Industry faces a shake-out from overbuilding; tax legislation further compounds market changes

By JERRY C. DAVIS

Squeezed by lenders, victimized by tax reformers and traumatized by overbuilding, the hotel industry faces conditions that promise an unprecedented shake-out and restructuring in the next two years.

Yet, the mood is surprisingly upbeat among many industry leaders, who feel that the excesses need to be wrung out of the system so that it will emerge more healthy than ever.

"The tax law changes represent the most positive external event that has taken place in the last decade for us," says Frederic Malek, president of Marriott Hotels and Resorts, in Silver Spring, Md. "Over the next several years, demand will catch up with supply and occupancies and rates will rise. We estimate that new construction will be cut at least in half."

Malek says the oversupply in many markets "has been fueled to a large extent by projects developed by syndicators driven by the tax code instead of economics. They produced a lot of projects that never had a chance to be profitable, just to create fees for the syndicators."

The tax changes "will put a slowdown on development and make people with relatively pure motives of cash yield do deals that people on the marginal edge, driven by taxes, will not do," says Laurence Geller, executive vice president for development of Hyatt Hotels Corp. in Chicago. "I like it (the tax act) overall because it's good for the whole country."

Geller believes along with other executives whose companies have emphasized cash-on-cash returns that "We will see a lot of properties fall out of bed this year because they were structured for the 2-1 tax writeoffs."

"As the new tax code sinks in, backers will see losses as real and not just as tax advantaged benefit," says hotel broker and consultant Thomas M. Hamm of the company bearing his name in New York City. "The less well-capitalized players will run out of gas and either become present-day struggling mom-and-pop type local or regional operators, or become absorbed by one of the bigger boys. The shake-out is coming."

Lloyd S. Farwell, executive vice president of Hilton Inns Inc. and senior vice president with Hilton Hotels Corp. in Beverly Hills, Calif., agrees that major players will pull ahead as a result of changes to the tax law.

"The independent properties are going to be hurt more," he says. "Lending institutions are looking into good solid feasibilities on properties, and also good solid management. On that basis, major corporations in the hotel management business that are well identified companies will benefit."

Farwell added that efficient management of hotel properties may take on added significance during the coming market flux. "As we all know, there is a lot of overbuilding," he says. "Management has a great deal to do with the success of these properties, particularly when you get into an area where there's been a lot of overbuilding. The better operated properties are going to succeed, so I think management contracts are definitely going to be a thing of the future."

Brian McCabe, senior vice president with Rodeway Inns in Morristown, N.J., sees another advantage in the tax changes. "Those who are in it totally for the tax benefits we've seen scrambling to get out of it — as fast as they can. These were people who bought properties and then as absentee owners would let them run down. They weren't really interested in the industry. The good thing I see is that this leaves the professionals back in there."

Michael Dickens, president of Hospitality Partners, a hotel management company based in Washington, D.C., says a number of factors are influencing the market at this point. According to Dickens, the top is oversupplied, brand segmentation is further contributing to a widespread increase in available rooms and there is a general lack of feasibility studies. He predicts the market will not even out until 1989. The properties to survive, he says, will need "a good distribution system, solid management and solid marketing."

In any mild shake-outs that may occur due to the oversupply of rooms in many markets, well-known properties with an aggressive sales and marketing staff and a strong competitive position stand to fare better than older, independent properties in secondary locations, states a September 1986 report by New York-based Salomon Brothers Inc.

The Salomon Brothers summary,

"Room price cutting will become even more fierce than it has been in the past as economic properties struggle to hold on. Price pressures also will be increased by the market segmentation in the hotel industry as more chains compete in all sectors of the industry. Everybody is going after everybody else's customers."
J.W. Marriott
Marriott Corp.
Silver Spring, Md.

"The window of easy money has closed. Capital sources interested in tax benefits or thrift institutions anxious to put out money both have calmed down in financing hotel projects that are ill-conceived."

W. Michael Murphy
Fox Hotel Investors
Foster City, Calif.

Hospitality

Fundamentals of the Hotel Industry: An Economic Overview, also predicts that tax changes will cause new hotel construction to slow by about half its current level by 1988.

Some syndicators that have developed hotel limited partnerships applaud the new tax code. Says W. Michael Murphy, executive vice president of Fox Hotel Investors in Foster City, Calif., "The window of easy money has closed. Capital sources interested in tax benefits or thrift institutions anxious to put out money both have calmed down in financing hotel projects that are ill-conceived."

Troubled properties are themselves becoming a window of opportunity. Dallas-based Prism Hotel Development Co. has already benefited by the mistakes of developers and of the lending institutions that increasingly are being forced to take back failed properties around the nation.

