

Final Report

**Evaluation of Hotel Market
Conditions and Impact Analysis
of a Convention Hotel**

Prepared for

**Portland Development Commission
Portland Oregon Visitor's Association
Oregon Convention Center**

Submitted by

Economics Research Associates

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INTRODUCTION

The Portland, Oregon metropolitan region has experienced a decade of economic expansion and hotel demand growth. In addition, a major expansion is planned for the Oregon Convention Center (OCC) located in the Lloyd District of Portland's Eastside. In light of these changes, the Portland Development Commission (PDC), in partnership with the Portland Oregon Visitor's Association (POVA) and the OCC, commissioned this study to provide current information about the hotel market in Portland and to examine the financial feasibility and economic impact of a 600- and a 800-room convention hotel located near the Convention Center

It has been nearly ten years since the Portland Development Commission has undertaken a study of the convention hotel market. This evaluation is intended to provide information for PDC, POVA and MERC staff, public officials, and hotel industry partners. It sought three main answers. The first was to describe current demand, supply and market conditions for the hotel industry in Portland. Second, to determine if ample market support exists for the private sector to develop a convention center hotel. And third, if private development appeared unlikely due to a gap in financial feasibility, to evaluate the level and timing of public investment that could be required and assess the likely return for that investment.

A four-member selection committee, representing the client group, selected Economics Research Associates (ERA) to conduct the assignment after reviewing written proposals. Founded in 1958, ERA is now the largest consulting firm in the United States specializing in land planning and real estate development economics. This study was performed by the San Francisco office of ERA, with William W. Lee serving as project manager.

Section I

EXECUTIVE SUMMARY

Communities typically build convention centers and sometimes induce the construction of convention hotels because of they wish to enjoy the additional spending that delegates bring into the community. The full economic impact of the Portland region's investment in the expansion of the Oregon Convention Center will not be fully realized if the region is not able to offer a more competitive hotel package. This package would include either a major convention headquarters hotel and/or more larger hotels willing to offer room-blocks of 250-rooms or more. However, since the risk for hotel development is typically assumed almost entirely by the private sector, market forces play a major role in shaping the decision to develop a convention hotel or other large hotels. Those same market forces will also heavily influence the magnitude of economic impact and if such a convention hotel will likely proceed without public inducement. This study examines the future balance of the Portland hotel market and the implications of alternative strategies for a convention hotel.

DEMAND GROWTH

For the past decade, the economies of Oregon and the Portland Metropolitan Area have been experiencing steady growth. During the past ten years, employment levels in the Greater Portland Area and the State of Oregon have increased at average annual rates of 2.6 and 3.0 percent, respectively. The unemployment rate in the Portland-Vancouver PMSA is currently a low 4.0 percent.

The steady economic growth and Portland's downtown renaissance fueled hotel demand growth. From FY1990/91 to FY1999/00 gross hotel room revenue in Portland essentially doubled from \$109 million to \$215 million. As measured by air passenger volume at Portland International Airport, which has a strong correlation to hotel demand, the demand growth was most pronounced during the early and mid-1990s. Passenger volume increased from 6.4 million in 1991 to 12.6 million by 1996.

The strong mid decade increase in hotel demand stimulated considerable new hotel construction, and the proposed expansion of the Oregon Convention Center has further encouraged hotel development. Since 1987, over 5,100 total hotel rooms, including over 2,000 convention-grade rooms, have been added to the Portland region. In the period between 1997 to 2000 alone, a total of 1,800 hotel rooms were added to the city of Portland

market, including approximately 730 rooms in convention-grade hotels. For this assignment, convention grade hotel are defined to be the hotel properties most likely to compete with and influence the room and occupancy rates of the subject convention hotel.

Continued addition to hotel supply is expected from the current year to 2003. The estimated net gain in additional rooms over the next three years in the city of Portland market is approximately 1,350. In the six years from 1997 through 2003, the city of Portland will add approximately 3,200 hotel rooms, and about half of this inventory growth will be in convention grade hotels.

MARKET OUTLOOK

After rapid growth in the early to mid-1990's, hotel demand growth in Portland has slowed since 1996. Due to slowing demand growth and continued supply build-up, the average hotel occupancy rate in Portland has fallen from last year's 71.5 percent to this year's 66.6 percent, when comparing the January through July periods. The average room rate in downtown Portland has also fallen by 6.4 percent from \$110 in 1999 to \$103 this year. By the time the Downtown Hilton expansion is incorporated into the calculations in 2002, ERA expects the overall occupancy rate for the Portland hotel market to be around 62 percent and the occupancy rate for convention grade hotels to be below that level. Given the currently falling occupancy and room rates and the fact that three more convention grade hotels are expected in downtown Portland, the financing of another major new hotel in the Portland market will be difficult during the next two to three years.

The planned Oregon Convention Center expansion will add approximately 100,000 to 150,000 room nights over the course of the next decade. With continued economic growth and OCC expansion, hotel occupancy rates will climb back above the 70 percent range by mid-decade. A convention hotel in the Lloyd District should be considered after the average annual occupancy rate has climbed back into the low- to mid-70 percent range, and that is not expected until a couple years after completion of the OCC expansion.

IMPACT AND FEASIBILITY

Weak Market Conditions

The impact and feasibility assessment detailed in this report indicates a clear set of conclusions. The value of a large new convention hotel in Portland's Lloyd District varies

with the strength of the local hotel market. When room rates and occupancy rates are low and headed lower, existing larger hotels will be more willing to offer room- blocks to the convention center. This greater availability of room-blocks reduces the number of conventions deciding against Portland due to the lack of hotel capacity or the need to scatter the delegates in too many properties. Because it will attract fewer additional conventions, the new large convention hotel has relative lower economic impact on the region during weak hotel market conditions. The additional room-night capacity provided will have a relatively higher competitive impact on the other local convention grade hotels at a time when these hotels will have difficulty sustaining such an impact. At the same time, because of its own lower room rates and occupancy rates, the gap in feasibility or the need for subsidy is much greater (see Table I-1).

