Abstract: As retail real estate locates closer to and/or incorporates other property types, the shopping center industry is carefully considering the synergies between retail and one of those uses: hotels. Developers planning such projects should remember that hotels are “an operating business unlike anything else,” according to Marc Potash, President of Sea Glass Hospitality Partners. The following article, based on a recent interview with Mr. Potash, covers the trends, opportunities and challenges associated with the hospitality industry, stressing that “in hotels, every specific aspect must be handled on a daily basis.”

A fragmented industry
As of June 2018, there were 55,695 hospitality properties in the U.S., according to STR, an American company that tracks supply and demand for the industry. That overall number aligns with the combined 55,171 hotels and motels in the database for CoStar Group, a commercial real estate data provider. CoStar reports that nearly three-fifths (57.7%) of its number are listed as hotels, with the remainder counted as motels. CoStar also notes that 567 properties are now under construction and that 778 are proposed.

At its most basic, the hotel industry is divided between full-service (150+ rooms, with a food service component) and limited-service (usually less than 120 rooms, with no full-service restaurant, though complimentary breakfast may be offered) properties. Some offshoots of these are resort (larger than full-service), extended stay (characterized by longer length of stays, with suites larger than standard guest rooms, with kitchens/kitchenettes), and focused-service (a hybrid between full-service and limited-service) properties.

Another basic classification scheme for the industry involves two types: branded, which is possibly a franchise, such as Hilton or Marriott, and independents, which have no affiliation with a brand at all and, with no large supporting national organization, have to do everything on their own.

Potash describes the industry as “extremely fragmented,” a characterization perhaps best illustrated by hotels’ classification according to the chain scales seen in Figure 1.

Figure 1
Hotels, by Chain Scale Types and Examples

<table>
<thead>
<tr>
<th>Luxury</th>
<th>Upper Upscale</th>
<th>Upscale</th>
<th>Upper Midscale</th>
<th>Midscale</th>
<th>Economy</th>
</tr>
</thead>
<tbody>
<tr>
<td>InterContinental</td>
<td>Embassy Suites</td>
<td>DoubleTree</td>
<td>Hampton</td>
<td>Best Western</td>
<td>Days Inn</td>
</tr>
<tr>
<td>Four Seasons</td>
<td>Swissotel</td>
<td>Crowne Plaza</td>
<td>Holiday Inn</td>
<td>Quality Inn</td>
<td>Econolodge</td>
</tr>
<tr>
<td>Conrad</td>
<td>Wyndham Grand</td>
<td>Hilton Garden Inn</td>
<td>Holiday Inn Express</td>
<td>Extended Stay America</td>
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</tr>
</tbody>
</table>

Lessons Learned

- The hotel industry is extremely fragmented, not only in terms of ownership but also in terms of the number of parties involved in a single project.
- Nationwide, supply and demand currently appear aligned, with oversaturation confined to individual markets or even sub-markets.
- Airbnb has affected hotel development less than online travel agencies.
- Municipalities are attracted to hotels as generators of jobs and transient occupancy taxes, and may offer incentives for construction.
- Millennials are having an impact on the hotel industry in terms of guest management and property design (e.g., greater fitness offerings).
- Among the most significant hotel industry trends are talent retention; faster consumer decision-making; intensified sustainability efforts; integrating technology across the whole range of operations; and offering unique experiences.
- Five challenges facing the hotel industry include offsetting labor cost increases; anticipating the impact of increased employee benefits; gauging the potential effect of higher commodity expenses; scheduling and budgeting for construction personnel and other skilled labor; and improving cybersecurity.
- Opportunities opened up by technology and customer loyalty programs include limited robotics to improve efficiency; front desks that can take advantage of mobile check-in; points earned and recommended offers; and extending experiences.

1 Sea Glass Hospitality Partners is a hotel management company based in San Diego.
Fragmentation may confuse outsiders trying to understand the authority structure even in a single hotel. For instance, a Hilton Garden Inn might be franchised by Hilton, owned by Jones Co., and operated by Sea Glass Hospitality Partners.

