

Average rates are up and supply growth is flat in Annapolis, which bodes well for the city's overall hotel performance picture. Have local hoteliers been able to reach a better balance between leisure, commercial, government, and group demand?

Maryland's capital city of Annapolis, a historic seaport some 30 miles south of Baltimore, relies on tourism, state and local government activity, and renowned institutions of higher education for its economic livelihood. Very few new hotels have entered the market over the past ten years, and no proposed hotels are on the horizon. Yet, like so many aspects of Annapolis, this is less a sign of stagnation than of stability. Average rates for the city's hotels have risen steadily since the recession, and new economic developments are underway that aim to rise the tide of demand. The following article reveals some of the fundamentals of the Annapolis economy and lodging market and where they stand in terms of weathering new challenges.

Tourism and Group Demand

Tourism represents the bulwark of demand for Annapolis hotels. Millions of tourists visit Annapolis each year to walk the brick-paved alleyways of the city's historic downtown, enjoy the views of the Chesapeake Bay and the Annapolis waterfront, and tour institutions like the U.S. Naval Academy, the Maryland State House, and numerous theaters, museums, and mansions. Events such as the U.S. Sailboat Show and the U.S. Powerboat Show have been held annually in Annapolis since 1970. Annapolis Restaurant Week, the Annapolis Film Festival, and the U.S. Naval Academy Commissioning Week also draw thousands of visitors to the area yearly. Residents of the Mid-Atlantic within driving distance of Annapolis regularly take to the city as a weekend destination, and guided tours along the Boston-Washington corridor also often stop in Annapolis. The multitude of boutique retail shops and restaurants that line the downtown streets further bolster Annapolis's status as a tourist destination.

Meeting and group demand has a singular impact on Annapolis hotels. Given the lack of a dedicated convention center or event space, the city of Annapolis is largely dependent on hotel meeting space to attract and retain conferences and events in the city. According to the Maryland Tourism Development Board and the Department of Business and Economic Development, visitor spending in Maryland totaled over \$14.9 billion in 2012, nearly 20% of which was spent on lodging (see Figure 1).

Business, Industry, and Development

State and Local Government

Government activity throughout the year helps anchor the economy in Annapolis. The city is home to Maryland's historic capitol building, the Maryland State House, which dates back to 1772 and is the oldest center of government still in continuous use in America. Annapolis is also the county seat for Anne Arundel County, and a multitude of other county officials and municipal offices are housed in the city to support the county's operation. The city hosts the Legislative Session for the Maryland General Assembly, beginning the second Wednesday in January of each year, and local officials and hoteliers report that the presence of government officials during this 90-day session significantly bolsters demand in Annapolis during the city's shoulder season.

Higher Education

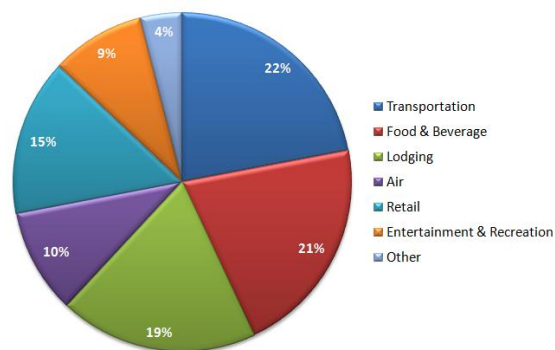
Higher education has a long and lauded history in Annapolis and serves as a central support for the city's economy. St. John's College, a private, liberal arts school in Annapolis, was founded in 1696 and chartered in 1784. The United States Naval Academy (USNA) is the second oldest of the five U.S. service academies and offers education for U.S. Navy and U.S. Marine Corps officers in training. Special weekend events at both St. John's College and the USNA, including graduation ceremonies, parents' weekends, and home football games, make a significant economic impact on the city and drive demand to local hotels.

Real Estate Development

For several years, most new construction in Annapolis has taken the form of mixed-use developments with retail and residential components. Annapolis Towne Centre, which highlights this type of development, features an outdoor shopping pavilion with nationally recognized retailers, restaurants, and fitness facilities, as well as condominium and apartment components. Another mixed-use development, to be built at the intersection of Spa Road and Forest Drive, is currently in the planning and approval stages.

Such large-scale, multimillion-dollar development efforts have less chance of cropping up in Annapolis's historic downtown district, according to local officials, given opposition from residents and business owners who place a high premium on maintaining the small-town, vintage, boutique character of the old city. Of the millions of tourists to Annapolis each year, many, especially international visitors, come for the city's antique American charm, something residents and officials have to work to keep in balance with advances in development.

FIGURE 1: MARYLAND'S VISITOR SPENDING



Source: HVS with data from the Maryland Tourism Development Board and Department of Business and Economic Development

Hotel Market Segmentation

Corporate and Convention Hotel Demand—Cracks in the Hull?

Of course, tourism alone does not provide enough demand to keep Annapolis hotels full throughout the week, even in the busiest season of the year. One primary weakness reported by local hoteliers is a lack of significant corporate demand to fill midweek room nights. As such, hotels in the market are in healthy competition to capture their fair share of group demand to fill rooms from Sunday through Thursday. Market participants also bemoan the lack of a dedicated convention center in Annapolis, which prevents the city from hosting large-scale conventions and receiving the economic benefit that big events tend to deliver.

The majority of group room nights in Annapolis comprise association business. SMERFE (social, military, educational, religious, fraternal, and ethnic) demand plays a strong supporting role, followed by a significantly smaller amount of corporate group demand, which is reportedly limited to small regional meetings, seminars, and focused training groups. SMERFE groups take on a stronger role in the late summer and early fall seasons, as the number of weddings held in the region peaks during this time of year. Given the heavy weekend- and leisure-oriented nature of demand in the market, average length of stay reportedly falls between two and three nights, while booking windows vary largely depending upon the type of group business.

