

## The Boston Lodging Market: What the Supply Surge Means Moving Forward

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By Sebastian J. Colella

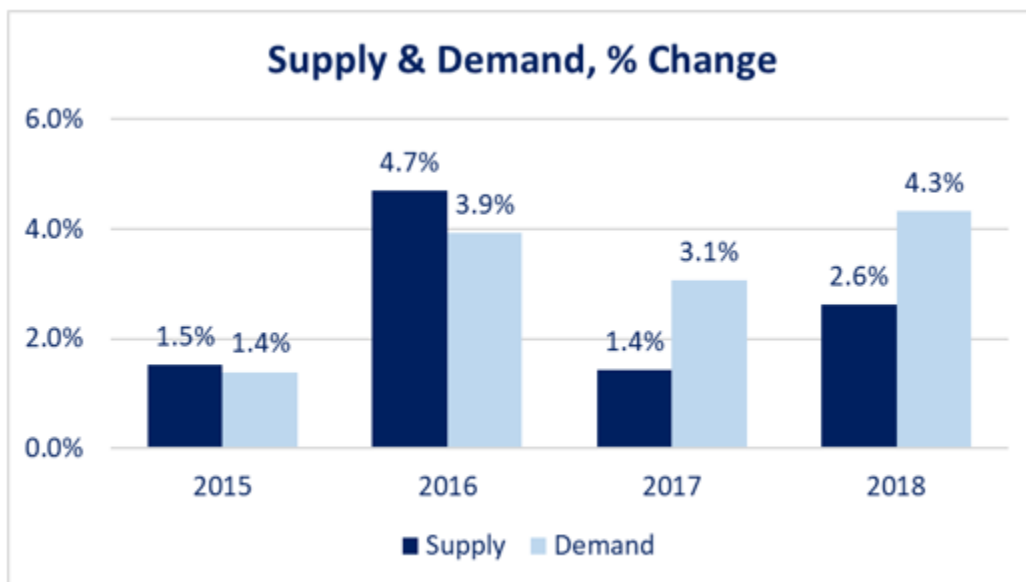
At year-end 2018, the Boston and Cambridge lodging market was comprised of 105 hotels with approximately 24,000 rooms. While this has grown considerably in four years, lodging supply in this market remains small relative to other major gateway cities. The ongoing building boom in Boston and Cambridge has contributed greatly to the recent surge in lodging supply and is expected to continue through 2021 and beyond.

What does the pipeline of hotel development, its largest in recent history, mean for the Boston lodging market's performance?

### Recent & Continued Supply Growth

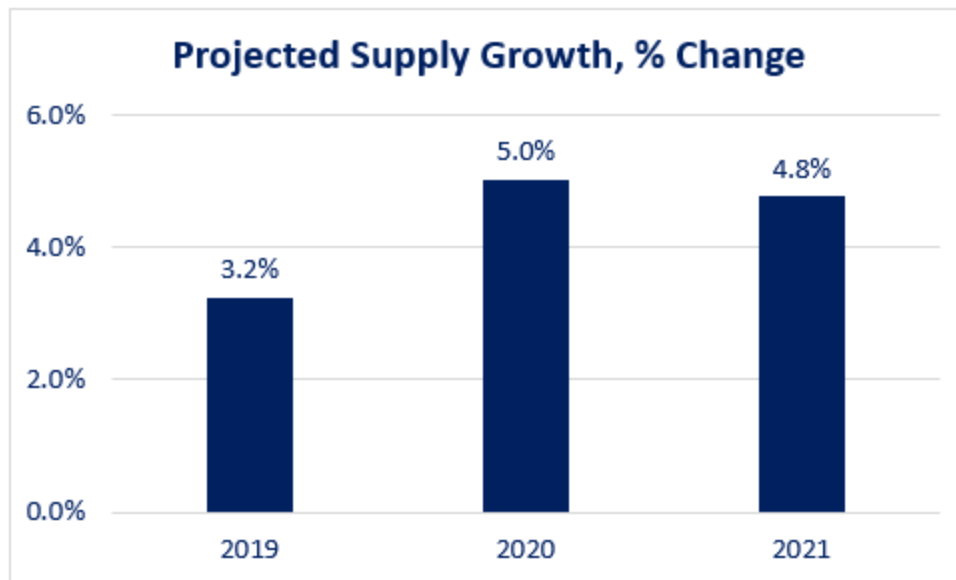
Between 2000 and 2014, rooms supply in market increased at an average rate of 2.3% annually. As financing became more readily available and market dynamics continued to improve, hotel projects began moving forward. Between 2015 and 2018, over 2,600 rooms opened in the Boston lodging market, a 12% increase in just four years with the largest increases experienced in 2016 and 2018.