Strong Market Conditions

As market conditions strengthen, room-blocks from existing hotels will become less available and more conventions will decide against Portland unless a new larger headquarters type of hotel is constructed in the vicinity of the convention center. When the hotel market is strong, the value of the new convention hotel in attracting delegates to Portland is much greater. Its competitive impact on other convention grade hotels will be less noticed. Because along with other hotels it will enjoy higher room rates and occupancy rates, the gap in feasibility or the need for subsidy also will be much less.

Comparison of Economic Impacts by Hotel Project

ERA estimates the additional delegate spending impact that a convention hotel would bring to be as follows. The low estimate represents weak hotel market conditions and the high estimate represents strong hotel market conditions. The delegate spending impacts are millions of dollars per year for the entire Portland Metropolitan Area.

Additional Delegate Spending Impact (\$millions)	Low	High
Add 300 rooms and renovate existing 476 unit hotel	\$17.9	\$35.5
Build new 600 room convention hotel	\$23.8	\$47.3
Build new 800 room convention hotel	\$25.3	\$51.1

Market Conclusions

This analysis suggests that during weak market conditions like that expected during the next two to three years, expansion of an existing major hotel is the appropriate convention hotel strategy. However, as the hotel market regains strength, development of a major new convention hotel appears to be the most appropriate strategy.

Due to the large amount of meeting and pre-function space needed in a convention headquarters type of hotel, it is unlikely that such a hotel in the 600- to 800-room range would actually be built by the private sector in the Portland market during the next decade without some type of financial inducement. Even in conditions of a strong hotel market, the private sector is not likely to build a hotel larger than 400 or 500 rooms in the Lloyd District in one increment. The constraint is the size of the Portland market and the fact that the larger and more lucrative commercial market segment, which is important to any large hotel, prefers to be across the river in downtown Portland.

MARKET RESPONSE TO ALTERNATIVE STRATEGIES

The City of Portland probably has three alternative strategies concerning convention hotel development, and the private sector response will depend upon the option selected:

No Subsidy

If the City adopts a firm policy of no subsidy for hotel development other than convention center expansion itself, the Doubletree will likely expand and upgrade to become the convention headquarters hotel when market conditions justify. Because the Doubletree will be able to become the convention hotel with a 200- to 300-room expansion and some renovation, its risk is lower than that of a new 600- to 800-room hotel development. If the

Doubletree invests effectively to become that convention headquarters hotel, it will likely preempt the development of a hotel adjacent to the convention center for a decade or more.

Remain Ambiguous to Keep Options Open

If the City of Portland remains ambiguous about the possibility of a public subsidy for a convention hotel, the Doubletree will not likely upgrade or expand. Doubletree's financial risk of having invested heavily in expansion and upgrading, only to see a newly subsidized competitor rise in a stronger location, will simply be unacceptable. When the market rebounds, no new convention scale hotel development will occur in the vicinity of the OCC unless one is able to negotiate some type of subsidy.

Subsidy at the Appropriate Time

If a new 600- to 800-room convention hotel very close to the OCC is the City's objective, then the optimal strategy is to time the completion of the convention hotel for when the average hotel occupancy rate in the Portland market is both climbing and reaches the mid-70 percent threshold. Depending upon the strength of the national economy during the next decade, this will likely occur from three to six years after completion of the OCC expansion. Since the OCC expansion is scheduled to be completed in March of 2003, and recognizing that the Hilton Tower will be completed in 2002, the large convention hotel should be timed for completion within the 2006 to 2009 time frame. The deal structuring, planning, design and construction of such a large public/private development project is likely to require four years. If the current economic expansion continues well into the next decade, then the planning for this hotel should begin in earnest in 2002. If a recession intercedes during the next two or three years, then serious planning for this hotel should probably be delayed until mid decade.

Given that the private sector in Portland has historically been able to develop hotels up to 500 rooms in one increment, the subsidy should be restricted to projects that provide in excess of 500 units. All hotel projects that are able to provide more than 500 rooms and are within walking distance of the convention center should be able to compete for that one-time subsidy. The walking distance proximity eliminates the need for buses to shuttle the delegates. The competition might be like a "beauty contest" and the evaluation criteria could include the following:

1. Financial credibility of the developer and project,

2. Proximity to the convention center,
3. Quality of design and finish,
4. Quality of the operator,
5. Ability to increase hotel brand competition within the Portland market place,
6. Amount of common and meeting space internal to the hotel, and
7. The size of the hotel in excess of 500 units.

An overt policy of subsidy for the convention hotel will likely discourage other convention grade hotel development in locations away from the OCC and create developer interest for the desired project. If the timing of this competition is correct relative to market conditions, the amount of subsidy needed should approximate the cost of the land parcel required for the convention hotel and its parking garage.

Restrict Competition

Because the development of smaller hotels in locations away from the convention center diffuses the market and makes the development of a large hotel near the convention center less likely, some proponents will advocate for policies to restrict competition. During the 1980s, the City of San Jose did adopt a policy of not permitting any hotels larger than 150 or 200 rooms and with more than 5,000 square feet of meeting space to be built outside of its downtown until the downtown had achieved a critical mass of 2,000 hotel rooms. This policy had a two-fold impact. It probably did accelerate hotel construction within the downtown and adjacent to the convention center; however, it also did cause several major hotels to be built in surrounding communities like Santa Clara, Sunnyvale and Milpitas.