"We've developed a track record with institutions like Manufacturers Hanover Bank, the Federal Deposit Insurance Corp. and the Federal Savings and Loan Insurance Corp., in which we are managing properties for them," says Prism's chairman Stephen L. Van. "We have been able to go in and make dramatic turnarounds for lenders, mainly by controlling costs."

"The hotels we work with are rescuable, but an awful lot are not. In many cases, the original equity holders, such as limited partnerships, will take it on the chin and lose their investment. Institutions that picked up the mortgage may come out alright, but they will have to lower their interest rates and be prepared to accept reduced room rates. Hotels can be saved if the financing and operating numbers are right."

Howard (Bud) James
Global Hospitality Corp.
San Diego

Takeovers a growth business

The rescue of distressed properties in the hands of lenders may become one of 1987's biggest growth businesses in the industry. For example, former Sheraton Corp. chairman Howard (Bud) James and former Del E. Webb Corp. vice president Donald Stephenson this year formed Global Hospitality Corp. of San Diego for the principal purpose of helping financial institutions and contractors with their workouts.

"The hotels we work with are rescuable, but an awful lot are not," James says. "In many cases, the original equity holders, such as limited partnerships, will take it on the chin and lose their investment. Institutions that picked up the mortgage may come out alright, but they will have to lower their interest rates and be prepared to accept reduced room rates. Hotels can be saved if the financing and operating numbers are right."

James believes many of the problems stem from unrealistic assessments of markets in which only so much luxury product can succeed.

"A lot of hotel developers spent too much and their rates are just too high for the markets they are in," he says.

James cites the example of a property Global took over in the heavily oversupplied Orlando market, a resort with 1,000 rooms and three golf courses. Global reduced rates and put together package deals to appeal to a broader cross-section of the market.

"We improved occupancy by 12 points by doing the right marketing job," he says. "We don't try to compete with Marriott and Hyatt, which capture the high end of the market in Orlando, because there are not many people who can pay their rates."

The availability of distressed properties interests some investors, but Fox Hotel Investors is cautious about these properties, even at what look to be bargain prices, says the investment firm's Murphy.

"Distressed properties will be available at per-room prices that will be very attractive sounding," he says. "But, our approach has been to acquire properties with good track records and outstanding locations. We may see more of those solid properties available this year and in the transition year of 1987 because sellers want to take advantage of lower capital gains rates."

Segmentation leads trends

The industry now is consumed by the desire to find the "niche" in the market that will enable it to continue to expand. That niche might be geographical, or more likely it will be a segment that is perceived as not being served. Salomon Brothers lists Marriott, Quality Inns International and Ramada as leaders in what it terms "the most visi-

"There are still some areas of the country that are not overbuilt like the major cities. The United States has 1,000 different markets for a mid-priced chain. Secondary and tertiary cities have not been building hotels, so they have obsolete products. There is room for new product in those areas that will be very competitive."

Gus Boss
Ramada Inc.
Phoenix, Ariz.

Hospitality

ble industry trend today" — market segmentation.

Geographically, says Gus Boss, the Ramada Hotel Group's senior vice president of development, in Phoenix, Ariz., "There are still some areas of the country that are not overbuilt like the major cities. The United States has 1,000 different markets for a mid-priced chain. Secondary and tertiary cities have not been building hotels, so they have obsolete products. There is room for new product in those areas that will be very competitive."

But, in major markets, Boss predicts that "we are likely to see a lot more Houstons and New Orleanses and Denvers cropping up because of overbuilding and reduced demand. We expect an average drop in occupancy for the industry as a whole of 3% to 5%. New properties coming on next year are not going to perform at even those levels," he says.

All-suites are hot and economy properties are not, according to most industry sources. Pannell Kerr Forster turned people away from a sold-out, national all-suite hotel conference in Dallas last March. A second conference is planned for February 1987. Some highlights from this year's seminar include:

- All-suites outperform more traditional properties. Occupancy averages 15% to 20% higher, while room rates are 25% higher.
- All-suite hotels are growing in number. All-suites under construction represent 2.5% of the nationwide room inventory. It was estimated that 6% of all rooms will be in all-suites by the end of 1988.
- All-suites are becoming more specialized.
- However, all-suites run the risk of outstripping demand. At the current rate of construction, 15% of all hotels in the 1990s could be all-suite.

Of developers interested in the trend, Marriott is especially strong on the suites concept, launching its development program this year in Southern California, Chicago and Atlanta.

"Some travelers would always stay in a suite if they could afford it," says Marriott president Frederic Malek. "There is definitely a segment of demand there, and it is our intent to meet that segment by development of new suite hotel projects."

Marriott also likes the suburban market, though it continues to develop convention and resort properties, as well as its moderate-range Courtyards by Marriott with no decline in commitment.

