SUPPLY & DEMAND

CON QUIGLEY details the twin perils facing the Irish hotel industry.

Like any economic equilibrium, our hotel industry requires, at minimum, a balance of supply and demand in order to sit at even keel. If the concepts of hotel supply and demand were self-contained, it would be simple to provide a quick-fix diagnosis and redress the balance whenever it dropped off the scale. Instead, hotel supply and demand, two defining factors of hotel market fundamentals, are the sum of a range of factors, heavily influenced by an economy's own structural equilibrium and policies.

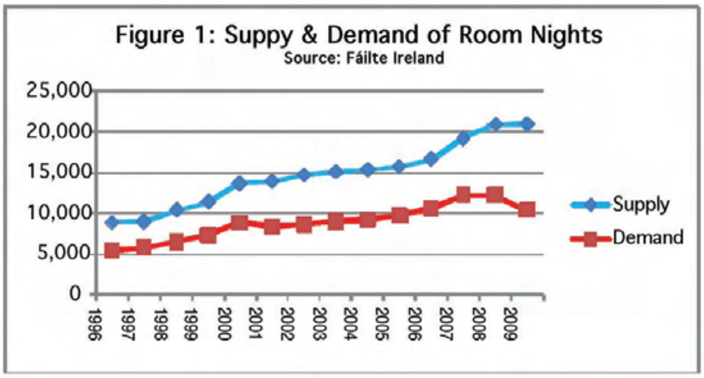
If one thing is clear, it is that our economic equilibrium has never been as out of sync as during the recessionary climate since 2008. Hotels have suffered a savage dip in trading and demand. While in any normal situation this would prove challenging, it has brought saturated markets near collapse. This article examines the hotel supply and demand equation and the possible route to Irish market renewal including tips for hoteliers trying to avoid rate discounting in the face of abundant hotel supply and depleted demand. Comparison will also be drawn with Barcelona, a city which experienced phenomenal demand growth, to then be seriously curtailed in its hotel performance by oversupply.

WHAT BALANCE IN THE IRISH EQUATION?

A country's economic ascent typically correlates directly to a rise in hotel demand, historically, as a rule of thumb, on a 1:1 ratio – meaning a 1% rise in GDP should give rise to a 1% increase in hotel demand. Basic economic principles tell us that increased demand will normally be balanced with increased supply. So, where a market experiences a surge in demand for hotel accommodation, developers, owners and operators should seize the opportunity, assess hotel feasibility for their product in that market and, if positive, deliver new hotel rooms to meet demand.

While simplistically put, this process should generate a profitable and healthily competitive local hotel industry in normal market conditions. Unfortunately, this is often overlooked where other factors become the catalyst for hotel development. The Irish hotel market typifies these circumstances as capital allowance tax incentives and easy availability of debt led to an avalanche of new hotels over the last 10 years. The troubles created by this tide of poorly structured hotel development have been compounded by the onset of the economic crisis which has broken down the historic 1:1 GDP/demand correlation. Globally, the effect has been unprecedented with hotel demand falling four times as fast as the decline in GDP.

Through the late 1990s and 2000s, radical hotel developments were instigated across Ireland, often without consideration of the project's individual viability. Obvious questions such as – is this the right location, the right concept, the right brand and the right number of rooms?, were not asked. Fortunately, demand did exhibit positive growth throughout the period 1996-2007, and this helped existing and new hotels maintain acceptable occupancy levels. According to Fáilte Ireland's Hotel Survey, during this period the number of rooms available grew by 136%, while demand grew 121%. However, the arrival of the downturn in 2008 revealed the total market imbalance that had been coming into play – a plethora of highly leveraged new hotel stock, serious pressure on existing hotels (ironically, often the least debt encumbered) and no continued significant uplift in demand to soak up supply. *Figure 1* shows the trends in supply and demand of room nights in Ireland for the period 1996-2009.



Ultimately, in the current market, the weakest players will not survive – new branded operators are able to outmanoeuvre and often render a market's best performing hotel its worst, as independent hotels are unable to match the sales and marketing strength and brand equity of the global brands. For the most leveraged owner operators, their future most likely lies with the decisions of their banks, creditors or perhaps NAMA.