Preserve Sites for Future Hotel Development

Regardless of the policy option selected, it would be in the economic interest of the greater Portland community to preserve the land parcels in the immediate vicinity of the OCC for larger scale hotel development. Some level of minimum density zoning may be appropriate, and allowing for interim use to offset land holding cost should be considered.

Section II

AN OVERVIEW OF THE ECONOMY

STATEWIDE ECONOMIC EXPANSION

The Oregon economy has been experiencing steady growth over the past decade. The state's economic growth as measured by employment gains has been consistently strong from 1990 to 1999. During the first half-decade (1990-1995), Oregon's non-agricultural employment grew by about 13.7 percent, and unemployment shrank from 5.5 percent to 4.8 percent. The growth continued in the second half-decade (1995-1999), with state employment increasing by 10.9 percent. This amounted to an increase of 154,000 jobs since 1995 (see Table II-1).

The construction sector has been the leader in this statewide growth. Employment in this sector grew 31 percent in the first half of the decade and 21 percent during the past four years. Significant gains were also achieved in the service sector (17 percent) in the most recent past four years. With this growth, the state economy is decreasing its dependence on the sectors that were important in the past, such as traditional manufacturing, timber production and government.

PORTLAND METROPOLITAN AREA LEADING GROWTH

Growth in the Portland-Vancouver PMSA has been even stronger than in the state of Oregon. As illustrated in Table II-2, the employment gain in the greater Portland area from 1995 to 1999 was 13 percent. Growing employment sectors were construction (17 percent); services (18 percent); and transportation (14 percent). Like most urban economies, the manufacturing sector is losing relative importance; total Portland-Vancouver PMSA manufacturing employment makes up only six percent of total employment. Meanwhile, transportation, communications and utilities (TCU) and services are becoming some of the most rapidly growing sectors of the Portland economy.

The area's unemployment rate is an indicator of the current strength of the Portland economy. In 1999, the average unemployment rate for the Portland-Vancouver PMSA was 4.5 percent, and it is currently 4.0 percent.

FACTORS CONTRIBUTING TO GROWTH

A number of factors contribute to Portland's steady economic growth, and a few are highlighted below:

- The city's already strong reputation as a great place to live has been strengthened by the renaissance of its downtown area, which was in part due to the limitations placed upon expansion at the suburban edge.
- The recession of 1992 hit California exceptionally hard. The contraction in the number of jobs in California during the early 1990's stimulated out-migration to communities like Portland. Migration still accounts for the majority of the population increase in the state of Oregon.
- The Portland metropolitan area labor market has reached a sufficient size to attract major employers like Intel.
- The Oregon economy is in transition from a traditional dependence on timber and wood-related industries to one led by the high-tech industry. The high-tech industry is largely responsible for much of the growth in the state economy during the 1990's.

THE REGIONAL OUTLOOK

With the national economy having sustained its longest period of continuous expansion since World War II, another decade of steady expansion is unlikely. Some moderation in national economic growth is expected, and a recession is possible during the early to middle part of the 2000 to 2010 decade. The Portland regional economy will slow as national economic growth slows.

Some in Portland believe that the super-heated economy in the San Francisco Bay Area and the hot economy in the Seattle Metropolitan Area will push growth into the Portland Metropolitan Area. Clearly, Bay Area office market is facing sky-high office rents and very high labor cost, and Seattle is not far behind. Traffic congestion in both of these metropolitan areas is also beginning to stifle mobility and economic productivity.

ERA's view is that both of those regions still have room for internal expansion, and many of the cost-sensitive components of those economies have already moved out during the past decade or two. The strong office demand growth in San Francisco will push new

development into Oakland, which enjoys relatively good regional access due to the freeway network and the BART system. In the Seattle area, southern King County and Pierce County still have considerable land, infrastructure capacity and desire for growth. In addition, the firms moving cost-sensitive components out of those metropolitan areas will look for much lower cost locations that covet job growth, such as Nevada, Arizona, Texas, the Carolinas, Georgia and Mississippi.

POPULATION GROWTH

Even with some slowing of national and regional economic growth, Portland metropolitan area population growth is expected to be more rapid than that of Oregon or the nation as a whole. According to Portland State University, the Portland-Vancouver PMSA (includes Clackamas, Columbia, Multnomah, Washington, and Yamhill Counties and Clark County in Washington) will gain 281,800 people over the next 10 years. As shown in Table II-3, population in these communities is projected to increase from 1.84 million in 1999 to 2.12 million by 2010. This represents an increase of over 15 percent in the next decade.

LLOYD DISTRICT

Over the last couple of decades, the City and the region have made major investments to upgrade the Lloyd District. The MAX light rail system that connected the district with Downtown Portland was completed in 1984. The very elegant Oregon Convention Center was completed in 1990. More recently the Rose Garden arena was built and street improvements were made that enhanced the district's appearance.

Over the next five years, the Portland Development Commission has allocated over \$41 million towards continued upgrading of the district. PDC recently assembled the Lloyd District Development Strategy Steering Committee to create a master plan to guide future development in the district. The master plan concept includes:

- Pedestrian improvements to enhance the connections between the Lloyd District and Downtown Portland, the River District, and Old Town.
- Development of new high-density housing to strengthen the neighborhood.
- Promotion of mixed-use development and diversity of retail and restaurant uses to strengthen the district as a destination.
- Creation of parks and open space.

- Improvement of pedestrian connections between existing hubs of activity, such as the Convention Center and the Lloyd Center Mall to better integrate the district.

The massive amount of public investment has attracted substantial private investment in the Lloyd District as well. Major local property owners are poised to add office buildings and retail stores. The improvements programmed by the PDC plus the OCC expansion will create a more favorable setting for larger scale hotel development as well. A major convention hotel, which would complement the region's investment in expanding the OCC, has long been one of the important objectives of the Lloyd District master plan.