"We're seeing a lot more growth today than in the past in suburban pockets," Malek says. "Office development has fostered tremendous growth in suburban areas. We have developed a new full-service hotel designed to go into those markets with 220 rooms, less ballroom space and a smaller restaurant. We can come in at a much lower cost for that size property."

Hilton is poised to embark on a similar development campaign. In addition to the current $1 billion renovation program on existing hotels, Hilton plans to grow to more than 380 hotels with 133,000 rooms from the current 280 properties with about 100,000 rooms in the next five years.

According to Hilton's Farwell, much of that development would be with a smaller product in the mid-price range, as a courtyard-type facility. Tentative plans call for a "150-room property that will be a full-service hotel but will be in the middle range, at a rate of $55 to $70, depending on the location in the country," Farwell says.

He indicates that, in terms of new development, "We're getting away from the major convention hotel, and we're getting away from the high-level luxury property such as our Waldorf Astoria and that kind of property. A mid-rate property tends to lend itself to high-tech areas, suburban locations around major cities that presently aren't being serviced with that type of a facility. Those are the areas we're looking to, and the 150-unit property we think could fit into many of those areas."

Farwell adds that smaller properties

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Silver Spring, Md.

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Lloyd S. Farwell
Hilton Hotels Corp.
Beverly Hills, Calif.

Hospitality

built in clusters offer operating advantages. "In suburban areas of major cities where there might be two or three of them, they could have a general manager and then have operating people within the facilities that would report to him," he says.

Hilton is looking both at mid-range properties as a franchise possibility and at a suite development program, which would be corporate.

Mike Dickens, of Hospitality Partners, is another all-suites proponent. "By every single measure, occupancy, room rates, GOP or customer satisfaction, all-suites beat single-rooms in every study that's ever been made," he says. "It's a better mousetrap. It is a better product. At the same time, it isn't magic. It won't make up for a bad market. It won't make up for any of the other things you have to do in management."

Hospitality Partners was created earlier this year when the former top management — chief executive officer, chief financial officer and chief operating officer — of Guest Quarters, which had changed hands, joined to form a limited partnership with The Donohoe Cos. Inc., Washington, D.C. Their first joint property, a $12 million, 221-room Holiday Inn in Arlington, Va., opens this month.

"In hotel operations, with tax packages no longer as attractive, real income becomes a lot more important. A premium is going to be placed on being able to make money. Property owners are going to be more attentive than they have been in the past about what kind of cashflow comes out of a hotel."

Michael Dickens
Hospitality Partners
Washington, D.C.

Future plans for the company include development and management contracts for Holiday Inns, Embassy Suites and Guest Quarters properties. Dickens anticipates striking a balance of 40% single-room and 60% all-suites activity in the next three to five years, with an overall goal of developing a management organization with 12 to 15 hotels at the end of that time.

"Those who ignore all-suites," Dickens says, "are going to be missing out on the largest part of the corporate transient market in the next few years."

Predictions that suite hotels eventually will take 10% of the market are discounted by John Lanahan, vice president of Laventhol & Horwath in Chicago.

"Suites have a lot of price value, but they have to charge $80 to $100 a night while Red Roof is charging $29.95," Lanahan says. "The pressure on suites will come from the low side."

Economy segment feels pinch

The economy segment of the business is feeling the financial crunch and many of the operators will have to find a merger partner or end up "reading Chapter XI of the Federal Bankruptcy law," says Daniel W. Daniele, senior principal at Laventhol & Horwath, who spoke at the firm's Annual Economy Lodging Conference held in Chicago in September.

"Mergers and acquisitions and consolidations will occur at an ever-increasing rate in 1987 as smaller, less financially stable regional chains find it increasingly difficult to compete," he adds, pointing to Days Inn's several acquisitions to enter new regional markets.

Another significant economy lodging gainer in the last year was Hampton Inns, a Holiday Inns product that attracted wide investment interest, including limited partnership commitments from syndicators such as Fox Hotel Investors.

Rodeway Inns, a product rated at the top end of the economy market, is also expanding. Rodeway's McCabe says the company, which will have opened 44 properties by the end of the year, has 50 signed contracts for development in 1987, which would bring its total to 210 by the end of that year. Of that number, as much as 40% could be new construction, with conversion and enlargement taking place at the rest.

The firm, which presently has 40% of its properties offering limited service and 60% with full service, expects to move toward an equal balance by adding more limited service with its new construction.

Hyatt's Laurence Geller thinks the industry's segmentation fervor is misguided and will be regretted when the markets become saturated with compet-

ing products from the same hotel company.

"We believe that for the most part any customer who would use our room one night and a suite the next is always the same customer," he says. "Our task is to maximize distribution of Hyatt properties where needed, not try to develop gimmicks. Some hotel companies have been looking for ways to increase revenues by finding something to do, and that is an artificial inducement."