Hotel Room Supply

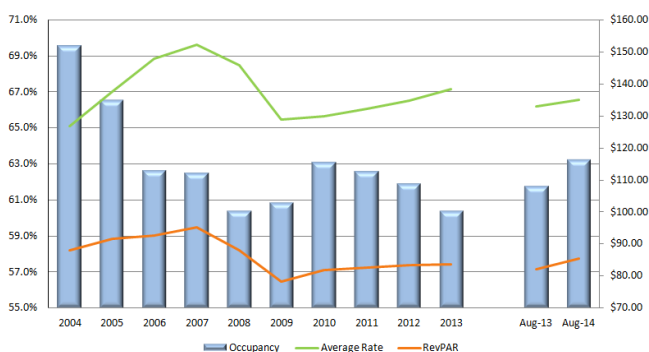
According to Smith Travel Research (STR), Annapolis housed just 21 hotels and 2,630 available rooms as of August of 2014. To put Annapolis's cozy

hotel community in perspective, the area's supply nearly quadruples to 10,504 rooms with the inclusion of hotels proximate to Baltimore Washington International Marshall Thurgood Airport, which is about a 30-minute drive to the north. While rapid hotel development in other Mid-Atlantic cities such as Baltimore and Washington, D.C. has been prevalent over the last five years, supply in the Annapolis hotel market has largely been stable since 2007, when both the Westin Annapolis and the Hilton Garden Inn Annapolis opened for business. Furthermore, according to HVS research, no new hotels are currently in the development pipeline for the city.

Hotel Market Performance

Figure 3 illustrates hotel performance trends through year-end 2013, as well as comparable year-to-date periods through August of this and last year. These trends reflect Annapolis's select- and full-service hotels, as defined by the inclusion of at least one for-profit food and beverage operation on property.

FIGURE 3: AVERAGE RATE GROWTH STRONG SINCE THE RECESSION



Source: HVS with data from Smith Travel Research (STR)

While supply has remained virtually unchanged over the last seven years, demand has fluctuated widely. The Annapolis market was disadvantaged by government sequestration and budget cuts in 2013, though the strength of leisure demand has helped maintain respectable occupancy levels—between 60.4% and 63.1%—since 2007. Notably, hoteliers have been able to push average rate in the years following the worst of the Great Recession, as evidenced by year-over-year average rate growth in Annapolis since 2009. As a result, RevPAR among select- and full-service hotels in the market modestly increased from \$82.69 in 2011 to \$83.60 in 2013.

Hoteliers remain optimistic as we near the end of 2014, which marks the first year since 2010 wherein occupancy, average rate, and RevPAR registered positive growth through the August year-to-date period. Moreover, RevPAR is on pace to finish the year at a new post-recession high, with year-to-date RevPAR just shy of \$85.50.

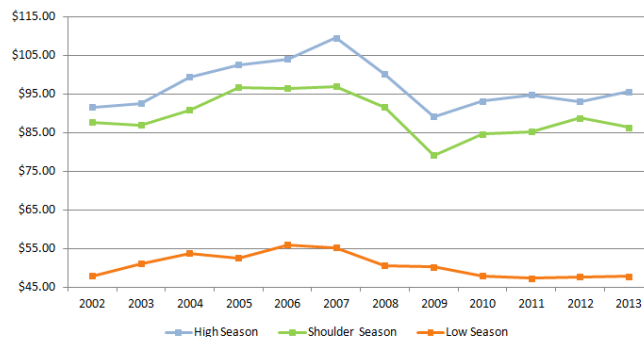
Ebbs and Flows of Hotel Demand

The Annapolis hotel market is highly seasonal in nature, with occupancy levels typically exceeding 70% during the months of May and June, as well as in September and October. Weekend demand often drives occupancy into the mid-to-high 90s throughout the high and shoulder seasons, largely due

to strong leisure demand and government activity.

Again, while tourism drives the market during the peak summer and fall months, hotels in Annapolis largely depend upon group demand to fill rooms during the midweek. Figure 4 illustrates the deep disparity in RevPAR between the high and shoulder seasons versus the low (winter) season in Annapolis. The data suggest that the shoulder season is the closest to recovering to pre-recession levels on the basis of occupancy and RevPAR. Average rate, while experiencing a solid recovery, had yet to reach pre-recessionary levels as of August of 2014.

FIGURE 4: FALL, SUMMER SEASONS BOAST STRONGEST REVPAR (2002 – 2013)



Source: HVS with data from Smith Travel Research (STR)

Outlook on Annapolis

Opportunities and Concerns

While a lack of strong corporate demand in the market remains the foremost concern for many Annapolis hoteliers, the dock posts for government and tourism in the city are as firmly fitted as ever. Both government activity and the influx of leisure demand to Annapolis are, however, highly seasonal, and the market relies heavily on association groups to fill rooms and meeting space midweek. Additionally, increases in supply in nearby Washington, D.C. and Baltimore have reduced the amount of compression and overflow into Annapolis during citywide events. Nevertheless, the prospects for growth within the government sector become more evident as the regional and national economies continue to strengthen, and a literal lack of new supply in the market should bolster average rate growth as demand levels stabilize. Hoteliers, city officials, and other resident stakeholders in the Annapolis economy present a positive outlook for the city's lodging industry, sharing predictions that occupancy will remain stable in the low-to-mid 60s through the near term. As this year comes to a close on a note of stable supply and rising rates, the next is expected to usher in stronger rate-driven strategies as RevPAR in the market approaches pre-recession levels. It will pay to keep a close watch on the lodging dynamics of this historic eastern seaboard city, especially if performance continues to improve and new opportunities for proposed hotels come to light.

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