CARLTON FIELDS

Post-Election Predictions: What the Hospitality Industry Can Expect in 2017

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In this podcast, real estate lawyers David Adams and Dan Weede discuss the impact of the election on the commercial real estate market - in particular, the hospitality industry. They share their observations and predictions on short- and long-term trends, millennials and social media, the share economy, minimum wage, occupancy rates, and financing of large hospitality projects.

TRANSCRIPT

David: Welcome and thank you and our listeners and welcome to the first in our series on the national and commercial estate market. My name is David Adams and today I'm talking with Dan Weede – a guy who needs no introduction in the regional hospitality industry. He is the co-founder and former president of the Atlanta Hospitality Alliance, an approximately 300-member, Atlanta-based, professional development and networking group that meets quarterly to socialize and discuss hospitality industry trends and developments. I thought it very fitting to ask him about what he sees in hospitality industry in 2017.

Dan: Thank you Dan.

David: Since the election, the overall business sentiment in the U.S. appears to have changed for the better in a positive sense. How do you think this will impact the hotel industry and broader hospitality real estate market?

Dan: That's a great question and inauguration day is still two weeks away. So, by definition, we're still talking about perceptions and speculations, but I think it's very positive. I think that if you were to ask most people going into the election what would happen with President Trump, they would have thought that it was going to have an adverse reaction on the economy and it's clearly not. So that's been a surprise. It's been a good short-term bump. But, I'm not convinced that it's going to have a longer-term effect on the industry other than some of the trends and headwinds and tailwinds we're facing right now, that we're going to talk about in a little bit, I think those will continue to play out – and I think it's going to be less about the short-term balance and speculations and it's going to be more policy-driven over the next four years.

David: I think that's a great introduction and what I like to do is look at overall industry trends. As someone who is involved in the commercial real estate market and not the sub-market, the hospitality aspect of the commercial real estate market, it appears to me that there are three particular trends that are impacting the financing of projects, and so I'd really like to get your thoughts on those. One that keeps popping up over and over again – and I recently saw this on a U.S. census department release – is that millennials now make up the largest cohort in a working population. It's hard to say millennials without mentioning social media but since millennials with their addiction to social media are now again the largest group in the workforce, how do you think that this going to impact the hospitality industry overall?

Dan: Well, it's going to have a critical impact. It has had a critical impact. You mention social media and just how a person books a room, from just simply a few decades ago or even more recently you may go directly into your brand of choice and book a room. You might go into Expedia and book a room. You may do minimal research. You may just go back to the same hotel that you stayed at the last convention. Social media has changed all of that. I think the millennials' preference for an *experience* where they stay, not just looking for a clean bed and a nice meal – that's changed everything. All the new brands coming out are essentially catering to that new millennial preference. So whether you like it or not, millennial desires are a major force driving hospitality brands today.

David: Keeping on that train of thought with millennials and the positive trends in the hospitality industry, do you think various reservation services like Airbnb or their competitors are going to have a positive impact on the hospitality industry or is that something that the industry is just going to learn to deal with in the future? That seems to be an aspect in the hospitality industry that gets a lot of press right now.

Dan: It is, it's funny, I was going to roll in Airbnb when I talked about the millennials. But I don't think Airbnb is necessarily millennial-driven. It's probably embraced by millennials more so than it is by older generations. But just two years ago at one of our industry events, very few people in the industry – let alone across the country – even heard of Airbnb. About a year ago I was in front of a group of Georgia legislators with a hotel group and they were raising concerns regarding Airbnb. The legislators, they were honest – they said six months ago that they had never heard of it… that it has been an enormous game changer. I think, when people think Airbnb, they think of ski country, or resorts, or New York City, but that's going to change – it's going to affect everybody, even in a market like Atlanta. One example that I just read about was in Austin, Texas, at the SXSW, and it's almost a sponge of Airbnb. So, as SXSW has grown, demand during those two weeks has spiked as you might imagine. Rates tracked very, very closely to the demand spike until recently the last couple of years… and you see rates topping off with demand continuing to increase. So, that doesn't make any economic sense, but the reason was Airbnb. So there are people that might not normally put product on Airbnb but when the price is right they will. So they might not have their spare room available for rent 50 weeks out of the year at $200 dollars a night, but if it's $400 dollars a night they'll do it.

David: That's an interesting point because we sit in Atlanta right now, and one of the big news stories of 2016 and 2015 was both a bid and the receipt in Atlanta of the Super Bowl coming to Atlanta in a few years. You would think that the hospitality industry would be behind such a bid because, like they did in the Olympics and other big national events like the NCAA basketball tournament, they would be able to increase their average daily rate. So, is it your understanding now that because of these services, that spike in rates is going to go away?

Dan: Yeah. We probably haven't seen it yet. So Airbnb is not considered a big threat in Atlanta like it is maybe in New York City. Some estimates in New York City can be 20% of room supply on a given night may be controlled by the Airbnb. They're very protective of their numbers and in Atlanta we don't feel that as much. But we have surge events and I think if you're not feeling it now you're like, "Well, it's not a factor, I don't need to even worry about it for my hotels there" in Atlanta or Tampa, or you might have a secondary market like Chattanooga or Nashville as well, but they will when there is a surge event. I think it will put downward pressure on the rates that a hotel can charge and you'll probably still see a bump, but it's not going to be the bump that I think a lot of hotel owners and managers anticipate in Atlanta, say for the Super Bowl or for a big NCAA event.

