

“The State of the Chicago Hotel Market and Its Reflection of Economic Conditions”

by Matt Baron, Staff Writer, ULI Chicago

This is a summary of the October 30, 2009, meeting of the ULI Chicago District Council, whose members gathered at theWit, A Doubletree Hotel in Chicago, to discuss the state of the hotel market including:

- The challenges faced by hotel owners, operators, and lenders due to the current economic trends and conditions.
- Prospects for different hotel market segments and properties.
- Insight and the outlook on the projected timing of the economic recovery.

Panelists:

Hans Detlefsen, MPP, *Managing Director*, HVS Global Hospitality Services – Chicago

Laurence Geller, *CEO and President*, Strategic Hotel Capital, LLC

Scott David Greenberg, *President*, ECD Company & Creator of theWit

Moderator:

Donald Shindler, *Partner*, DLA Piper LLP (US)

There is good news and bad news for the hotel industry.

The good news? Things will get significantly better. Alas, the bad news is of the in-your-face variety: business is down, and it will remain so for at least a few years before we experience the good news.

Much of those fortunes hinge on the timeless supply-and-demand equation. Even as demand has waned over the past year or two, the supply of hotel rooms has been growing, said Detlefsen.

Nationally, occupancy rates are at 57% this year, down from 63% last year, while the average room rate has dropped from \$107 to \$98, he said. In Chicago, those figures are a projected 62% occupancy in 2009 (down from 71% in 2008) and an average room rate in the \$160s (down from mid-\$180s).

Detlefsen forecast the hotel market would begin its full rebound in 2011.

Geller offered a more pessimistic assessment, at least in the short term. High-end hotels have been especially struggling, prompting him to quip, “Owning a Ritz Carlton for the first half of this year was like having leprosy.”

And in blunt terms, Geller railed against the “consistent idiocy” of hotels, including some chains, that have been “slashing rates for no reason.” Those moves, he said, are often in reaction to competitors dropping their rates.

“The consumer is getting a bargain that he doesn’t deserve...it’s a slippery slope,” said Geller.

As demand increases, he said, “The ones who hold their rates now will be the winners.”

While acknowledging Geller's point about the perils of dropping rates more than is necessary, Greenberg noted, "You can't sit there in the market and be oblivious to what is going on...it's the degree to which you (lower rates)."

Geller voiced optimism that systemic changes in hotel operations, such as leveraging the Internet, e-mail marketing and social media for marketing, will create economic efficiencies that help bolster hotels' profit margins over the long haul.

Industrial engineering techniques have "changed the face of the industry," said Geller, and led to a reduction in wage costs by at least 25 percent.

"That cost is gone forever. It ain't coming back," said Geller. "Operations are much smarter and better and that's going to make a big difference."

Geller predicted new hotels would not get built until 2015 or 2016. That lag bodes well for recent entries to the market, such as the event's host, theWit, which opened at 201 N. State St. in June 2009.

Among other benefits, Greenberg said the down economy enabled the hotel to hire personnel that would otherwise never have been available. In addition, the hotel has quickly attracted a strong following, particularly among those using the hotel's rooftop restaurant.

"We've been very grateful for our success in this business," said Greenberg, about whom Geller said, "He's in a good position because his product is great."

Therein lies a key element repeated often during the session: the importance of offering a truly differentiated product. In addition, plugging into a strong customer-loyalty program, as theWit has done with Doubletree, is crucial.

Panelists agreed that for Chicago, focusing on the U.S. domestic market, such as regional visitors seeking a "staycation," is the way to go.

"There has been a tremendous drop in international business in Chicago, and hopefully that will come back," said Greenberg. "The devaluation of the dollar may help a bit."

Geller said the city ought to invest more heavily and be more proactive with its Convention & Visitors Bureau.

"Chicago is a meat and potatoes city, driven by conventions" that create a "ripple effect" throughout the local economy, particularly hotels, said Geller.

As for hotels' long-term financial health, Geller said each site ought to be honest with lenders about their economic outlook, what the hotel is doing to make it through these difficult times, and treat lenders as partners.

"Lenders don't want to take too many write-downs if they don't have to.....They want you to keep (the hotels)," Geller added. "They need more friends than enemies right now."

Panelists seemed as optimistic in the long-term as they were pessimistic about the short-term state of the hotel market.

“As the market demand comes up, the differentiated product will do better than the homogenized product because they have a reason to charge more,” said Geller.

Making use of Internet marketing, especially social media, such as Twitter and Facebook, has become increasingly relevant. Geller said the Internet has rapidly altered hotel marketing and will help reduce marketing expenses.

Greenberg and his senior staff have been investing significant time in their quest to understand the best way to leverage social media.

“Social media is less expensive if you use it (intelligently), but it must be used carefully,” said Greenberg. “It’s a huge thing. We’re spending a lot of time drilling down deep and really thinking through it. It’s very, very easy to misuse social media because it’s out there in the public.”

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