

New York City Hotel Trends:
2005 Mid-year Review and Outlook

By Sean Hennessey

Who knew?

Who knew that the recovery from the City's low point in 2003 would be so dramatic? That concerns over safety, that the sluggish rebound in corporate travel, and that a host of other issues would fade to the background? That 2005 would be a year for the record books?

As the midpoint of the year approaches, New York City is clearly on a path for one of its best years ever – perhaps reaching or exceeding the heights achieved in 2000. The hotel market is clicking on nearly all cylinders: occupancies are nearing a natural ceiling, room rates growth continues at a double-digit pace, advance booking trends are firming, and asset prices are reaching all-time highs. Even the expansion of the Jacob Javits Convention Center, in the planning since before the center originally opened, is now moving forward.

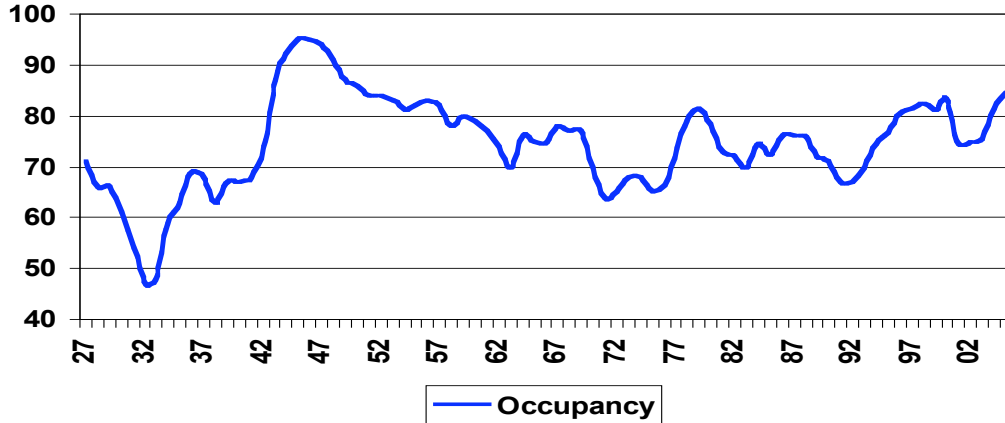
The market is not without some concerns, however. The conversion of hotels to residential condominiums is high on the radar of municipal leaders, including Mayor Bloomberg. The expiration of the current union labor agreement, affecting most of the city's hotels, will occur in mid-2006, raising concerns. Ongoing operating cost increases have hindered a robust expansion of profits despite a strong revenue picture. And uncertainty regarding the development of a Jets/Olympic stadium is wreaking havoc on the psyches of local travel industry participants.

Revenue Trends

Occupancy

The occupancy outlook for New York City is as robust as it has been in recent memory. The city's occupancy has averaged 85% for the first half of the year. Because the second half of the year is typically several percentage points higher, it appears that New York should finish the year between 84% and 85%. You would have to go back to the years of World War II and the post-war boom to see occupancies above this level, as shown in the table below.

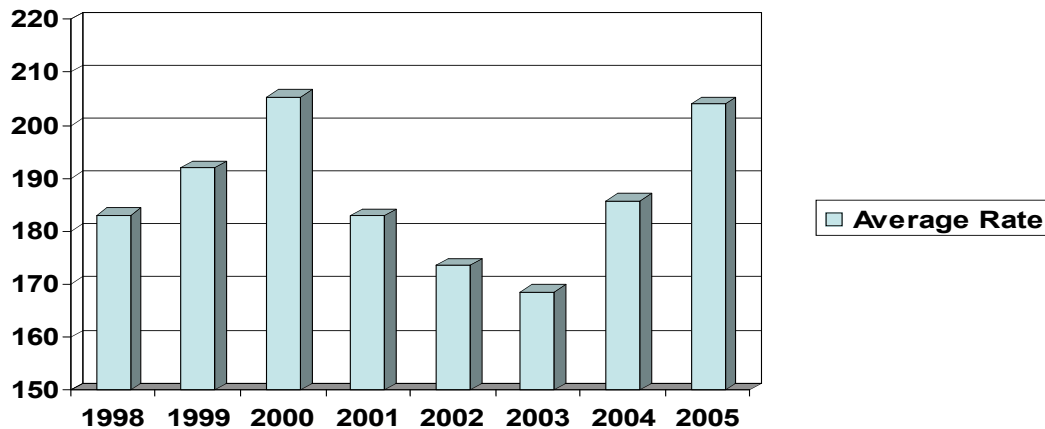
New York City Long-Term Occupancy Trend



At this point, the city is typically close to sold out during mid-week periods and achieving mid-70 percent occupancies on the weekends. The pace of occupancy improvement in NYC has slowed considerably over the past half year. However, the strong performance of the city has yet to foster strong hotel demand in the greater NY/NJ/CT metropolitan area. In 2000, it was not unusual for travelers to stay in hotels at Newark airport, White Plains, and Stamford when they had business in Manhattan. Those hotel markets are just now starting to see the benefits that NYC has been enjoying for the past year and a half.

Average Rate

Room rates are up strong, and stand at approximately \$190 at mid-year. Again, the second half of the year is much stronger, and room rates are expected to finish above \$200 for the first time since 2000 (see table below).