Although Figure 1 is filled with a number of familiar brand names, independents constitute 29% of supply in the industry. (See Chart 1.) A particularly interesting market niche is occupied by the “boutique” hotel, which is either independent or part of a smaller brand. What it may lack in size (anywhere from 40 to 300

**Hotel Operations Differ from Other Asset Classes**

If they are going to become involved with hotels, retail real estate personnel need to realize that hotels are often different from their— and other—classes:

- **Operations occur on a 24/7 basis**, requiring the use of all team members and the inherent employment issues that come with that; it does not involve leasing space to other companies who employ people, as a landlord would do with a retailer;
- **Hotel room rates** may need to be adjusted daily, even hourly, while leasing terms are generally set in defined periods with annual increases;
- **Rooms are sold daily**, not through month-to-month, annual, or multi-year leases;
- **Service standards are expected to be high for upscale and luxury hotels**, requiring intensive training and guest interaction;
- **Brands** add another layer of complexity; with guest and brand expectations already known, operators must work towards that daily, necessitating decisions on what improvements can or cannot be made in operations as well as in terms of capital expenditures, furniture, fixtures and equipment; and,
- **Marketing and accounting efforts** must support all of the above on an ongoing basis.

Likewise, financial statements for hotels are different from properties in other sectors. The Uniform System of Accounting for Hotels incorporates such relevant metrics as:

- Average Daily Rate (ADR);
- Occupancy rate;
- Revenue Per Available Room (called RevPAR), or ADR times occupancy—a measure that is so prevalent because it normalizes ADR and occupancy;
- Gross Operating Profit (GOP)—a baseline for how the operator is performing;
- GOP per Available Room (GOPPAR), a newer metric to measure hotel profitability vs. its competitive set;
- Management fees, which usually represent 3-4% of total revenues;
- Earnings before interest, tax, depreciation and amortization (EBITDA);
- FF&E (Furniture, Fixtures & Equipment) reserve—especially important as it is used for capital expenditures and upkeep, with most lenders assuming it accounts for 4% of total revenue.

These metrics are relevant when reading a profit-and-loss (P&L) statement conforming to the Uniform System of Accounting for Hotels (with the exception of the FF&E reserve, which is recorded on the balance sheet and not on the P&L).
rooms) and meeting space (usually less than 10,000 sq. ft), it makes up for in distinctiveness. Generally upscale or luxury, it offers a design-centric and/or unique experience that cannot be duplicated elsewhere.

For the chains, which serve different economic niches, their shares of overall supply and revenue diverge at points. At one end of the scale, “luxury” chains make up 2% of supply but 7% of revenues in the industry. At the other extreme, “economy” chains account for 15% of supply but only 7% of revenues.

Supply and demand, growth potential and the role of Airbnb

Nationwide, supply and demand appear aligned. Lender money has been flowing more to refinancing and acquisition than new development. Where there is oversaturation, it has tended to be market- and even submarket-specific.

One source of growth potential exists mainly in limited-service properties. On a percentage basis, these can be more profitable because they have fewer expenses.

Among the more intriguing types of developments are repurposed hotels, an adaptive reuse of a historic or iconic property. Although data on these properties are not extensive, anecdotal evidence suggests that they are more prominent in urban infill environments. As centers weigh what to do with vacant big boxes, developers may consider whether it is better to demolish them and build something new or repurpose them as hotels.

Developers’ potential area of concern comes from the enormous amount of brands. After Marriott acquired Starwood, for instance, it had 30 brands. Consumers might be confused about the differences among them.

Through the second quarter of 2018, the five metro areas that had seen the most hotel development were, in descending order, New York, Dallas, Houston, Nashville and Los Angeles. Additional heavy development has also taken place in such cities as Austin, Fort Worth and San Jose. Hotel development has largely coincided with areas of the country where the most economic growth has recently occurred.

The adverse impact of one trend on hotel development has turned out to be overstated. Far from representing the decline or even death of hotels, as some observers mistakenly thought after it became prominent four or five years ago, Airbnb has arguably had a greater impact on online travel agencies (OTAs) like Expedia and Booking.com. While one study from CBRE found that the ADR premium had diminished or was generally not as high since Airbnb became a major force in the industry, another, from Penn State, concluded that Airbnb actually increases demand, since many users would not have traveled otherwise. There has even been a backlash against Airbnb in some communities, which has even taken the form of proposals to ban it unless it is in primary residences and for durations shorter than six months.