At the end of 2009, Horwath Bastow Charleton recorded a total of 61,184 hotel rooms in Ireland of which 26,253 rooms had been added between 1999 and 2008 – an increase in room stock of 75% over 10 years. *Figure 2* breaks down new hotel supply in Ireland for the period 2004-2008

In his report for the Irish Hotel Federation in November 2009, Dr Peter Bacon asserts that the market is operating with an excess of between 12,300 and 15,300 hotel rooms and called for a state instigated program of room elimination. While formal recognition of oversupply is a positive step forward, our experience at Horwath HTL highlights that a broad brush approach to elimination will not resolve this issue, given the trading dynamics of local markets in Ireland where some are faring better than others. While the worst affected hotels may face closure, owners should also look at conversion to alternative use; however this can prove to be a more onerous structural clean up process with hotels than with other asset classes.

Dismal trading conditions have been the cumulative result of the massive oversupply of hotel rooms, dramatic decline in overseas visitors and the recessionary fallout. Cork, Limerick and Dublin areas have been worst affected in terms of revenue per available room. *Table 1* shows a downward spiral in revPAR performance in key Irish markets between 2008 and 2009:

Table 1: Local market RevPAR performance

Location	RevPAR 2008	RevPAR 2009	Variance
Limerick	€43	€31	-28%
Dublin	€85	€65	-24%
Cork	€59	€45	-24%
Galway	€60	€47	-22%
Waterford	€42	€36	-14%
Average	€58	€45	-22%

Source: Horwath Bastow Charleton Hotel Survey

The bad news has continued in 2010 with STR Global recently scoring Dublin in second place behind Copenhagen in listing the bottom five revPAR performances across Europe – Dublin recorded a decline of -5.8% in revPAR for year to April 2010, compared to 2009.

In the normal equation, excessive hotel supply might be welcomed by visitors who enjoy a greater accommodation choice, but ultimately it creates volatility as occupancy rates often suffer and price wars emerge, as hotels attempt to drive demand for their product through competitive rates. The economic crisis has cast a double blow at Irish hotels and resulted in a frenzy of rate-cutting. Operators discounted in an attempt to create demand for their product, only to be quickly matched by their numerous competitors with the effect of depressing average rate across the whole market in the face of stagnated or falling demand.

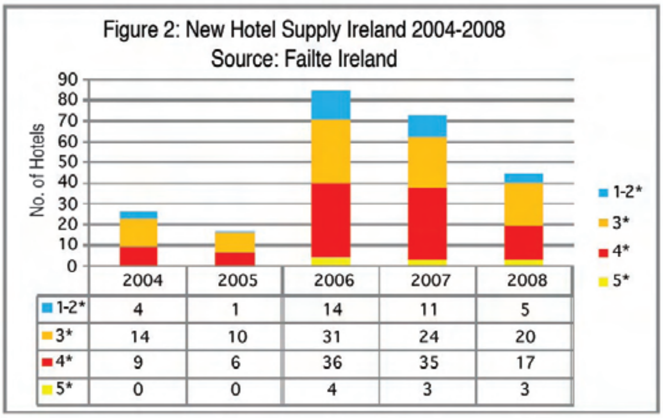


Figure 2: New Hotel Supply Ireland 2004-2008
Source: Failte Ireland

pay closer attention when identifying opportunities and assess the project's viability in detail with cognisance of all factors affecting feasibility.

Otherwise, the rescue for Ireland will only really come with a significant and sustained uplift in hotel demand and a strategy for facilitating this must be devised both at national and local market levels. A joined-up approach to Ireland's tourism strategy is required by Tourism Ireland with full stakeholder involvement. Equally, as they progress in their undertakings with the hotel industry, NAMA should keep the wider hotel community informed on an ongoing basis of the picture emerging from affected hotel real estate.

Owners and operators now need to take a step back and analyse their business strategically and intelligently – hotels with clear market positioning and understanding of their guest base and their competitors will be best placed to survive. Appointing a third party adviser, whether it be to conduct a one-off operational review of the hotel or to become more involved in the ongoing asset management, can bring a fresh set of eyes to a property's trading and the perspective to make suggestions and recommendations which might not otherwise have been identified when management has become overwhelmed by a hotel's demise. As discussed, further indiscriminate rate discounting should be avoided where possible

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It is well established that, in a situation of oversupply, across the board rate cuts should be avoided as they result in a lower average price point sometimes on a higher cost base (as occupancy may be marginally increased). Equally, it makes guests even more price and service-level conscious and the road to pre-crisis rate levels even more drawn out. Where a hotel has responded by implementing drastic, indiscriminate rate and cost cuts to hold up performance, this not only lowers revPAR, but can also affect service levels, damaging the overall guest experience and quality perception of the hotel going forward.