David: That's a very interesting point to keep down average daily rates. Keeping with the theme of what the hospitality industry is looking like post-election… one of the big issues not only in the hospitality industry but in the entire commercial real estate industry has been the enactment of several rules impacting financing of large projects. Some of these include risk retention rules and HVCRE, which stands for High Volatility Commercial Real Estate rules. Do you see these rules going away in your crystal ball, and second, do you think that they'll be a headwind to the financing of large hospitality projects?

Dan: Well I think – and this is all speculation as we haven't seen anything under the Trump administration yet – I think the thought is that there will be less regulation. But we hear that every time there is a Republican administration and it doesn't seem like much changes. I don't think it's going away. I represent lenders who represent developers who represent investors – those sort of headwinds where everybody wants more, easier financing – but as we've recently learned, that can create a bubble and bubbles are very painful to deal with. So I would almost say that the headwinds that we say were the tighter financing – it's healthier, it is not unhealthy, and it is not chunking out the industry. It is making it much more difficult to get transactions done, but the best deals generally are getting done, the weaker deals are not. It's still going to be a challenge, but you might also look at that and instead of calling it a headwind, calling it health. There's a healthy tension there and there are reasons perhaps the hospitality industry is being treated a little bit tougher than perhaps other real estate investment opportunities, but I think generally we still see a good balance between supply and demand.

David: I think that's really interesting. One sort of variable that has also popped up since the election is something that I read about yesterday and that is 17 states across the country have minimum wages that now exceed the federally mandated minimum wage. You know a lot of hospitality employees and people who are active in this business will be impacted by some of those rules. What are your clients telling you and what does your crystal ball say about whether this is going to have a material impact on the industry?

Dan: You know, I'm not an economist and I always worry about the law of unintended consequences. We represent clients all over the country but just focusing on Atlanta for a second – Atlanta is a large metro area but a very small city area – so if Atlanta were to pass a minimum wage ordinance, it would be easy for somebody coming into Atlanta to go just outside the perimeter outside the city boundaries, which in many cases is within the perimeter, and book a hotel room. I would have to think that it would affect the ability to get people in beds inside of Atlanta. The number one expense of any manager is its people and a good manager is going to look for ways to reduce expenses in order to make sure that profits continue to increase. So that's where they're going to focus – it would just stand to reason it's going to be on personnel. So I don't know but I would strongly suspect that it will have a negative effect on employment. But if everybody is doing it then perhaps overall if we're seeing this is as a true trend and a lot of other metros areas are starting to do it, then I think you probably have that moderating a little bit. So it's difficult to tell… I'm not an economist, but I'm a little bit cynical on how it's really going to affect the hospitality employment.

David: You were talking about occupancy rates across the Southeast, and you and I have been discussing prior to the taping that occupancy rates are even higher in some of the major metros on the coast – New York, Los Angeles, most of the country is aware of the tight housing situation in San Francisco and other areas on the West Coast. Do you think those high occupancy rates are going to lead to additional projects or is this market one where there's been a lot of building during the recession and now it's an opportunity to just move forward?

Dan: Coming out of the recession, demand increased and it was still difficult to get loans, so supply lagged demand, which caused an increase in average daily rates – it's a good thing. Slowly, supply has been coming back online but for reasons we've talked about in this podcast up to this point there's still some headwinds so we're still not seeing crazy supply coming online. So I think it's pretty stable and pretty healthy, the industry as a whole right now, so I don't think across the country we're going to see huge downward pressure on rates because of a tremendous amount of new supply. You know, for those maybe listening to this podcast and are not as closely following the industry, a 70% occupancy rate is very, very strong. That's about the average and that's as high as we've seen. It's a very strong national occupancy rate. We get much more than that – if the hotels are at 72% occupancy, it's a good case that you're going to have a new competitor pop up across the street and then you're going to be at 65% and building back up. There is a norming effect to that, so I think as we get more supply it will come online. It's going to create less occupancy and downward pressure on rates but that loss will correct itself.

David: Is there anything else that we should pay attention to as a result of some of the things we've touched on? The election, the recent moves and the financial markets – what would be the overall trend for 2017? What does your crystal ball say – mine's pretty foggy?

Dan: Well, I'll just speculate like everybody else. 2016 was about – depending on who you trust and who you look to for statistics – deal volume was down about 30 or 40 percent from 2015, and 2017 probably looks to be similar to 2016. I think that's the new normal. I think the easy deals were done, big portfolio deals. The future is now. This is what we're going to be doing. This is a normal economy. So I think that if this feels like a lot of work, and it *does* feel like a lot of work… If it feels like things aren't easy, and it's not – I feel that as well – that is what we're aiming for, for the next decade. At one of these industry meetings the other day they were predicting maybe a slight recession in 2018, maybe 2019, so it's a lot of the same old, same old. Having gone through the great recession I'm not looking forward to doing that again, so I think slow and steady wins the race and I'm fine with that. I'm happy with that.

David: Well, your description in 2017 sounds a lot like what I think other commentators are mentioning in the overall commercial real estate industry. So thank you for your time today and I appreciate everyone out there listening to this podcast.

Dan: Thank you very much.

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