Worldwide hospitality market remains strong

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Abstract

After several difficult years earlier in the decade, the worldwide hotel industry has been experiencing a market rebound that appears to be holding steady for the foreseeable future despite recent credit woes.

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After several difficult years earlier in the decade, the worldwide hotel industry has been experiencing a market rebound that appears to be holding steady for the foreseeable future. One area that appears to be especially strong is the Middle East, which is experiencing unprecedented levels of growth. Countries and emirates, such as Dubai (which anticipates an additional 40,000+ hotel rooms coming online within the foreseeable future), are experiencing a hotel construction boom to accommodate — or perhaps to create — mind-boggling capacity rates.

This emerging force in the hotel market has captured the world's attention. Global hotel operators are piling into the region. Most of the global brands are already represented in Dubai, and many have aspirations beyond the tiny emirate. More than one major 'Western' hotel operator is planning to establish each of its brands in the major Middle Eastern markets.

Despite all of this international interest, however, capital flows from outside the region into the region are comparatively nonexistent. Most development capital is currently provided by the ruling families of each emirate or country, making it difficult for traditional investors in the West to compete. Additionally, Middle Eastern investors are finding more opportunities within the region than elsewhere, prompting them to reinvest back into the region. Markets in the United States and Europe (and some of the primary cities in China) are seen as relatively mature,

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with relatively high barriers to entry and volatile credit markets. However, the marginal growth in some of the developing Middle Eastern regions is outpacing growth in the United States, despite the fact that development is still dwarfed by development in the United States.

While capital appears to be plentiful in the Middle East, it remains top of mind in other markets. The cheap-debt monetary policy of recent years contributed to an increase in hotel investing, resulting in more money chasing a limited supply, and, in turn, pushing up prices. According to the International Society of Hospitality Consultants (ISHC), expectations of revenue and profitability growth continue to spur the flow of equity capital available for new development. This is expected to continue as long as the industry's expansion continues.

Even prior to the recent credit crunch, loan-to-value ratios had moved upward for both primary and mezzanine debt, and heavy competition had pushed down interest rate spreads, with mortgage defaults remaining low. However, according to ISHC, the margin for error in hotel investments is diminishing. So far, this has had little impact on equity capital availability. Hotels remain, in most major markets, more attractive than other commercial asset classes. But, as with any cycle, there is a plateau in the expansion on the horizon, which, combined with the current lack of liquidity in the debt markets, will impact the flow of capital to the hotel sector.

Also, hotel owners and managers are facing many of the same overhead concerns as they always have, particularly including labour and construction costs, which are driven by the brands efforts to distinguish themselves. There is also increased attention on lifestyle experiences and premium services and amenities, especially challenging as the demographic of travellers changes. According to ISHC, now, more than ever, hoteliers must offer design and amenities that cater to the special needs of aging consumers (Baby Boomers), as well as younger travellers (Gen-X and Gen-Y), who have high expectations in regard to design and technology. This, of course, directly impacts both investment capital and operating costs and, ultimately, net cash flow and returns on invested capital. Prudent hotel owners already know to negotiate cost controls into their management agreements. They will have to continue to do so in order to maintain a healthy balance between keeping their hotels competitive, but preventing unwarranted 'amenity creep' and spiralling costs.

As we know, the hospitality market, which is vulnerable to a variety of influences, can be unpredictable. Investors may wish to take advantage of equity capital availability now, while there is still a market. However, they should also take steps to mitigate the costs of operating a hotel and the uncertainty presented by turmoil in the debt markets and the inevitable plateau in expansion.