Hotels’ benefits to municipalities

Municipalities look favorably on the hotel sector. This property type does not make demands on local schools but does add jobs. Particularly for smaller municipalities, hotels can constitute a welcome addition to their general fund in the form of transient occupancy taxes charged to travelers for occupying accommodations up to 30 days in hotels, motels, inns, hostels and similar places. In some municipalities, these taxes represent the second- or third-largest contributor to the general fund. Moreover, revenues generated by these taxes are local—i.e., guests both stay and spend in the community.

For that reason, municipalities are willing to provide a number of incentives for hotel construction, including:

- **Expedited permitting**: A city might be willing to shrink the time it takes to secure required permits—which in some cases could take anywhere from six to 18 months—down to two or three.
- **Zoning change**: Changing an area’s zoning to hospitality.
- **Parking ratios**: A city might collaborate with a developer to modify these requirements to ensure that the project works and undue expense might not be incurred for parking that might or might not be used.
- **Transient occupancy tax (TOT) rebate (or holiday)**: This can vary by length of time and by whether it’s partial or full, but would involve the TOT being collected by the city, then turned back around into the hotel.

Demographic drivers

These and other developments in the hotel industry have assumed greater momentum because of the influence of major demographic groups. Several types of travelers characterized by lifestyle and/or occupation are notable, including so-called “SMERF” (Social, Military, Educational, Religious and Fraternal) visitors, leisure, corporate, and a blend of the last two nicknamed “bleisure.” This last type of traveler will often extend a business trip through a weekend, so hotels will find themselves catering to visitors who have come for both business and pleasure.

Although Baby Boomers, because of their size and huge buying power, remain a force, two other age cohorts are now the subject of increasing attention in the hospitality industry. Gen Z—roughly speaking, the generation born after 1995—is just entering the workforce, and hotels are attempting to stay ahead of the curve in understanding their needs. On the other hand, Millennials, well along in the workforce and forming households, are already heavily influencing the hospitality industry in its property design and catering to guests.

For instance, instead of returning to their rooms to work alone while on business trips, Millennials prefer open shared spaces with colleagues. Consequently, lobbies have been redesigned as

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2 One example of such a repurposed property is Loews Philadelphia Hotel. This reuse of the former Philadelphia Savings Fund Society (PSFS) Building, which opened in 2000, retained the bank’s distinctive neon initials at the top of the structure, while incorporating its vaults and other features in meeting spaces.

engaged social meeting spaces, with rooms reduced in size but without feeling smaller.

Millennials’ interest in health and wellness is also affecting hotel design and offerings. In the past, a hotel fitness center might be around 350 square feet. Now it would be far larger (often, a minimum of 750 sq. ft.), complex and more prominently located. For example, for the IHG brand EVEN, the fitness center is behind the front desk, visible to visitors upon entering. Specific pieces of equipment are even provided to individual rooms so guests do not need to go down to the front desk to request them.

*International travelers* have also received increased attention. Hotels have tried to be sensitive to the cultural needs of this segment. For example, Chinese travelers might be provided slippers in their rooms, or rice, tea, or other offerings that are part of traditional Chinese breakfasts.

Cutting across the spectrum of age, racial and ethnic cohorts is heightened demand for electronic devices. A visitor might come to a hotel with a laptop, a mobile phone or a smart reader, all drawing on a room’s Wi-Fi. To minimize the possibility of a guest moving a dresser or other large piece of furniture to find secure access, the hotel would either install more outlets or provide “smart boxes,” or multiple outlets in a single box. Moreover, Wi-Fi must be high-quality, allowing for fast loading on and streaming—and requiring significantly increased investment in this amenity.

**Top five trends affecting the industry**

Five trends are particularly impacting today’s hospitality industry:

1. **Finding and retaining qualified talent:** In the current low-unemployment environment, retaining labor is coming under pressure. For those particularly at the lower end of the wage scale, $0.25–$0.75 more per hour can make an enormous difference. With the movement toward a $15-an-hour minimum wage gaining strength, the ability to retain workers not just through higher salaries but through other incentives has become more essential.

2. **Faster consumer decision making:** Booking windows have been shortened from four weeks to often less than seven days, so managing revenue has become a daily, even hourly, process. In peak periods, adjustments might have to be made three to five times a day, depending on market conditions.