ROAD TO SURVIVAL – KEEPING COMPETITIVE

Hard lessons are being learned now as operators struggle to lift rates and improve cash flow, while some are being squeezed out of the market. Additional supply has thankfully been forestalled by the economic crisis and current low levels of development activity or intent. This will allow some natural readjustment to take place, granting some breathing space to existing hotel operators. Equally, it is often the case that the overall market will benefit as the tired or poorer quality hotel stock will be the first to suffer in the resulting cull of supply. Aspiring hotel owners of the future will hopefully as this merely lowers revPAR performance in comparison with the competitive set. Rather, focus should be on specific markets and product distribution. At Horwath HTL, we have had a surge in demand for hotel operational reviews and we are advising our clients to adopt some of the following practices:

1. Maintain marketing spend to keep current guests, explore new market segments and work to increase market penetration

2. Identify all new possible revenue streams e.g. diversify your convention, spa or food and beverage business

3. Try and obscure your rate, rather than discounting – incorporate additional elements for guests such as free parking, breakfast or a spa treatment

4. During lower occupancy periods, use opaque distribution channels to offer defined promotions without revealing a cut in base rates

5. Be brand and service aware – focus on keeping standards high, monitor your competitors and intelligently cut costs that won't damage the overall experience.

The operators who are quickest to respond based on a full understanding of their product and demand profile will likely fare best as the crisis abates. Ironically, some of these may be the most controversial new hotels developed in the era of oversupply.

Table 2: Barcelona & Dublin Hotel Performance							
	Occ (%) 2009 YTD	ADR (€) 2009 YTD	RevPAR (€) 2009 YTD	Occ (%) 2010 YTD	ADR (€) 2010 YTD	RevPAR (€) 2010 YTD	RevPAR Variance
Barcelona	53.8	112.65	60.63	58.2	111.53	64.86	+7%
Dublin	55.3	87.59	48.42	56.7	77.32	43.86	-9.4%
Source: STR Global, April 2010							

CASE STUDY: BARCELONA

Fortunately, examples can be learned from other markets which have been defined by their volatility as a result of a serious case of oversupply. Barcelona represents a curious example of a market which should have thrived given the massive surge in demand for it as a destination. Instead, it has sat most recently on the cusp of a major crisis as oversupply has encroached on demand, not helped by the economic crisis. RevPAR fell by 30% from 2008 to 2009, the largest trading dip in a decade in a market which had not experienced a single fall in total visitor numbers from 1997 to 2008.

As Olympic host in 1992, the city increased hotel capacity by 35% in the run up to the Games. While the Olympics arguably created a positive legacy-effect for Barcelona, the global perception of the city as a 'cool and hip' leisure destination, and its immense popularity with budget airlines, also accounts for the significant demand growth. Its appeal was akin to Dublin and Prague which were also simultaneously establishing themselves as easily accessible, trendy cultural destinations. Barcelona is also extremely strong for MICE business and has ranked third in terms of number of international congresses held in the last seven years.

Between 2000 and 2009, Barcelona continued to record remarkable hotel growth, with an estimated 86% increase in supply and particular growth in the four and five star sectors. This has continued in 2009-2010 and additions such as the 473-room W Barcelona, 98-room Mandarin Oriental and 77-room Marriott Edition (expected 2011) continue to enhance the city's luxury market. It is anticipated that 14 new four and five star hotels will open in 2010, representing nearly 1,500 hotel rooms.

While the continued supply increases might threaten occupancy, Barcelona is now showing great resilience to further attacks on rate, as felt in 2008 and 2009, and has been forced to adapt as demand and supply have fallen out of sync. Improved infrastructure has been rolled out, such as the high speed rail link between Madrid and Barcelona, and the city remains committed to maintaining its MICE and short leisure break segments, helping ensure more stable year-round occupancy and rate.

Table 2 shows the comparative performance for Dublin and Barcelona for the year-to April 2009 and 2010 and how different markets are coping with significant hotel supply. ◆

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