Consultant Thomas Hamm takes the strong position that "Franchisors have little at risk and are actually promoting aggressive development in competition with established franchisees, even in marginal markets. Even Marriott will have to defend developing Courtyards by Marriott in franchisees' backyards."

Hamm foresees a rebellion by franchisees. "Franchisees tell me that franchise companies are so anxious to plant the flag in already competitive markets that they will cause a severe drag on existing franchise holders, making their business marginal at best and potentially backbreaking," he says.

"We are seeing increasing numbers of owners who are fed up with franchisors' often frivolous modernization requirements and lack of respect for franchisees' market areas. They are selling to new investors who are being given strong incentive to convert properties to Days Inns, Howard Johnsons, Park Inns, etc."

Some hotel developers, though, are deciding not to franchise. The Anchorage Hotel Corp., a newly formed subsidiary of The Anchor Group, has chosen to launch a line of all-suite limited service hotels. The properties, targeted for highway-visible locations seven to 10 miles outside metropolitan locations, will all carry the same name — The Anchorage. But Anchorage Corp. president Tom Sheehan says he is staying away from franchising.

"Franchising creates a problem in that the franchisor loses control," Sheehan says. "If one property is doing a 'D-minus' job, that can prevent a guest from staying at another franchise that might be doing an 'A' job.

"We just believe that we'll be better able to maintain higher standards of courteous service, quality-control and maintenance if we have control. With franchising, that's difficult," he adds.

The Anchorage properties will be developed with equity financing, with a five-year goal of opening 75 to 100 hotels with a possibility of a public offering at the end of five years. The proposed operating plan calls for a daily rate in the $60 to $65 range.

At the same time, another mid-rate, limited-service product, the Compri Hotels chain, has elected to continue franchising. The Prism Hotel Development Co.'s Van notes that his company holds franchise rights in the Compri Hotel chain launched by Phoenix, Ariz.-based Doubletree Hotels two years ago. The Compri chain specializes in properties that focus on business travelers, using operating principles that Van describes as being dependent on enhancing the bottom line.

"Compri is strictly cash flow-oriented to produce higher return on investment than the typical hotel," he said. "With fewer personnel and no big banquet or public spaces or kitchen facilities, more cash flows to the bottom line."

Two of the industry's largest companies, Hyatt Hotels and Omni Hotels, have chosen not to segment beyond their full-service products. Both have announced development plans over the next few years.

Hyatt has added a smaller version of its full-service hotels to enter suburban and small city markets, and plans to spend $750 million on at least 40 of these 200- to 300-room properties by the end of 1990. Earlier, the company announced a $750 million expansion of its traditional hotels and resorts, also over a five-year period.

Hyatt's Geller is firm about avoiding

continued on page 72

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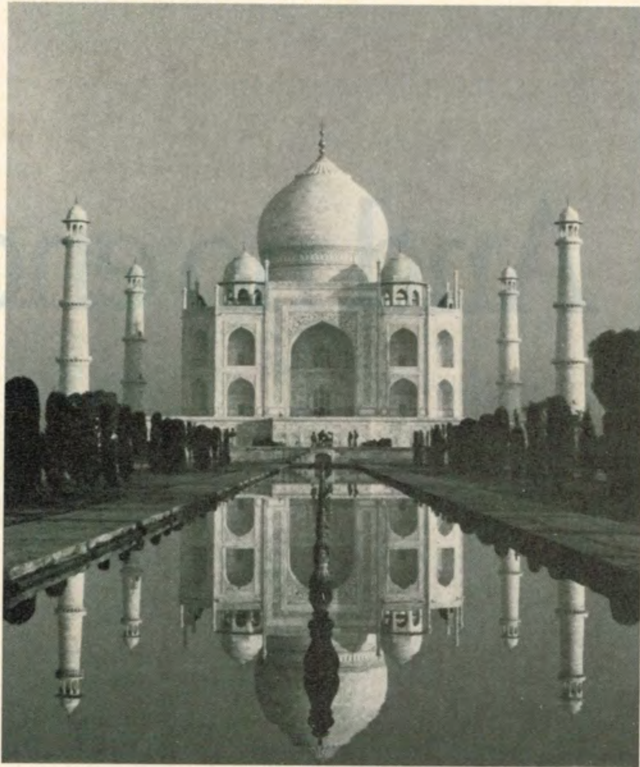

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continued from page 68

segmentation. "Quite simply," he says, "research shows that in the long run, our customer will not accept and patronize the concept of a 'budget' or 'middle market' Hyatt." He also warns that "hotel companies that are introducing a variety of different products to increase business may add to the hotel glut in some markets."

Omni Hotels, too, is sticking to its established property type. The company believes its best area of growth is through franchising luxury hotels to quality independents that "more than ever need to be part of a strong marketing network," according to Jon Canas, president of the Boston-based company.