Section III

CONVENTION HOTEL MARKET OPPORTUNITY

MARKET FORCES DETERMINE NEW DEVELOPMENT

The economic impact of the State and regional investment in the convention center expansion will not be fully realized if Portland is not able to offer a more competitive hotel package. This package would include either a major convention headquarters hotel and/or more larger hotels willing to offer room-blocks of 250-rooms or more. However, since the risk for hotel development is assumed by the private sector, the decision to develop a convention hotel more able to satisfy the needs of the expanded Oregon Convention Center will be determined largely by market forces. Public policy and financial inducements can influence developer response in the short term; however, market forces prevail in the long term to determine financial success or failure. In order to anticipate how market forces will influence private sector hotel development and financing decisions, an evaluation of the Portland hotel market in general and of the hotels most likely to compete with the subject convention hotel is of critical importance.

INDICATORS OF DEMAND

The hotel market across the country was strong during the mid- to late 1990's, and financing for major hotel projects were typically available. With downtown renaissance and steady economic growth, hotel demand in the Portland area grew rapidly. Responding to the build-up in demand, a number of new hotels have been constructed since 1997. The boom in new hotel construction, along with slowing demand growth, has caused a decline in occupancy levels and room rates. The following are some indicators of the recent developments in the Portland hotel market.

Air Passenger Volume

From experience we know there is a very strong statistical correlation between air passenger volume and hotel demand. Since 1991 passenger volume at Portland International Airport has increased very rapidly. As shown in Table III-1, the increase was strongest from 1992 to 1996, with annual rates of growth between 12 and 18 percent. During this period,

passenger volume almost doubled from 6.4 million to 12.6 million. Since 1997, the annual passenger volume growth rate has slowed to an average of just under three percent.

Room Revenue

The most direct and accurate measure of hotel demand is hotel/motel revenues from which the City calculates its transient occupancy tax collections. As shown in Table III-2 and Figure III-1, total hotel revenue in the City of Portland has increased by \$37 million from 1995 to 1999. Rates of increase were 10.7 percent in FY1995/96 and 11.7 percent in FY1996/97. Since 1997, room revenue growth has slowed to a more modest rate of 5.9 percent for FY1997/98, 3.6 percent for FY1998/99 and 6.0 percent for FY 1999/00.

Convention Center Attendance and Expansion

Statistics from the Oregon Convention Center show that the facility has received 4,600 events and close to 6.3 million attendees since its opening in 1990. The Convention Center has generated approximately 1.1 million room-nights in the last decade. As shown in Table III-3, the major increase in room-nights (after the first year of operation) was from 89,000 in 1992 to 151,000 in 1993 as the Convention Center began operating at effective capacity. Since the mid-1990's, the number of room-nights generated has not varied greatly from the 1993 to 1999 average of 135,000. With many past user groups out growing the OCC and competing cities expanding their convention centers, the number of room-nights generated by the OCC is not likely to exceed the approximate 135,000 per year range without a major convention center expansion program.

THE SUPPLY PICTURE

Existing Inventory

The city of Portland hotel market currently has 10,726 hotel and motel units in properties with over 60 units (see Tables III-4). Until the past couple of years, fairly high room rates and occupancy rates characterized the Portland market. As a result, 4,803 new hotel rooms have been added to the Portland metropolitan area between 1997 and 2000. In the City of Portland, 1,774 hotel rooms have been built, 730 of which are considered to be competitive with a new convention hotel. These rooms are in the Marriott City Center (249

rooms) and the Westin (205 rooms), both completed in August 1999, in addition to the Embassy Suites Downtown (276 rooms) completed in 1997.

Competitors to Convention Hotel

Of the total Portland inventory, ERA has selected twelve properties as the hotel properties most likely to compete with the subject convention hotel. Since any Lloyd District convention hotel will still need to generate 40 to 50 percent of its business from non-convention center sources, it will compete with downtown properties for commercial business. Because it will also need to compete for the smaller self-contained group meeting that will not use the convention center, it will also compete with the two major Jantzen Beach properties. These twelve properties, with a total of 3,818 units, were selected because they are expected to have the most direct competitive impact on the room rates and occupancy rates of the convention hotel and not necessarily because they all provide room-blocks for the convention center. The criteria for selection included:

- Properties in excess of 200 rooms,
- Quoted corporate room rate in excess of \$100 per night to reflect hotel quality,
- Contains at minimum 5,000 square feet of function space,
- Past willingness to block rooms for OCC as indicated by POVA staff, and
- Likely future willingness to block rooms for OCC as the market softens, as determined by ERA interviews.

Throughout this study, we have defined these hotels to be “convention grade hotels.” The client mix of the twelve convention-grade hotels is estimated be 49 percent commercial or business travelers, 33 percent conventioners (either using the hotel, the Oregon Convention Center or another venue), and 18 percent tourists (Table III-5). Even for a new convention headquarters hotel in the Lloyd District, the commercial market segment will be a very important segment for many years into the future.

Occupancy Rates and Room Rates

Hotel occupancy rates and room rates in the Portland market have been dropping in accordance with the slowing of demand growth and the supply build-up of recent years. According to Smith Travel Research, year-to-date (January through July) hotel occupancy

rates for convention-grade hotels in Portland have decreased from 71.5 percent in 1999 to 66.6 percent in 2000, a drop of 4.9 percent (see Table III-6). According to PKF/Wolfgang Rood Hospitality Consulting, the first six months of 2000 indicated an occupancy rate of 63.8 percent for downtown Portland hotels, compared to a rate of 69.7 percent in the first half of 1999, a decline of 5.9 percent (see Table III-7). Suburban Portland hotels have also had a decline in occupancy rate from 62.7 percent in 1999 to 59.1 percent in 2000.