3. **Intensified sustainability efforts:** Hotel guests have been increasingly interested in recycling, solar panels and water-retention measures. These can be factored into development and construction expenses, with benefits from reduced costs in labor, chemicals, water, and electricity.

4. **Integrating technology across the board in hospitality:** Operations must keep up with such aspects of technology as free and fast Wi-Fi, revenue management, artificial intelligence, and back-end systems (e.g., Broadvine and Profit Sword).

5. **Offering unique experiences:** Guests desire sites that promise adventures and memories, often able to be captured in images with enduring appeal. In keeping with the changing nature of technology, what were once considered guests’ “Kodak Moments” have become “Instagram Moments.”

**Top five challenges facing hotels**

The hospitality industry is also dealing with the following five challenges. The first three revolve primarily around expenses, while the last two pose other operational issues.

1. **Offsetting labor increases:** Traditionally 33% of revenues, labor has gone up in recent years. In California, annual gains in the minimum wage are not being matched by rising daily rates. At the same time, the attempt to adjust schedules to secure maximum hours for team members must also recognize budget limits. How do hotels offset those increases—through technology, “smart scheduling,” or other areas?

2. **Anticipating the impact of increased benefits:** This has become a nationwide issue. Anticipating the magnitude of such increases has tested the hospitality industry’s long-term modeling, as distribution and internal rate of return are harder to predict.

3. **Gauging the potential effect of higher commodities:** As with all other sectors, hotels have had to prepare for these greater expenses. Lumber has increased approximately 25% in the last 18 months, and the prospect of higher tariffs and trade wars has only complicated the situation.

4. **Scheduling and budgeting for elusive construction personnel and other skilled labor:** Increased development has meant that construction companies are more booked up. Securing qualified plumbers, electricians, and similar personnel has also tested the hotel industry.

5. **Improving cybersecurity:** Hotels have been tugged between what the brand might require and the back-end systems unique to each hotel. Although investments in security every few years can test the bottom line, hacking and credit-card leaks have ramifications in finance and marketing that cannot be ignored. For that reason, audits, Personally Identifiable Information (PII) compliance, and the Payment Card Industry Data Security Standard (PCI DSS) have become crucial. Comparatively speaking, the cost of cybersecurity is low, as committing money and resources upfront to identify and address vulnerabilities is preferable to waiting until crises develop.

**Opportunities powered by technology and customer loyalty programs**

The evolution of the hospitality industry has led it to the brink of opportunities that can spell new advancements in revenue or cost containment.

1. **Limited robotics,** for example, can improve efficiency. Some companies provide robots that bring towels and sheets to rooms. Guests do not have to wait for a staffer to come from a distant part of the hotel with the item, and hotel management welcomes the chance to reduce labor expenses while maintaining adequate staff levels at key positions throughout the building. Demonstrating the range of these technological innovations, a hotel owned by e-commerce giant Alibaba, set to open in Hangzhou, China, features not only robotics, but also facial recognition, smart speakers, voice-activated lighting and room service, and automated alerts for cleaning.
2. **Front desks** can take advantage of mobile check-in technology. Despite the increased tendency toward guests bypassing the front desk, many visitors like the human touch it represents. What may develop is a check-in kiosk similar to what is now present at airports. Several terminals would be present with perhaps one or two front-desk agents on the shift to assist guests needing help.

3. **Points earned and recommended offers** can result from hotels’ encouragement of direct booking by guests. With online travel agencies charging anywhere from 12% to 30% commissions, hotels see direct booking through their own Websites as a means of curtailing costs. Guests taking advantage of this can reap rewards through more points, more nights, or better stays. One example of such customer loyalty programs, Hilton’s “Shop to Earn,” has included recommended offers with such retail partners as Macy’s, Wal-Mart, and the Apple Store.

4. **Extending experiences** is another method of using loyalty programs. These could involve “escape rooms,” concert tickets, or artist meet-and-greet sessions, for instance, all earned through accumulated points.

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ICSC Research would like to thank Marc Potash for sharing the insights that inform this article. **Part 2 will explore more specifically the interactions and opportunities underlying the evolving hotel-shopping center connection.**

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