"Independents are increasingly recognizing that an individual hotel can't compete effectively on its own" he says. "It must receive help from a national brand-name affiliation. One of our strategies to capture this opportunity in the market is to enter the franchising field so good quality hotels can link under a common marketing umbrella.

"We will use the Omni name as a prefix in front of the existing hotel's name to allow the hotel to maintain total regional identity and still gain from the national identity of Omni," he adds. "We expect our current 23 hotels to reach 60 by the end of 1988 by a combination of managing contracts and franchise agreements."

With the exception of Hyatt and Omni, and Hilton on the borderline, few hotel companies have given up on the concept of segmentation. In fact, quite a few are testing new products, including Ramada, Radisson and Howard Johnson.

Ramada plans 20 locations for the residential-style, 143-room inn with 25% suites that it test-marketed in a Chicago suburb this year. Carlson Hospitality Group of Minneapolis, operator of the Radisson Hotels, plans to take advantage of its Country Kitchen restaurant division to build adjacent Country Inns with 85 rooms and a rate of about $35 a night.

Howard Johnson will offer a new line of mid-priced hotels for business travelers by building 200 moderately priced Park Square Inns in suburban areas over the next five years. The company plans to upgrade existing properties to the same level. The new inns will offer 120 to 150 rooms that Howard Johnson estimates will cost $40,000 to $60,000 a room to construct.

Howard Johnson will be offering territorial franchises, with target sites to include emerging business centers, office parks, and hospital and airport vicinities. Territorial franchises are initially being offered in Boston, Atlanta

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Jon Canas
Omni Hotels
Boston

Hospitality

and Raleigh/Durham, N.C.

Robert Sage, president of The Sage Hotel Corp., Boston, owner of five Howard Johnson properties, says the improvement in lodges is essential to compete for the business traveler.

"We added conference areas in each room because a growing number of executives enjoy holding meetings in their rooms," Sage says. "We also updated the meeting rooms with state-of-the-art audio/visual equipment and special electrical outlets for computer equipment."

Financing is key question

As can be seen, expansion is still the mode for most companies, but the question is where the financing will be found. In the absence of institutional financing because of the many foreclosures on hotel properties, some companies that want to expand have found the public markets a more than ample substitute.

"The public market is salivating for the economy lodging deals," says Dan Daniele of Laventhol & Horwath. "Look at the success of Days Inns' public stock offering. Motel 6 is in the public market with a master limited partnership with Drexel Burnham Lambert. La Quinta, already a public company, has registered with the SEC for a public offering through Merrill Lynch to sell about 35 properties to the public and retain management."

Rodeway's McCabe notes that even economy properties will find it much more difficult to finance new properties, as a result of the tax changes. "The banks will still be looking for a brand name company, of course, and whether your management company is well known and if their track record has shown that they are capable in the industry. And it will require an increased amount of equity from the individuals involved.

continued on page 78

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Sterling Park
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"The tools we will use to create venture capital will be affiliated trust funds, land banks and REITs. It's like lending to yourself with the trustee in the middle."

Peter Morris
VMS Realty Inc.
Chicago

Hospitality

continued from page 74

"I think we'll see franchising play an increasing role. They'll be asking 'who's your flag?' before financing anything," McCabe says. "And we'll see some people play with limited partnerships. We're seeing that already, although I don't know how much of a role they'll continue to play."

MLPs to be important

The master limited partnership (MLP) looks like an important new device to finance expansion, according to Robert Moore, executive vice president and director of development for San Antonio, Texas-based La Quinta. His company offered a combined debt and equity MLP that could raise up to $138 million, and that will be traded on the New York Stock Exchange.

"We are offering a mix of existing properties and new inns," Moore says. "The partnership has been structured so the general partner will focus on cash distributions and capital appreciation rather than tax losses. The offering raises funds for us to continue to expand without losing control of the management services, as is common in franchising."

VMS Realty Inc. of Chicago raises money through a real estate investment trust, which then provides mortgages on the company's hotel acquisitions and developments. The VMS Hotel Investment Trust raised $84.2 million early this year with the lure that it will pay out 100% of taxable income in dividends.

"The tools we will use to create venture capital will be affiliated trust funds, land banks and REITs," says Peter Morris, president of VMS. "It's like lending to yourself with the trustee in the middle."

Syndication remains a factor in the financing of hotels, but with the operator guaranteeing a minimum level of

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performance and return, says Gus Boss of Ramada.

"I saw one that guaranteed 9% returns for a period of years as protection against the failure of the property," he said. "I had not seen that before."

Boss doesn't expect conventional lenders to finance many of the new projects. "Because of the rash of properties being taken back by lenders, we find ourselves as a licensing company actually licensing lending institutions. They have no market for these properties unless they are willing to take a tremendous write-down."