In the past year, average daily room rates have also decreased. The average room rate in Downtown Portland for the first six months of the year has dropped from \$110.42 in 1999 to \$103.33 in 2000, a decrease of 6.4 percent. Suburban Portland hotels have seen a drop from \$82.19 to \$79.21 for the same period. First seven-month room rates for convention-grade hotels remained in the vicinity of \$112 because of the higher rates of the newer properties.

New Development

Hotel development in Portland has been active in recent years after a quiet first half of the decade. As mentioned above, since 1997 downtown Portland has added four major new hotels. Other planned and proposed hotel developments total nearly 2,400 rooms (see Table III-8), including those proposed in suburban communities around Portland. Some of the most important projects are highlighted below.

Portland Hilton Executive Tower

The Portland Hilton Executive Tower, planned for completion in Spring 2002, is located across the street from the existing Hilton Hotel in the center of Downtown Portland. The Greyhound bus depot located on the site was demolished in April 2000 to make room for the project. The 22-story addition will add 321 rooms to the complex, for a total of 776 rooms. After the expansion the Hilton Hotel will become the largest hotel in Portland, and it is on the MAX light rail line.

Residence Inn by Marriott

Construction has already begun on the 250-room Residence Inn by Marriott located at Riverplace. The hotel caters to extended-stay guests and is scheduled to open in Summer 2001. Estimated cost for the project ranges from \$20 million to \$30 million.

Courtyard by Marriott

Impac Hotel Development and Louis Dreyfus Property Group are planning the development of a 200-room Courtyard by Marriott at the south end of downtown. The project is intended to be completed by 2001.

Riverplace Hotel

Riverplace Partners has been chosen by the Portland Development Commission to develop a 100-room hotel in Riverplace. The project would include condominium units, retail, and affordable housing. Construction is scheduled to begin in early 2001.

Smaller Limited Service Properties

In addition to these four hotel developments, a number of smaller limited service hotels and motels are in various stages of actual development or discussion for development. Many of these are in suburban communities such as Beaverton, Hillsboro, and Vancouver. Not all of these smaller properties will be built as falling occupancy rates make hotel financing more and more difficult to secure.

Total Supply Additions

ERA estimates that a total of approximately 1,500 rooms will be added to the city of Portland market by 2003. Since the demand forecast includes only the major hotels (over 60 rooms) in the Portland market, the new supply planned in surrounding jurisdictions have not been included in the statistical comparison. In addition, due to more intense competition we expect some 150 older motel rooms in weak locations to convert to longer term housing or be redeveloped into other uses during the next few years. The estimated net gain in Portland over the next three years is therefore 1,300 to 1,400 rooms. In the six years from 1997 to 2003, the Portland market will add approximately 3,200 hotel rooms, and approximately half of this inventory growth will be in convention-grade hotels.

DRIVERS OF FUTURE DEMAND

Convention Center Expansion

The existing OCC has 150,000 square feet of exhibit space, 25,000 square feet of ballroom space and 30,000 square feet of meeting rooms. When the currently planned expansion is completed, it will have 265,000 square feet of exhibit space, 55,000 square feet of ballroom space and 60,000 square feet of meeting rooms. This represents an 85 percent expansion in function space. With this expansion, the OCC will be able to accommodate not only larger conventions previously not coming to Portland but also smaller conventions that use only a portion of the center simultaneously. With this expansion, ERA estimates that number of annual room-nights generated by the convention center will climb from 135,000 to 280,000 to 290,000. The increase in room-nights will be dramatic during the first few years after completion of the expansion; but as the facility once again approaches capacity, the room-night growth will slow. As suggested by other studies performed for the OCC and MERC¹, the additional room-nights induced by the expansion will create considerable economic benefit for the Portland Region. Positive economic benefit is the fundamental reason for convention center expansion.

Forecast Components

The critical issues of this assignment rest with the comparison of future hotel demand growth with on-coming supply. ERA's forecast of demand growth, separated by convention-grade and other hotels, is presented in Table III-9. The actual new hotel units needed, again by convention-grade and other hotels, is detailed in Table III-10. The assumptions used in the demand forecasts are summarized below:

- Annual demand from business travelers for convention-grade hotels will increase in the 2.3 to 4.0 percent range.
- Demand growth from convention room-nights is projected to increase by 100,000 during the 2003 to 2005 period when OCC expansion is first completed. The growth rate slows as the expanded center once again approaches capacity and as

¹ Economic Impact of the Oregon Convention Center, performed annually by CIC Research inc.

the novelty of the new facility wears off. With the convention center expansion, the number of room-nights generated is expected to double over time.

- Tourist demand for convention-grade hotels will grow at 2.0 to 2.4 percent per year.
- The overall annual demand growth for convention-grade hotel rooms, which is a compilation of the growth in the above three market segments, is projected to be in the 3.2 to 8.0 percent range from 2001 through 2005. The higher growth rate during the early part of the decade is fueled by the convention center expansion. After 2005 the projected growth rate drops to the 2.3 to 2.8 percent range.
- The growth pattern for the non-convention hotels is similar to the convention-grade hotels. However, the influence of the convention center expansion is less pronounced.

In translating the growth in room-night demand to the number of hotel rooms needed, we use 70 percent average occupancy for the industry as market equilibrium. A large majority of the hotel properties are able to operate at break-even or better with an occupancy rate in the 65 to 70 percent range. At 70 percent industry average occupancy, the top performing hotels are making handsome profits, the average properties are making satisfactory profits, and all but the weakest properties are at break-even or better.

