that is being marketed. These development, plus economic factors result in a modest outlook for both occupancy and ADR growth over the next several years, gradually climbing up to a 67 percent by 2017, a new high for the most recent 20 year period. ADR growth is expected to recover to the 2007 level by 2014, economic conditions permitting. The growth in occupancy is supported by a compound annual growth in demand of approximately 2% over the past 10 years.

Every year when we try to put together a forecast for the DuPage market, we always look for something new to discuss. In the past, we've talked about things such as the interplay between the Chicago market and the suburbs, the effect of OTA's, and more.

This year, while we're not out of the woods just yet, you should be able to see the light from here. Our estimates from 2011 turned out to be a half a point too high in occupancy and $2.50 short in ADR. The result was a dollar off in RevPAR. Which isn't bad. We've done better in other years, but that's the danger of forecasting in a down market. At any rate, we're recovering, and while we knew last year was going to be better, the real news is just how much better we have been since the crash.

We took a look back on our forecasting since 2010, and the difference between then and now is really a story of trading rate for occupancy. While we were way off in 2010 in terms of occupancy (too low) and rate (too enthusiastic), we did OK in forecasting RevPar for that year. By August last year, it seemed as though we were going to sacrifice ADR at the altar of Occupancy and get very little back for it. And while that turned out to be true, what we're seeing going forward is that Occupancy will likely recover to a higher level than we originally thought, and eventually rates will follow.

In short, people have been arguing over whether this is a U shaped recession, or a V shape or an L or whatever for a long time. We're at a point now where we've seen enough of it to tell you that it really depends on which metric you're using.

For occupancies, the worst is over. As we say at these meetings every year, it's going to be a LONG time before we see occupancies around 70% again, but we're essentially "out of the woods". We anticipate a curved V pattern, with one really bad year, two mediocre collar years, and then a return to some amount of normalcy.

For rate, the situation isn't as good. We've lost a lot of ground that's going to be very hard to make up. That ten dollar reduction in rate is going to mean we're going to need two stellar years of strong ADR growth to bring it back up to where it once was. With the overall economy having slightly better than anemic recovery, we're anticipating a "Check Mark" pattern for this one, with a few years of middling rate growth.

Of course, we would love to be wrong, and if there are signs the economy is really turning the corner, we'd anticipate rate to shoot up 7 or more percent within a matter of months, as was the case with the last recession, but international and national economic conditions are still unstable and the election year continues that uncertainty.

Overall for the suburban area, the 2001-4 recession was weaker than this one, with a more gradual drop in occupancies and rates as people began to realize that business was going to remain low for a while. The most current recession was met with an immediate drop and panicked pricing, placing it at the lowest it's been in years, virtually overnight. A lot of people were taking a wait-and-see approach, hoping that they could either weather the storm, or take advantage of the weakened state of other companies to expand their business. The giant sell off that everyone was expecting never happened. And although there are still plenty of under-performing assets and in-debt properties, I'm guessing there won't be a large movement to acquisitions or bankruptcies that will have an impact on the market. The sales that are taking place are being done quietly, and aren't really affecting the practical side of the hotel business much at all.

A quick analysis of the mix of business and the elasticity of demand in the suburban properties outlines a portion of the problem from a pricing standpoint. Properties reacted immediately to a drop in demand by dramatically discounting rates. This was exactly the wrong move, just like it was last time. The mix of business is approximately one third each corporate individual; group-both business and leisure (SMERF); and leisure-related to area residential. Of that mix some of each of those segments is inelastic demand, travelers who will pay rack, and a portion is certainly rate sensitive. The proportions vary by demand source with about 75% of the commercial mix inelastic demand. Of the group business, about 60% is inelastic business and about 30% of the leisure is inelastic or less rate sensitive.

Running these numbers out, the inelastic business, or the portion that would pay rack rate, is 55% of the overall mix, yet we dropped rates across the board rather than working on packaging, special rates and limiting conditions on dates, facilities, guaranteed reservations, cancellation and other fences to manage the discounted rate segments. The across the board rate cuts resulted in giving away the premium business at discounted rates, discounting what could have been booked at rack. Now we have established a price/value perception in the minds of our premier and full rack rate guests that will require an extended education and promotion program to overcome. A business traveler who has become used to paying $60 to $80 a night will not appreciate a quick move to a $120 rate level without seeing a physical change in the properties. Part of that, much to the chagrin of the owners, will come about as the chains enforce their standards and require PIP expenditures to correct deferred maintenance. So, while owners may groan about the need to install flat screens and adopt the new lobby schemes, it will produce the vehicle to create the "new image" that will leverage rate growth.

We thought we had learned the lesson in the 2001-2004 recession on rate discounting, and certainly having gone through it twice, we have reinforced that experience. Hopefully the next time around the industry will take a more pragmatic approach to pricing. Of course, it only takes one or two franchised hotels to start, and soon everyone else is following. As it turns out, in real life, Lemmings don't actually run themselves over the sides of cliffs when faced with adversity. It's a pity that hotels do.

Here are some other things we are seeing on a national and regional basis. The demand growth is slowly recovering, more strongly in the leisure segment and especially in SMERF and group leisure activity. The corporate market is still rate resistant because of transparency of rate information, aggressive negotiations by corporate travel organizations and strong competition among area properties struggling to build occupancy at the cost of rate growth. The international travel is also growing but the Midwest isn't benefitting as strongly from this activity at the present time. Redevelopment and repositioning activities are focused on creating the social activity focused lobby area, improvement in band width, flat screen tv's and the addition of refrigerators, coffee makers (some single cup brewers), conversions to showers replacing tubs, and brands working to achieve a more experiential focus.