Foreign chains seek U.S. presence

An important source of additional financing for hotel investment and development will come from overseas, especially Asia, hotel sources believe.

"Foreign hotel chains are aggressively pursuing a presence in major U.S. markets," says Daniel H. Lesser, director of Consulting and Valuation Services in New York City. "As overseas chains expand their representation domestically, offshore capital to finance many of these deals is likely to follow."

Says Laurence Geller of Hyatt, "The interesting thing is that financial sources today are not merely institutional investors, but world-wide cash and equity players. They have exotic means and methods that offer new financial vehicles by world investment houses. We need major players for our volume of deals, and they are available and like to be with us. When we feel good about a project, we can attract special investors who will share our opinions."

"We are offering a mix of existing properties and new inns. The partnership has been structured so the general partner will focus on cash distributions and capital appreciation rather than tax losses. The offering raises funds for us to continue to expand without losing control of the management services, as is common in franchising."

Robert Moore
La Quinta Motor Inns Inc.
San Antonio, Texas

VMS recently sold one of its Honolulu hotels for $245 million after buying it two years earlier for $113 million. The buyer was the Japanese firm, Azabu, which paid all cash. VMS now is joint-venturing on another big development in Hawaii with investors from Japan.

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Morris. "Japanese investors are flush with capital and seeking outlets in U.S. real estate. The closest area and one that captures their imagination is Hawaii, and we are believers in that market too. We are going to expand along with Asia's growth in economic power, which is happening before our very eyes."

European hotel operators want to get into this country too, and several are backed by international airlines, such as Swissair, KLM and Air France. Swissair has been vigorous in opening new U.S. hotels, including one recently started in Chicago. KLM has said it wants to have company-owned hotels in each U.S. city that it serves, which would include Houston, Atlanta, Chicago and Los Angeles, plus New York, where it already operates the Barbizon Plaza as a "Golden Tulip" hotel.

Air France subsidiary Meridien hotels intends to add Chicago and Los Angeles to its six-hotel U.S. operations as soon as possible, according to Alain Eman, senior vice president for development in North America.

"The last area where we can develop hotels on a large scale is the United States," Eman says. "We can find financing easier for U.S. development. Money people say the United States is where we want to be, so we expect to build 10-15 hotels in this country."

Says the French hotel Accor's Georges Le Mener, president of the North American operation, "We don't have too many places left to go in Europe. The North American Hotel market is the largest in the world and if you want to expand you have to come here."

Discounting will heat up

Like the overseas hotel people, most American operators regard the problems of the industry as short-term. However, they anticipate pressure on room rates and occupancy for a while, and that can be painful.

"We have had the opportunity to increase rates every time we needed to over a period of many years," says Jon Canas of Omni. "Now we are facing too much competition to do that. Rates will have to go down, which means every hotel must operate on a more efficient basis than four or five years ago."

"We're going to see a drop in average occupancy this year of 3% to 5% of the industry as a whole," says Ramada's Gus Boss. "Our occupancy decline will be under 1%. The good operators have to take it out of the hide of those that are less competitive."

Says J.W. Marriott, chairman of the Marriott Corp., in Silver Spring, Md., "Room price cutting will become even

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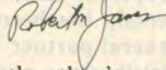
BY BOB JAMES,
PRESIDENT OF MHM, INC.



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more fierce than it has been in the past as economic properties struggle to hold on. Price pressures also will be increased by the market segmentation in the hotel industry as more chains compete in all sectors of the industry. Everybody is going after everybody else's customers."

The trend is being exacerbated by corporations trying to make deals with hotels on a chainwide or individual hotel basis, he adds.

According to *U.S. Lodging Industry 1986*, the Laventhol & Horwath annual study on the industry, competition in the industry is a major cause of a high level of discounting. Figures for 1985 indicate that hotels in resort locations showed the steepest level of discounting, while highway properties reported the smallest discount.

Management becomes critical

The report also predicts a turnaround in the industry by the fourth quarter of 1987, following a peak by the end of this year in the trend of adding huge numbers of rooms.

In the face of such market flux, efficient management may take on increasing importance. As Stephen W. Brener, president of Stephen W. Brener Associates Inc., New York, said in a recent issue of *Lodging Hospitality*, "What these investors want is a management team that has qualified personnel and can operate a hotel project for at least as long as it takes to make an investment economically viable, if it is not already so."

Hospitality Partners' Dickens agrees. "There are a lot of forces at work for management to respond to," he says. "In hotel operations, with tax packages no longer as attractive, real income be-

continued on page 86

(Compri) Hotels, Doubletree capture two market niches

By PAULA STEPHENS
NREI Editor

Segmentation of product to meet the demands of a diverse marketplace is a recognized force in the hospitality industry. Marriott Corp. and Hilton Hotels Corp., for example, have aggressively introduced new lines to meet the challenges of an increasingly crowded and competitive market.