MARKET ANALYSIS CONCLUSIONS

In the current year (2000), assuming market equilibrium is measured at 70 percent average occupancy, the Portland market is not able to justify another major hotel. In fact, it has an excess supply of nearly 1,000 rooms, and this excess supply is expected to climb to over 1,500 rooms by 2002. For convention-grade hotels, the over supply is only 273 rooms in the current year; however, with the completion of the two Marriott properties and the new Hilton tower, the over supply will climb to over 800 rooms in 2002 before receding as the impact of the expanded convention center becomes apparent (see Tables III-11 and III-12).

With new supply continuing to come into the Portland market, the overall occupancy rate is projected to decline over the next two years from approximately 64 percent this year to around 62 percent in 2002. For convention-grade hotels, the decline will be sharper from an estimated 65 percent this year to approximately 58 percent in 2002, when the Hilton Tower is completed. As the new convention center comes on line and demand continues to

build due to economic growth, Portland hotel occupancy rates should climb back into the 70 percent plus range by mid decade.

With the recently falling occupancy rates and room rates expected to continue for another two years, financing of another major new hotel in the Portland market will likely be fairly difficult in the near term future. Therefore, a new convention hotel in the 600 to 800 room range could be considered after the market occupancy rate climbs back into the low to mid-70 percent range, and ERA does not expect that to occur until a couple of years after completion of OCC expansion. If the current national and regional economic expansion cannot be sustained and a recession takes place, it could be later.

SITE AND PROMIXITY ISSUES

Private Market Perspective

Because the commercial segment is the largest segment of the market and generates the highest room rates, most local hotels will first target this segment. Since much of Portland's office concentration is in downtown and many of the better restaurants are also on the Westside, the larger hotels have preferred and will continue to prefer a Westside or downtown location because it is the choice of their guests. With the MAX system providing convenient linkage, the larger Downtown Portland hotels can first market themselves as business hotels and secondarily claim to be convention hotels. When the tower is completed, the Hilton complex with 776 units will likely adopt this strategy.

Locating the Oregon Convention Center on the Eastside did contribute importantly to the upgrading of the Lloyd District. However, given that a large majority of Portland's non-convention hotel guests prefer to be on the Westside, the development of a 600 to 800 room convention hotel in the immediate vicinity of OCC on the Eastside is financially more difficult, because such a hotel will likely still need 40 percent or more of its business to be from non-convention related guests. Because Portland is not like Seattle, where the convention center is located adjacent to the downtown office and retail hub, the private market is not likely to build a 600 to 800 room convention-grade hotel on the Eastside near the OCC.

Convention Center Perspective

The role of the Oregon Convention Center is to bring conventioners to spend money in the greater Portland community. The OCC, assuming that it proceeds to expand, can better compete against other cities and their convention centers if it is able to offer a large convention hotel in close proximity to the center. For purposes of the OCC, the larger and higher quality the convention hotel, the better. Since this hotel will still need substantial non-convention business, its location criteria needs to be as follows:

- Visibility from the freeways
- Convenient access to and from the freeway system
- Close proximity to the convention center
- Convenient access to the MAX system for downtown and future airport linkage
- Convenient access to Lloyd District office buildings, restaurants, retail areas and entertainment venues

Since there are no sites on the OCC campus itself, the sites immediately across the street are ideal, provided that a parcel of ample size can be assembled. Although less than ideal, other sites within walking distance (half mile) of the OCC are also workable because they will not require the cost and management burden of shuttle bus support. The key consideration in distance between the convention center and the hotel is whether or not a system of buses are needed to move the delegates back and forth.

The MAX System

The MAX system tends to diminish the barrier of the Willamette River allowing the OCC to market rooms in downtown Portland as well. While it is very effective for transporting delegates to and from their hotels during most hours of the day, the MAX system does not provide sufficient capacity to move the large groups of delegates during peak conditions. The benefits of the MAX system in serving convention delegates can be enhanced if the Lloyd District were integrated into a “fare-free” zone with Downtown Portland. For visitors such a zone removes not only the cost of shuttling back and forth between the convention center and the downtown on the MAX system but more importantly the concern with having the proper currency denomination and the ability to operate the ticket machines.

Differences in Perspective on Proximity to the Convention Center

The convention hotel and the convention center will have slightly different perspectives on the ideal proximity between the hotel and the convention center. From the perspective of the convention center, a headquarters hotel directly linked to the convention center provides the best functional relationship as well as the best marketing package. However, that direct integration with the convention center will diminish the hotel's ability to attract non-convention business because commercial travelers and tourist typically prefer to avoid the scale and institutional feel of a convention hotel. From the hotel perspective, the ideal situation is close enough proximity to be marketed as a convention headquarters hotel but sufficiently detached to have a market image independent of the convention center.

Section IV

CASE STUDIES OF COMPETING COMMUNITIES

Because a convention headquarters hotel has an impact on a local economy, a number of communities have struggled with this issue of a convention hotel to support a substantial public investment in their convention center. Each has dealt with this issue in its own way depending upon the community's inherent attractiveness to visitors, its political climate for public support of private hotel development, the conditions of the hotel market and legal options available to the policy makers. The following discussion presents a review of what other communities that compete with Portland for convention business have and have not done to stimulate hotel development.

SEATTLE, WASHINGTON

Meeting planners tend to reserve rooms at the Seattle Sheraton Hotel and Towers and the Westin Hotel Seattle when booking conventions at the Washington State Convention and Trade Center. The hotels are comparable in size – the Seattle Sheraton Hotel contains 840 rooms, and the Westin Hotel Seattle contains 865 rooms. However, the Seattle Sheraton Hotel is located next door to the Convention and Trade Center, while the Westin Hotel Seattle is located about five blocks away. Other hotels in downtown Seattle accommodating meeting groups include the 553-room Renaissance Madison Hotel, the 415-room Crowne Plaza Hotel, the 450-room Four Seasons Hotel, and the 237-room Hilton Hotel. The 426-room W Seattle Hotel opened in October 1999, about five blocks from the Convention and Trade Center. The 146-room Paramount Hotel is the newest hotel in downtown Seattle, located just one block away. The two unofficial headquarters hotels, the Seattle Sheraton Hotel and Towers and the Westin Hotel Seattle, were built before the Convention and Trade Center.