Moving forward rate will continue to be the challenge and requires a confident approach to pricing and a rebuilding of the price/value perception of area properties.

Projected Occupancy DuPage

Month	2009	2010	2011	2012	2013	2014	2015	2016	2017
January	36.89%	39.10%	40.79%	45.84%	44.14%	44.81%	45.48%	46.16%	47.08%
February	43.48%	46.40%	49.08%	52.73%	52.53%	53.32%	54.12%	54.93%	56.03%
March	46.18%	52.20%	55.11%	57.47%	58.02%	58.89%	59.78%	60.67%	61.89%
April	48.54%	57.10%	58.95%	59.46%	62.22%	63.15%	64.10%	65.06%	66.36%
May	51.99%	60.40%	64.55%	69.34%	66.89%	67.89%	68.91%	69.94%	71.34%
June	60.38%	69.30%	73.98%	74.38%	76.99%	78.14%	79.31%	80.50%	82.11%
July	60.29%	68.55%	73.50%	74.62%	76.49%	77.64%	78.80%	79.98%	81.58%
August	58.47%	65.16%	69.56%	71.25%	73.03%	74.13%	75.24%	76.37%	77.89%
September	57.96%	66.67%	67.42%	70.83%	72.60%	73.69%	74.80%	75.92%	77.44%
October	56.14%	63.12%	65.54%	68.16%	69.86%	70.91%	71.97%	73.05%	74.51%
November	49.26%	56.81%	60.46%	61.42%	62.95%	63.90%	64.86%	65.83%	67.14%
December	39.60%	39.96%	44.33%	45.69%	46.83%	47.53%	48.25%	48.97%	49.95%
Annual	50.80%	57.14%	60.19%	62.00%	63.55%	64.50%	65.47%	66.45%	67.78%

Projected ADR DuPage

Month	2009	2010	2011	2012	2013	2014	2015	2016	2017
January	$88.69	$76.71	$79.32	$83.59	$88.17	$90.81	$93.54	$96.81	$100.20
February	$89.39	$78.58	$80.40	$85.83	$89.48	$92.17	$94.93	$98.25	$101.69
March	$88.90	$79.41	$55.10	$85.86	$80.49	$82.90	$85.39	$88.38	$91.47
April	$87.68	$79.31	$81.83	$87.79	$89.64	$92.33	$95.10	$98.43	$101.88
May	$86.01	$79.98	$84.27	$89.72	$90.16	$92.87	$95.65	$99.00	$102.47
June	$86.10	$82.60	$86.40	$91.17	$91.91	$94.66	$97.50	$100.92	$104.45
July	$83.24	$80.72	$83.80	$86.66	$89.26	$91.94	$94.70	$98.01	$101.44
August	$85.30	$82.39	$85.66	$88.62	$91.27	$94.01	$96.83	$100.22	$103.73
September	$86.72	$85.40	$88.07	$91.01	$93.74	$96.55	$99.45	$102.93	$106.53
October	$84.75	$84.71	$88.45	$90.21	$92.92	$95.71	$98.58	$102.03	$105.60
November	$81.62	$83.12	$86.58	$87.91	$90.54	$93.26	$96.06	$99.42	$102.90
December	$75.43	$76.24	$78.91	$80.65	$83.07	$85.56	$88.13	$91.22	$94.41
Annual	$85.13	$81.18	$84.51	$86.62	$89.22	$91.90	$94.66	$97.97	$101.40

	Projected RevPAR DuPage								
Month	2009	2010	2011	2012	2013	2014	2015	2016	2017
January	$32.72	$29.99	$32.35	$38.32	$38.92	$40.69	$42.54	$44.69	$47.18
February	$38.87	$36.46	$39.46	$45.26	$47.01	$49.14	$51.38	$53.97	$56.98
March	$41.05	$41.45	$30.37	$49.34	$46.70	$48.83	$51.04	$53.62	$56.61
April	$42.56	$45.29	$48.24	$52.20	$55.77	$58.31	$60.96	$64.04	$67.60
May	$44.71	$48.31	$54.40	$62.21	$60.31	$63.05	$65.91	$69.24	$73.10
June	$51.98	$57.24	$63.92	$67.81	$70.75	$73.97	$77.33	$81.24	$85.76
July	$50.18	$55.33	$61.59	$64.67	$68.27	$71.38	$74.62	$78.39	$82.76
August	$49.88	$53.68	$59.58	$63.14	$66.66	$69.69	$72.86	$76.54	$80.80
Septembe	$50.27	$56.93	$59.38	$64.46	$68.06	$71.15	$74.38	$78.14	$82.49
October	$47.58	$53.47	$57.97	$61.48	$64.91	$67.86	$70.95	$74.53	$78.68
Novembe	$40.21	$47.22	$52.35	$53.99	$57.00	$59.59	$62.30	$65.45	$69.09
Decembe	$29.87	$30.46	$34.98	$36.85	$38.90	$40.67	$42.52	$44.67	$47.16
Annual	$43.25	$46.38	$50.87	$53.70	$56.70	$59.27	$61.97	$65.10	$68.72