Other companies, not as widely known as Marriott or Hilton — yet — are also devising new products to fit targeted market niches. One such company is Doubletree Hotels Corp., Phoenix, Ariz. A relative upstart in the world of hotel giants, Doubletree started in 1969 with one hotel in Scottsdale, Ariz., and today has 15 luxury hotels throughout the West and Southwest, and has forayed into the East with the new Atlanta Doubletree, which opened last month.

Chairman G. Peter Bidstrup designed the Doubletree concept to appeal to the upscale/corporate business traveler. The hotels are generally located in major markets and are fitted to accommodate convention business.

But recognizing the need for less expensive yet first-class accommodations to serve the price-sensitive, frequent business traveler, Bidstrup has also devised a product to fit this specialized market niche. Thus the (Compri) Hotels system was born.

(Compri) hotels (the name is taken from compris, the French term for "everything included") feature a spacious yet intimately scaled lobby/dining/entertainment/bar area called the Compri Club. Its purpose is to provide a social setting for the business traveler.

The hotels do not have room service, restaurants or lounges. There is a fitness room equipped with exercise equipment, and there is usually a swimming pool.

The first (Compri) Hotel opened in August 1985, in Lakewood, Colo. Others were opened in Boise, Idaho, and Pleasanton, Calif., in December 1985, Santa Ana, Calif., in May 1986, and Ontario, Calif., in June. Future openings include Schaumburg, Ill., this month, and next year in Atlanta in February, Gaithersburg, Va., in May and Alexandria, Va., in June.

"We'll have 30 hotels open or under construction by 1987," says Kevin W. Holt, vice president of development for (Compri) Hotels. "With five hotels open, four more soon to open and 23 breaking ground by midyear of 1987, we are close to reaching our targeted goals."

The company's long-term plans call for 100 hotels by 1990, according to Holt. Groundbreakings have been held in Harrisburg and Ben Salem, Pa., El Segundo and Rancho Bernardo, Calif., Southfield, Mich., and Eagan, Minn. By mid-1987, groundbreakings will be held in Austin, Tex.; Boston; Chandler, Ariz.; Charlotte, N.C.; Chicago; Eden Prairie, Minn.; Hayward, Calif.; Livonia (Detroit); Milwaukee; Orlando; Pentagon City (Washington, D.C.); Phoenix (two hotels); Princeton, N.J.; San Antonio; and San Pedro and Yorba Linda, Calif. Construction takes one year from groundbreaking to opening.

Doubletree owns some of its Compris, but is primarily interested in franchising most of the new line.

Says Bidstrup, "The 2.8 million rooms in the industry can be divided up as 33% economy, 48% mid-scale and 19% upper. About 1978, we saw that most of the competition in the industry was at the economy and upper ends. Upper hoteliers included Hilton, Marriott, Four Seasons and others, while the economy level was attracting a lot of apartment builders. There was virtually no competition in the mid-scale area."

(Compri) is market-driven, Bidstrup stresses. "We want repeat business based on word of mouth, and not advertising."

For franchisees and joint venture partners, Bidstrup points out the cost of building a (Compri) hotel ranges from $54,000 to $75,000 and over per room, plus land costs, while, by contrast, the cost of an Embassy Suites, he says, is about $135,000 per suite.

(Compri) is also syndicating some of its hotels, selling units at $80,000 apiece. "We raised $2.4 million over a several-day period," he says. Bidstrup projects over a 15% return for this investment, which he underscores is economics-oriented, not tax-oriented.

Overall, (Compri) Hotels has "a strategic goal of becoming a national chain," says Kevin Holt. The company plans to or has begun developing in "major feeder markets, such as Chicago, Atlanta and New York," he says.

The initial fee for a franchise, Holt says, is $25,000 plus 6% of the room, food and beverage revenues. Of that 6%, 3% is a marketing fee that goes into a central marketing fund and 3% is a royalty fee. "We provide the name, concept, reservation system and an umbrella marketing program, which includes national advertising and training programs" Holt explains.

Upon opening a new facility, Bidstrup says, his first goal is to build occupancy. To do this, he offers a discounted room rate for the first 90 days. For example, when the (Compri) at Hutton Centre opened in Santa Ana in May, the discounted rate was about $60.

The best locations, Holt says, are in mixed-use developments. □

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continued from page 82

comes a lot more important. A premium is going to be placed on being able to make money. Property owners are going to be more attentive than they have been in the past about what kind of cashflow comes out of a hotel."

Hotels in the coming years, he says, will need to keep their management "as lean as possible," with a possible productivity crisis in the offing as the bottomline is squeezed by not only changes to the tax structure, but a decline in the standard service industry labor force as well.