Presently, the Washington State Convention and Trade Center is expanding to double the size of its exhibition space to 207,000 square feet. In order to finance the \$200 million expansion, land around the Convention and Trade Center was sold to private developers for the construction of supporting projects. A new five-star hotel, parking garage, office tower, and museum are to be constructed adjacent to the Convention Center. RC Hedreen Company is building the 450-room Elliott Hotel at the northwest corner of the expanded Convention and Trade Center complex. Each of the

projects will be financed privately, with no public subsidy. Because of its smaller size and the existing convention-grade hotels surrounding the Convention and Trade Center, the Elliott Hotel due to open in April 2001 will not become the official headquarters hotel.

According to the Downtown Seattle Association, a number of hotel projects are in the development pipeline. Wright Hotels is planning a 320-room Marriott Hotel for the eastern side of Alaskan Way across from the Bell Harbor International Conference Center, about 12 blocks from Downtown. Western International is also planning another 230-room Marriott for the Denny Triangle area on the northeast edge of Downtown. A 400-room hotel is also proposed at Fourth Avenue between Stewart and Virginia Streets, located six blocks from the Convention and Trade Center. These projects have all been planned and permitted. The Sheraton Seattle Hotel and Towers has proposed to add a 400-room tower on the south end of the existing Sheraton property, but no timetable has been set. Similarly, Hyatt Regency has proposed building a 26-story hotel about three blocks from the Convention and Trade Center. Finally, King County is considering redeveloping Convention Place Station (a county-owned transit station located between Ninth Avenue and I-5, close to the Convention and Trade Center) into a multi-use development that would include a 600- to 900-room hotel, offices, condominiums, apartments, and retail.

Because the Washington State Convention and Trade Center is located adjacent to downtown Seattle's retail and office hub, no direct public investment was needed to stimulate major hotel development or expansion. The convention center itself serves as an indirect inducement for private sector hotel development. The privately developed Sheraton and Westin serve as headquarters hotels for major events held at the Washington Convention Center.

DENVER, COLORADO

Hotels surrounding the Colorado Convention Center include: the 1,230-room Adam's Mark Hotel, the 613-room Denver Marriott City Center, the 511-room Hyatt Regency Denver, the 395-room Holiday Inn Denver Downtown, the 337-room Embassy Suites Hotel, and the 337-room Executive Tower Hotel. The nearest hotel is the Holiday Inn, located just one block from the Convention Center. The Marriott City Center and the Hyatt Regency are located nearby, two and three blocks away respectively. The Adam's Mark Hotel, the headquarters hotel for the Convention Center, is located five

blocks away. The Embassy Suites Hotel is also located further away, approximately seven blocks from the Convention Center.

In 1997, the Denver Urban Renewal Authority partly financed the \$135 million renovation of the 744-room Adam's Mark Hotel into a 1,230-room hotel. Located within the 15-block redevelopment area, the Urban Renewal Authority invested approximately \$25 million in tax-increment funds into the project. Due to its size and location, the Adam's Mark Hotel has been serving as the unofficial headquarters hotel for the Convention Center up to this point.

A feasibility study conducted in 1996 showed that an expansion of the Convention Center would be advisable in the near future, but would only be economically viable with the construction of an official headquarters hotel. In November 1999, Denver voters approved a measure for the expansion of the Colorado Convention Center to almost double its size, adding 292,000 square feet of exhibit space and 60,000 square feet of meeting space. (The adjacent Currigan Exhibition hall, located across the street from the Convention Center, will be removed to provide space for the expansion.) The City will issue bonds to cover costs for the \$268 million project, to be financed through a 1.75-percent increase in lodging taxes and an increase in short-term car rental taxes. The bond must be approved by a public vote. The newly expanded Convention Center is tentatively scheduled to reopen in the spring of 2004.

Recently, developer Bruce Berger Realty has been negotiating with various hotel operators to develop a new 1,100-room official convention headquarters hotel on a site directly across from the Convention Center. A letter of intent was signed on September 15, 2000 between Berger and both Hyatt and Starwood operators. An initial agreement between Berger and operator Marriott International did not proceed to an actual deal, largely because Marriott is a non-union operator. According to the Denver Metropolitan Convention and Visitors Bureau, the City has agreed in concept to provide approximately \$55.3 million of the total \$217 million hotel cost through the use of tax-increment financing, as the site is located in the Downtown Denver Urban Renewal District. Although voter approval is not necessary, the tax-increment financing must first be approved by the Denver Urban Renewal Authority and the Denver City Council. On January 15, 2001, the developer will be required to submit a financing package to the city; it is anticipated that separate packages for Hyatt and Starwood will be submitted. The hotel is tentatively scheduled to begin construction in spring 2001, to be completed in late 2003.

In addition, Lennar Partners plans to close the Denver Executive Tower Hotel, located one block away from the Convention Center, and renovate the structure to reopen in late summer 2001 as a 659-room Hilton Hotel. If both projects proceed to completion, 1,400 additional hotel rooms will be added within walking distance to the Colorado Convention Center by late 2003.

