HVS

MARKET REPORT

Bullish on Austin: A Look at Hotel Trends in the Capital City

OCTOBER 25, 2010

Residents and visitors have always been drawn to Austin's rich, historic offering of music, culture, business, government, and education. The strength of Austin's lodging industry over the past decade gives hoteliers something else to admire.

Austin's economy is the definition of robust. Even the Great Recession couldn't measurably whither the city's economic health. As just one piece of evidence, the local office market reportedly returned to pre-recession levels in the third quarter, and more than 150,000 square feet of commercial real estate was newly bought, sold, or leased between September 16 and 22 - a single week. That's a lot of new business.

Austin's diverse economic base gives the city the fortitude to weather even the most turbulent macro-economic storms. A large volume of commercial, education, tourism, and government activity has translated into high performance levels for Austin hotels in the past, and with an economic recovery underway, the city's lodging industry remains on firm ground. Below we briefly review aspects of supply, demand, and hotel performance in Austin.

Hotel Supply

Since Austin Convention Enterprises (a non-profit entity acting on behalf of the City) opened the convention headquarters Hilton in 2003, several high-rated hotels have entered the Austin inventory. Some of the newer select- and full-service hotels in Austin are listed below; these hotels are in addition to the numerous limited-service hotels that have opened in suburban submarkets of the city over the past several years.

Hotel	Room Count	Opening Date
Courtyard by Marriott Downtown	270 rooms	Sep-06
Residence Inn by Marriott Downtown	179 rooms	Sep-06
AT&T Hotel at UT-Austin	297 rooms	Aug-08
Hotel Saint Cecilia	14 rooms	Dec-08
aloft @ the Domain	140 rooms	Nov-09
Westin @ the Domain	341 rooms	Mar-10

The Courtyard and Residence Inn were constructed as one structure on a site near the convention center. The hotels include meeting, dining, and recreational facilities on a scale not normally found at these product types, which has helped the Courtyard and Residence Inn perform exceedingly well against their full-service competitors in the Central Business District. The AT&T Hotel, located on The University of Texas-Austin campus, is unique in the city in that it solely serves high-rated demand from the university. The Hotel Saint Cecilia, Bunkhouse Management's latest boutique offering, is styled for the arts and media communities. The aloft and Westin, both Starwood brands, were developed in concert with the master-planned mixed-use Domain development. Additionally, a W hotel by Starwood is set to open in December of 2010.

Numerous full-service hotels were slated for development prior to the most recent recession, from smaller boutique properties to group-oriented full-service hotels. The recession sidelined development for most of these hotels, though this chiefly reflects a lack of high-leverage, low-cost financing in the current climate—not depressed demand levels in Austin.

Diversity in Hotel Demand

A previous article on Austin's hotel market covered four cornerstones of demand: technology, government, education, and tourism. Austin has long been known as the focal point of the "Silicon Hills," a tech-heavy manufacturing and R&D mecca. Dell Computer Corporation, Samsung, Freescale, IBM, Applied Materials, and National Instruments round out some of the major players. Market research suggests that most technology entities have begun to hire following a period of layoffs in 2008 and the first half of 2009.

The University of Texas and federal and state government agencies, entities whose activity levels are largely unimpeded by economic lapses, continue to provide Austin hotels with a strong demand base, including meeting and group demand. The university's academic and athletic programs host events throughout the year, attracting regional and national groups to area hotels. The university also draws demand throughout the year related to orientation, graduation, and Texas Longhorn football games, among other events. The influx of government-related demand during the state's biennial legislative session, including related meetings and events, creates compression within the corporate segment—a good thing for Austin hoteliers trying to fill rooms.

Leisure demand in the area is primarily generated by a host of special events tied to Austin's well-known film and live music scene, as well as the established entertainment districts found throughout the city. Events such as South by Southwest and the Austin City Limits Music Festival highlight the multi-cultural dimension of Austin. Leisure tends to be the most price-sensitive segment of most lodging markets, yet the local lodging market attracts the city's most discerning and least price-conscious leisure visitors.

Hotel Performance Trends

Overall, Austin hotels posted healthy gains in room-night demand over the past decade. Occupancy recorded growth each year between 2001 and 2007, even amid considerable and steady supply increases. The montage of major industries across Austin has historically generated demand levels that outpace supply additions most years, allowing for these occupancy gains.

Demand fell nationwide in 2008 and 2009. Austin felt the impact, though the city's declines were less severe than in most major U.S. markets. A rebound has already begun, with strong trends emerging in 2010 as the area's top-performing hotels have posted sharp increases in both demand and occupancy. Furthermore, year-to-date 2010 occupancy is on par with levels from 2005—one of the industry's banner years. This reflects a notable resurgence from the meager economic conditions over the past two years.

Rate recovery in Austin ramped up from 2005 through 2007 following an extended period of discounting rooms, a practice introduced to attract demand and boost occupancy in the wake of the 2001/02 recession. The recovery in rate was aided

by the area's economic growth and the opening of high-quality hotels in Austin.

Average rates among Austin's high-rated hotels began to contract again in April of 2009, some 14 months after the onset of the latest national recession. This latency reflects Austin hoteliers' ability to maintain rate even in the midst of widespread discounting in other markets and a general decline in demand. Lower negotiated corporate rates did eventually take a toll on the market, despite fairly healthy local occupancy levels. Concessions by area hoteliers were common during the downturn in order to retain corporate contracts and remain competitive in the leisure market. This discounting has continued through year-to-date 2010, though at a much more moderate pace than during the previous year.

Conclusion

A full market or feasibility study is required to thoroughly chart and forecast market trends and determine which hotel brands and service levels a market can nourish. But the evidence presented above serves to broadly portray the strength and potential of Austin's lodging industry. The economic crash of the past two years grazed the city, but did not leave a crater, and investors looking to enter new markets would be well advised to investigate what opportunities await on Austin's level ground.