Despite these above-average increases to supply, demand has kept pace. Market occupancy has remained above 80% for six years, reaching a historic high of 82.7% in 2018. Much of this demand growth is a result of unaccommodated demand previously forced to stay elsewhere due to lack of availability, specifically weekdays throughout most of the year and weekends May through October.



Source: STR, Pinnacle Advisory Group

Operators in the market are bracing for continued growth in supply over the next three years as 14 new hotels are expected to open with approximately 2,400 rooms.



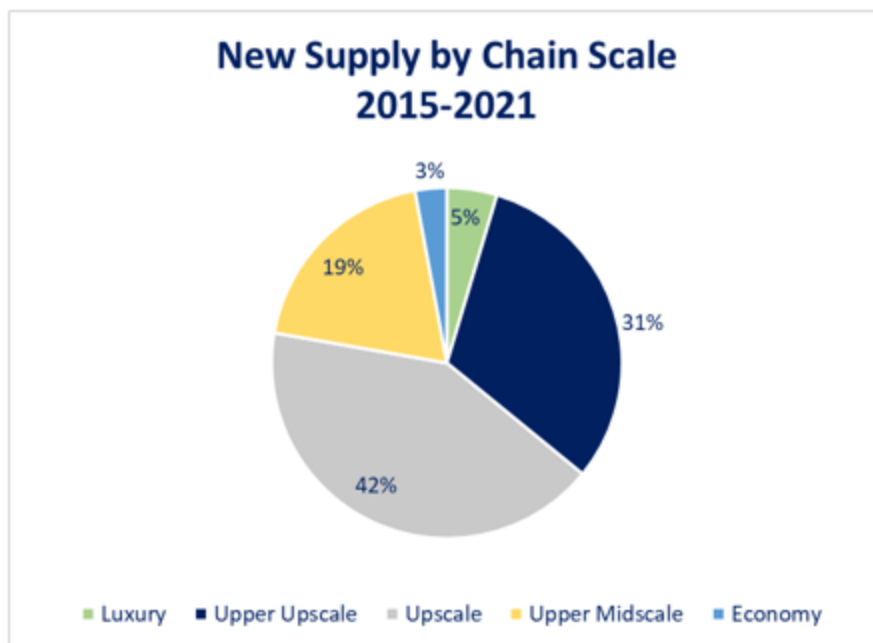
Source: Pinnacle Advisory Group

Supply is expected to increase 3.2% in 2019 with the opening of 8 new hotels. In 2020, supply will increase 5.0%, the market's largest increase since 2003 when occupancy declined two points and ADR declined 6.7%. Developers are anticipating that the 1,054-room Omni Seaport, the largest hotel to open in Boston since the Marriott Copley opened in 1984, will open in the second quarter of 2021. While other hotels could open in 2021, it is the only hotel expected to open at this time, contributing to the year's 4.8% increase in supply.

Certain submarkets will experience larger increases to supply than others, namely the Seaport District which will add almost 1,800 new rooms between 2019 and 2021, over 70% of the new rooms entering the overall market.

### **The Pipeline's Product Type**

The Boston lodging market has historically had a high portion of upper upscale, full-service hotels (over 60% of rooms supply in 2014). Between 2015 and 2021, the hotels that have opened, or are projected to open, consist of a wide range of product types and chain scales. Select and limited service hotels make up a larger portion of the pipeline currently due to their lower construction costs and high operating margins.



Source: Pinnacle Advisory Group

Over 60% of the new rooms are upper midscale and upscale hotels. These hotels are primarily affiliated with nationally recognized, select-service value-oriented brands such as Cambria, Hampton Inn, and Hyatt Place. Additionally, three micro-hotels affiliated with Yotel, CitizenM, and Moxy which offer standard rooms less than 200 square feet (almost half the size of a traditional room), will compete in the market by the end of 2019. As the market's inventory of rooms shifts to more value-based offerings, average daily rate growth is expected to slow.

