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Twelve months of hotel recovery feels good but it should feel better! - by Jim Luchars

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Jim Luchars

“We had the best December since opening in 2016!”

“We broke our ADR record last quarter!”

Quotes from general managers referencing how strong business has been in the Boston hotel market. However, despite all of this positive momentum, consensus is that it doesn’t feel like a full recovery and hotel owners have concerns. Staffing is a challenge, operating costs are higher than ever and the lending market is very challenging with interest rates higher than they have been in over a decade.

Let’s start with the positive. The first quarter of 2023 has proven to be a strong continuation of the hotel recovery in New England and across the country. With the Omicron surge in December 2021, New Year’s plans were cancelled and business and leisure travel plunged in January and February 2022. Fortunately, in Q1 2023, we saw a recovery from this and much stronger demand with Revenue Per Available Room (RevPAR) up 21.5% February YTD nationally. Unlike any other hotel recovery, Average Daily Rate (ADR) is pacing ahead of occupancy when compared to 2019, pre-COVID. This has been driven by inflation, pent-up leisure demand and the simple fact that the U.S. was not in a recession during the pandemic but rather experiencing a binary economic event. March alone is illustrative of these trends. According to Smith Travel Research, ADR was about 20% above 2019 ADR nationally and occupancy was 4% below 2019. This is unique and has never happened coming out of a recession/down cycle. The typical pattern is almost always occupancy recovery before ADR as employment improves, hotels offer discounts to entice people to travel more and, once demand fully returns, they can push rate growth.

Fortunately, the dichotomy that we are experiencing now has proven to be beneficial to hotel owners as they have been able to push rates during peak periods to offset increased labor and operating costs. So far, the customer has not pushed back yet but this may change in 2023.

Tracking national trends, Boston has also had a very strong January and February with a RevPAR 39% above 2022 for the same period. The hotels with the most diverse demand mixes seem to be doing the best as patterns have changed significantly. Corporate travel to Boston has recovered but sporadically with some segments like accounting/consulting and pharma very active and others like tech pulling back with budget cuts and offering more flexibility on remote options. Hotels along Route 128 in Greater Boston have experienced varying degrees of demand shifts. Mid-week corporate is not as strong as it was pre-COVID but, in some cases, this has been offset by leisure and “Bleisure” demand, combining business and vacation with more flexibility to work remotely.

Now, let’s cover the challenges. Heading into the spring and summer months, there are a few warning signs. Typically, the Boston Marathon/Patriots Day weekend is one of the strongest pre-sell periods all year. Pick-up at premium rates for three-night minimums has been weaker than expected and some hotels are having to discount to drive occupancy. May looks strong with a lot of graduation activity but it is difficult to read summer demand as the lead time for bookings is still very short. It seems unlikely that the historically high rates achieved in summer 2022 will be pushed further in 2023.

The financing market for commercial real estate, especially hotels, is upside down right now. If an owner has a property that has a loan maturing in 2023, they may be facing a refinancing with an interest cost that could be doubling as a result of the Fed’s monetary policy. This is impacting every asset class including high-end apartments and fully leased industrial buildings, both perceived to be the lowest risk. An owner may have a loan with a 3% interest rate on a multi-family asset with the only refinancing option priced at a 5% rate. This is a function of the increased cost of capital for lenders which is being passed on to their borrowers. While some borrowers may be insulated with extended loan maturities and no pressure to refinance, the shift in capital markets for many hotel owners is real and painful. For example, many hotel loans pre-COVID were secured in the 4% interest range and now can only be refinanced at an 8%+ interest cost. This is a problem and it is simple math. If you have a $20 million loan, your annual interest cost at 4% is $800,000. If you refinance at 8%, your interest cost just doubled to $1,600,000. Scenarios like this have resulted in a cash flow squeeze for owners who, in the worst case, can barely cover interest costs or, at a minimum, have less cash to distribute to their investors and to re-invest in their properties. The latter issue has also caused some misalignment between owners and hotel brands who are pushing for renovations and product refresh programs post COVID to improve guest satisfaction scores. It is difficult to cover shortfalls in order to survive a pandemic and now be faced with a brand mandated out-of-pocket reinvestment for your property.

Yes, the demand recovery feels good and we are seeing historically high rates, but profits are being eroded by high operating costs and now increased debt service. The Boston economy is healthy and more diverse than it has ever been. Hopefully, hotel demand in summer 2023 stays strong and we can weather this uncertain, high-interest environment.

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Prior to joining Stonebridge, Luchars was a principal at AEW Capital Management overseeing all hotel investments.

Luchars has over 25 years of experience in the hotel business and commercial real estate. Founded in 1991 by Navin Dimond, Stonebridge is a privately owned, innovative hotel development and hospitality management company. They manage a portfolio of 45 hotels across the United States, and provide investor opportunities, hotel development services, hotel management services, and hospitality career opportunities to its partners and associates. Currently, their hotel portfolio is comprised of 7,000 guest rooms across multiple select-service, extended stay, mid-scale, and full-service hotel brands located in primary and secondary markets.