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Boston hotel market remains strong - What inning are we in?

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As a resident of the greater Boston area, we continue to be spoiled by the ongoing success of our professional sports franchises. The Red Sox run to another World Series title coupled with the Bruins 2013 Stanley Cup appearance are the latest examples of this "Golden Age" of Boston sports teams. How does this relate to the hotel business? Well, from a practical standpoint, increased demand from both play-off runs has benefitted Boston hotels and many other businesses greatly. Hotels around Fenway more than doubled room rates over normally high, peak season October rates for each home game. The impact of successful Boston sports teams has buoyed an already strong hotel market that is well past recovering from the 2007/2009 recession and is in the middle innings and growth stage of the cycle.

Nationally, according to Smith Travel Research, the hotel market continues to record strong fundamentals with occupancy and average daily rate (ADR) up 1.5% and 4% year-to-date through September versus 2012, equating to an increase in Revenue per Available Room (RevPAR) of 5.5%. As typical of this stage of recovery, occupancies are reaching prior peaks and, in many markets, hotel operators are pushing higher rates during high volume, compression periods. When rates are being pushed aggressively, often the threat of new supply becomes a concern. However, the pace of new supply is still well below historical peaks in many markets. There are exceptions like New York which, according to Smith Travel Research, has experienced a 3.7% increase in supply annually since 2010. Fortunately, Boston appears to be a market that is well positioned to stretch out the growth stage of this cycle as new supply is limited and the barriers to entry including rising construction costs remain high. Of the top 25 US markets, Boston ranks 5th in ADR and RevPAR. The market has experienced RevPAR growth of 3.6% year-to-date through September 2013, slightly lower than national pace as a result of a very strong 2012 but still positive and supply growth remains below 1.0%.

Current macro trends in Boston point towards continued positive growth over the next two to three years. According to Meredith and Grew, Office vacancy in greater Boston was 13.1% in 2012 continuing a positive downward trend and unemployment in Boston was 6.7% in Sept 2013 versus 7.7% nationally. The Hines Convention Center and Boston Convention and Exhibition Center both recorded a very strong year in 2012 generating over 550,000 room nights of hotel demand and the booking pace remains strong in 2013 and 2014. Boston also continues to grow and thrive as a 24/7 city lead by the completion of the "Big Dig" opening up access from the financial district to the waterfront and the North End. This improved dynamic is no more evident than in the emergence of new residential and commercial development in the Seaport district including the relocation of the headquarters for Vertex Pharmaceuticals and State Street Bank. There are also several new projects under construction near North Station and TD Bank Garden, and this additional density and activity is improving the perception of Boston as a destination. Both corporate and leisure travelers are experiencing a city that is more dynamic than in the past and this all bodes well for future hotel performance.

The question that many real estate investors are pondering now is how long will the "good times" last? If the national economy continues its pace of slow growth recovery, the Fed will eventually ease off its monetary policy and allow interest rates to rise along with a measure of inflation. In the past, Hotels have proven to benefit from an inflationary environment in which operators can change their pricing model more quickly than other types of real estate where lease turnover takes months or even years. Some hotel markets in the US will begin to be impacted by new supply in 2014 and 2015 and, as with all cycles, supply growth becomes a real issue when it outpaces demand growth, typically leading to hotels competing for not enough business and reducing rates as a result of competition. This scenario does not appear to be a near term threat in the Boston market. Two new hotels have opened in Boston this year, both Residence Inns by Marriott at Fenway and downtown in Fort Point Channel. These openings have been absorbed quickly and, while there are numerous other projects proposed or in the planning stage, many of these will not come to fruition given the high cost of construction in the market and limited availability of financing. Unlike the past cycle where the city absorbed several large hotel openings, the number of viable projects in the pipeline is quite low and the percentage increase of new inventory appears in check at least through 2015. These trends coupled with overall growth in the city and positive marco trends will allow the market to experience two to three extra innings of growth.

From an investment standpoint, hotels continue to be a sought after asset class for private investors and funds allocating to real estate. While still the most volatile real estate asset class, hotels are a hedge against probable inflation with the ability to adjust pricing daily. Some experts warn of the exposure risk with hotels in a downturn but the upside of higher returns is alluring in the current stage of the cycle. The Boston market appears well positioned to benefit for next couple years and hopefully our sports teams will keep the momentum going. Congratulations to the Red Sox on an unbelievable season and World Series title!

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