Room rate increases continue to be improving as the year progresses. This is due to both the return of the high-end corporate traveler, and well as the natural increase in rates caused by high occupancy levels. Barring any change in the economy, we anticipate that room rates will continue to grow at above-inflation rates for at least two more years. This trend will allow hotel profitability to expand quickly over the next few years.

Transactions Summary

- Hersha Hospitality Trust has entered into purchase agreements for the Hampton Inn Herald Square near Madison Square Garden in Manhattan.
- Commercial Real Estate Alert reports the Blackstone Group has picked up the Rihga Royal for what sources said was about \$183 million. Blackstone also is prepared to spend nearly \$40 million on renovations and plans to add rooms by converting former meeting spaces and some larger suites. Marriott is rumored to be replaced by year end although the future brand/management choice is still pending.
- Alchemy Properties has purchased the Sutton East Hotel at 330 E. 57th St. for \$52.25 million. The seller was Glenwood Management. The Sutton East was redeveloped into a long-term stay, all-suite hotel in 1997 by Alan Friedberg.

Along with the 85 suites that will likely be combined into larger residential units, it has an indoor swimming pool, health club and restaurant.

- Intercontinental Hotels Group PLC announced it has agreed to sell its leasehold interest in the Crowne Plaza United Nations in New York to Halifax Holdings, Inc, an affiliate of Highgate Holdings, for \$34 million, marginally in excess of net book value. Completion is expected to occur in the near future. The Crowne Plaza United Nations (300 rooms) has been sold with a 10 year Crowne Plaza franchise agreement.
- The new owner of the Plaza Hotel is seeking to sell all or a portion of his stake in the 300-room hotel to a luxury brand. Elad Properties already paid \$600 million for the hotel and planned on spending another \$300 million on renovations to create 150 condominiums. According to Real Estate Investment & Finance, Elad Naftali has reached out to Prince Alwaleed bin Talal, a partner in the Plaza's former ownership structure. Naftali told REFI he was also in discussions with Raffles Holdings, Shangri-La Hotels & Resorts, and Bvlgari Hotels & Resorts, among others. If acquired by the Prince, it could bring Fairmont management back to the location.
- The Essex House at 160 Central Park South was reported as being sold to Fairmont Hotels and the publicly traded real estate investment trust, Host Marriott, for around \$400 million. While that deal appears to be dead, it is rumored that the property is listed for sale.
- The Park Central Hotel was acquired by Highgate Holdings and its financial partners in March for a reported price of \$200 million, which is approximately \$213,000 per room for the 935-room hotel. Extensive renovations are planned.
- The Stanhope was sold to a consortium headed by Intell Management in March for \$79 million.
- Four Seasons Hotels Inc. is being released from its management contract with The Pierre hotel. Taj Group, a luxury hotel management company based in India is reportedly planning on taking over the Pierre.

Update on Hotel Supply

A bill proposed by the City Council of New York would prevent existing hotels from converting more than 20% of their guestroom inventory to residential condominiums. While the bill is tabled at present, concern over conversions remains high. In light of these events, it seems like a good time to review trends in new hotel construction in New York City.

While the sale of several hotels for residential conversion have grabbed recent headlines, it is clear that the supply of hotel rooms in New York City is increasing. Consider the following statistics from the Lodging Supply Report for New York City, published by Smith Travel Research as of February 2005.

Historic Hotel Supply in New York City						
	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Hotels	329	347	358	362	369	376
Rooms	73,467	77,678	78,179	79,106	79,703	80,417
Source: <i>Lodging Supply Report; New York, NY</i> by Smith Travel Research (as of February 2005)						

Further, the same report indicates that there is a robust pipeline of projects envisioned for New York City. While not all of these projects will come to fruition, the tabulation provides a realistic view of hotel developer's interest in New York.

Projected Hotel Supply in New York City				
	<u>In Constr</u>	<u>Final Planning</u>	<u>Planning</u>	<u>Pre-Planning</u>
Hotels	21	6	25	10
Rooms	2,394	1,082	4,471	1,212
Source: <i>Lodging Supply Report; New York, NY</i> by Smith Travel Research (as of February 2005)				

With a pipeline like this, you may worry that the hotel market may get overbuilt. But many of the hotels contemplated today are planned on a different model than those of years ago. The following points summarize my interpretation of supply trends.

- Many of the hotels being developed are located in the Boroughs rather than in Manhattan. The high cost of developing hotels in midtown is contributing to this trend.
- Many of the hotels (with the notable exception of the Javits Center Headquarter Hotel) are relatively small. Because large development sites are so expensive in Manhattan, developers are adapting smaller commercial and residential buildings into hotel. Even those hotels that are being built from the ground up typically cannot be combined with other sites to make a larger development parcel.
- Many of the planned hotels are mid-market or even economy brands. It was once thought impossible to bring low-cost hotel projects to New York. But the fact is that many national chains have loyal customers who would stay with the brand in New York if they only had a Hampton Inn or Super 8 in town – and now they do.
- Many of the new hotels are either limited service or have restaurant and retail space that is leased rather than operated by the hotel itself. This model is generally seen as more efficient. Given this trend, the large convention hotels and group-oriented corporate hotels in New York should see few new competitors over the foreseeable future.

These are just a few of the trends occurring in the New York lodging market at present. We will undoubtedly see more trends as the year goes along, and we will keep you abreast of these changes.