#### **Average Daily Rate Deceleration**

The Boston market is one of the top performing markets in the country with occupancy levels above 80% and annual rate growth for nine years straight. With such high occupancy levels throughout much of the year, hotels can rely on yield management strategies focusing less on the online travel agents (OTA) and more on higher rated, and more profitable, channels. As more supply enters the market and competition levels rise, hotels will need to shift strategies and consider segments such as domestic crew, wholesale, tour, and FIT markets, the majority of which are accommodated in submarkets outside of Boston and Cambridge. Along with an increase in competition relying on OTA channels, there will be downward pressure on market rates.

Compression nights are generally defined as market occupancy in excess of 90-95% and are responsible for the lion's share of annual RevPAR growth, margin gains and profitability because outsized Average Daily Rate (ADR) growth is achieved when occupancy rates are at a premium. In the Boston & Cambridge market, compression is typically a result of heavy seasonal leisure demand between May and October, high levels of mid-week corporate demand, citywide events held at the convention centers, recurring and non-recurring events with high attendance levels (such as the Boston Marathon, Head of the Charles), or a combination of these occurrences. For the last two years, the Boston market has seen ADR increase on the nights with occupancy above 90% however ADR has declined on nights with occupancies below 90%. This pattern indicates that any rate growth experienced in the market the last two years was driven entirely by compression nights. Over the long term, compression nights are expected to decline as a result of new supply and alternative lodging options and as a result negatively impact ADR growth.

## Future Outlook

Boston's economy is booming and as a result, demand has increased between 3.0% and 4.5% annually over the last three years. Traffic through Boston Logan Airport has never been higher and continues to grow month after month. There is over 6 million square feet of office and lab development currently underway throughout Boston and Cambridge. Assuming fundamentals in the macro-economy remain consistent, we believe demand will continue to increase in the short term. However, with the supply increases expected over the next three years, we do not believe demand will keep pace and as a result occupancy will decline. Additionally, ADR growth will slow over the short-term as a result of the added competition.

Pinnacle Advisory Group's 2019 and 2020 projections were presented as part of the Massachusetts Lodging Association's 25<sup>th</sup> Annual Outlook event in August.

Boston & Cambridge Performance Projections					
	2018	2019	% Change	2020	% Change
Occupancy	82.7%	81.5%	-1.5%	80%	-2.4%
ADR	\$262	\$265	1.0%	\$269	1.8%
RevPAR	\$216	\$216	-0.2%	\$214	-0.6%

*Source: Pinnacle Advisory Group*

Despite uncertainties facing both the United States and the international economies, long-term prospects for the overall Boston lodging market are positive. Although increases to supply will negatively impact occupancy and ADR in the short-term and operating costs are expected to continue to increase, the market's positive fundamentals are expected to drive demand growth. Boston is, and will continue to be, one of the strongest lodging markets in the country as a result of its diverse demand base and high barriers to entry.

For Pinnacle Advisory Group's full 2019/2020 Outlook presentation click [here](#).

### About Sebastian Colella:

Sebastian J. Colella is a Vice President with Pinnacle Advisory Group based in the Boston office. With over 15 years in the hospitality industry, Mr. Colella leverages his operational knowledge and expertise from experiences in the field. Work with Pinnacle Advisory Group has included market and feasibility analysis, acquisition due diligence, departmental revenue and expense performance evaluations, facility recommendations, brand assessments and impact studies, as well as appraisals of both branded and independent hotels and resorts.

Prior to joining Pinnacle Advisory Group, Mr. Colella held a variety of management roles in hotels, resorts and private clubs. With capacities focusing on both sales and operations, he has worked for ClubCorp, the world leader in private clubs, Rosewood Hotels' flagship property in New York City, The Carlyle, and led efforts to open the first luxury resort in Zanzibar, Tanzania, Baraza Resort & Spa. Sebastian is a graduate of the School of Hotel Administration at Cornell University and currently serves as the President of the New England Chapter of the Cornell Hotel Society.