According to Dickens, a 9% decrease in the 18- to 26-year-old population over the next 10 years "reverses a 20-year trend of operating a hotel with more people rather than less."

"We added conference areas in each room because a growing number of executives enjoy holding meetings in their rooms. We also updated the meeting rooms with state-of-the-art audio/visual equipment and special electrical outlets for computer equipment."

Robert Sage
Sage Hotel Corp.
Boston

"The service industry hasn't thought through the need for productivity increases in the way that manufacturing industries already have," he says. "It's going to take thinking that is innovative, open-minded and aggressive in terms of the technical improvements you'll be putting into your hotels."

The frequent traveler programs into which hotels reluctantly followed the airlines represent another potentially expensive factor with which the industry will be forced to cope. Already, there are signs of escalating warfare in this area as hotels strive to convince business travelers that they have the most generous program in the industry.

On the positive side, Daniel Lesser of Consulting and Valuation Services believes demand will experience steady growth over the near term.

"Depressed domestic gasoline prices, the reduced purchasing power of the dollar abroad, continued domestic air fare discounts and concerns regarding the safety of overseas travel have con-

"We believe that for the most part any customer who would use our room one night and a suite the next is always the same customer. Our task is to maximize distribution of Hyatt properties where needed, not try to develop gimmicks. Some hotel companies have been looking for ways to increase revenues by finding something to do, and that is an artificial inducement."

Laurence Geller
Hyatt Hotels Corp.
Chicago

Hospitality

tributed to the favorable trend toward increased U.S. domestic travel," he says.

"Additionally, foreign business travelers and tourists are taking advantage of the enhanced buying power of foreign currency in the United States. Over the long term, the demand for lodging accommodations should be favorably impacted as discretionary income rises, service employment increases and the population grows older."

One wild card that pops up from the tax law changes is the reduction to 80% in the amount that can be deducted from formerly fully deductible business meals and entertainment. The loss in actual deductible expense is really about 35% when the reduced corporate tax rate is taken into account, so this factor could be of importance to cost-conscious companies.

It remains to be seen whether this change will cause companies to send fewer employees to meetings or to spend less on food and beverage in hotels, as some industry people believe.

"This will certainly have an effect on business meals and entertainment, but we cannot overlook the tax benefits to the middle class," say research personnel at Pannell Kerr Forster, the accounting and consulting firm, in *Outlook of the Hotel and Restaurant Industries 1986-1987*, a recent research report. "When fully implemented, 75% of the middle income class will receive a tax cut. This will bring about greater disposable income for these individuals who already spend a good deal of discretionary income eating away from home."

Larger players will gain

When the shake-out ends, "The large hotel developers with credit strength and proven track records of successful site selection and hotel development will remain in the playing field," consultant

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"Real estate developers are not hotel people and to allow them to dictate to professionals in the field is like allowing nurses to operate on heart patients. We have to stop saying yes to people who like to have a panoramic view and charge a $150 rate for it. There is a tremendous timidity by hotel people in honestly educating owners as to what the industry is all about before they sign management contracts. The business is suffering for it."

Mobashir Ahmed
Potomac Hotels Group
Arlington, Va.

Hospitality

Tom Hamm predicts. "There will be great opportunities for the stronger hotel companies to grow, focused on the fundamentals of the hotel business rather than write-offs."

Prism's Steve Van says his company's strategy will be to develop property and be a market leader in the Midwest and Northeast and acquire property in the Sun Belt.

Another smaller company, Potomac Hotels Group in Arlington, Va., thinks hotel operators will have to take a firmer hand in dealing with owners who do not know the industry, in order to survive.

"Real estate developers are not hotel people and to allow them to dictate to professionals in the field is like allowing nurses to operate on heart patients," says Mobashir Ahmed, president of Potomac Hotels Group. "We have to stop saying yes to people who like to have a panoramic view and charge a $150 rate for it. There is a tremendous timidity by hotel people in honestly educating owners as to what the industry is all about before they sign management contracts. The business is suffering for it."

The research study by Pannell Kerr Forster gives the industry reason for optimism despite all the negatives that appear on the immediate horizon:

"One industry analyst recently asserted that currently one out of every three rooms is over 25 years old and sorely in need of replacement," the study says. "The same survey revealed that up to 35% of these same facilities had no air conditioning, an amenity that many guests would find essential" Pannell Kerr states.

"Figures of the Department of Commerce indicate that six out of every ten rooms are going off line. That will obviate the need for an additional half million rooms by 1992. The doom seekers are too quickly predicting a storm that just will not occur." □

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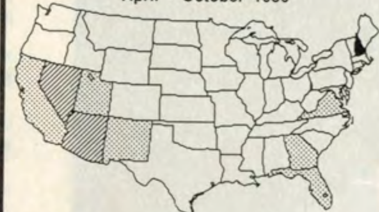

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