SALT LAKE CITY, UTAH

The major hotels surrounding the Salt Lake Convention Center are the 500-room Hilton Hotel (formerly Doubletree), 515-room Marriott Downtown Hotel, the newly renovated 393-room WestCoast Salt Lake City Hotel (formerly Cavanaugh's Olympus Hotel), and the 388-room Wyndham Hotel. Smaller hotels in the area include the 241-room Embassy Suites and the newly built 225-room Hotel Monaco. The Little America complex with 850 rooms, located some one mile from the Convention Center, and the Marriott Downtown Hotel serve as unofficial headquarters hotels for the Convention Center. The Marriott Downtown and the Wyndham hotels are located closest to the Convention Center, the former across the street and the latter next to the side door.

The Salt Palace Convention Center has been undergoing its second expansion, scheduled to be completed in the fall of 2000. The \$47 million project, funded by a tax on lodging, rental cars and restaurants, will increase exhibit space by 114,000 square feet to a total of 370,000 square feet.

Along with the Convention Center expansion, two new major hotel developments are nearing completion, adding over 1,000 rooms to downtown Salt Lake City. The 775-room Grand America Hotel will be built on the block due east of the existing Little America, and it is scheduled to open in early 2001. The Little America/Grand America complex, with 1,625 rooms, will likely become the unofficial headquarters hotel. In addition, construction is well underway for a new 358-room Marriott City Center Hotel on downtown Salt Lake City's central block, scheduled to open in November 2000.

When the current phase of Convention Center expansion was a topic of discussion, Salt Lake County considered a subsidy for a headquarters type hotel. However, the owner of a major hotel interest in town was able to prevent such a hotel development on the top ranked two sites. Once the public agencies abandoned their efforts to subsidize a convention headquarters hotel, the Grand America project broke ground. It will have no public subsidy and no national chain affiliation.

ALBUQUERQUE, NEW MEXICO

The Doubletree Hotel of Albuquerque, Hyatt Regency Albuquerque and La Posada de Albuquerque are all located in the immediate vicinity of the Albuquerque Convention Center. The Doubletree Hotel is connected through an underground concourse, while the Hyatt Regency and La Posada are just across the street from the Convention Center. The Doubletree Hotel, which contains 295 rooms, and the Hyatt Regency with 395 rooms, each serve as the unofficial headquarters hotels for the Albuquerque Convention Center. La Posada is a smaller hotel, with a total of 114 rooms.

The Albuquerque Hilton and the Albuquerque Marriott, with 263 and 411 rooms respectively, also accommodate conventions and meeting groups. However, both these hotels are located at some distance from the Convention Center. The Hilton is in Midtown Albuquerque, about ten minutes away by car, while the Marriott is located 15 minutes from Convention Center in the Uptown area, near the Sandia National Laboratories. The Prado Hotel, a new 151-room five-star hotel, is scheduled to open in downtown Albuquerque within the next three months. No other hotels are planned for the downtown area.

The City of Albuquerque commissioned a study in 1998 on the feasibility of expanding the Convention Center. According to the Albuquerque Office of Economic Development, the study indicated that an expansion would be viable only with the addition of nearby convention headquarters hotels. Any expansion would thus have to be tied to new hotel development. Although the City has had conversations with major hotel operators regarding a new convention headquarters hotel, there are still no projects on the horizon. According to the City of Albuquerque, the overbuilding of smaller hotels has softened the market and caused room rates to drop. In addition, up until last year, the Convention Center's performance was lackluster. Finally, the City of Albuquerque's ability to attract hotel developers is constrained by the New Mexico Anti-Donation Law, which prohibits public agencies from offering land to private developers. All of these factors have contributed to a lack of interest on the part of hotel developers to construct a new headquarters hotel in Albuquerque.

SAN JOSE, CALIFORNIA

During the 1980s, the City of San Jose did adopt a policy of not permitting any hotels larger than 150 or 200 rooms and with more than 5,000 square feet of meeting space to be built outside of its downtown until the downtown had achieved a critical mass

of 2,000 hotel rooms. This policy had a two-fold impact. It probably did accelerate hotel construction within the downtown and adjacent to the convention center; although those hotels did receive favorable deals from the San Jose Redevelopment Agency. However, this policy also had the unintended consequence of causing several major hotels to be built in surrounding communities like Santa Clara, Sunnyvale and Milpitas.

CONCLUSION

The communities of Seattle, Denver, Salt Lake City, Albuquerque and San Jose compete with Portland for convention business. Each of the cities has had its own way of dealing with the issue of headquarters hotel development to support their convention facility. Some cities, such as Salt Lake City and Seattle, have had major hotel developments without providing public subsidy. The expansion of their convention centers has encouraged private developers to build convention-grade hotels in those cities. In Seattle, recent hotel construction, such as the W Seattle and the Elliott Hotel, has come about without public investment other than the convention center expansion. In the same way, Salt Lake City's Grand America/Little America complex is purely a private development.

Denver and Albuquerque have not seen the same level of private sector interest as Seattle or Salt Lake City. Denver, for example, has invested in the development of headquarters hotels for the Colorado Convention Center through the use of tax-increment financing. Like the Adam's Mark Hotel, which completed renovation in 1997, the new proposed headquarters hotel is to be partially financed using this technique. The tax-increment amount proposed will cover roughly one-quarter of the project's total costs. Meanwhile, due to the lack of private market interest in Albuquerque, the City has yet to decide whether or not to commit public funds to the development of a convention headquarters hotel.

Seattle, Denver, Albuquerque, San Jose and Salt Lake City have had different approaches to inducing hotel investment. As the case studies illustrate, the strategies pursued by each of these communities have been contingent on the ability to attract private development, the political climate, and the strength of the hotel market.

Section V

ECONOMIC IMPACT AND FEASIBILITY

IMPACT OF CONVENTION HOTEL

A convention hotel will have two primary types of impact on the regional economy. The first is simply the additional convention delegate spending induced into the Portland region due to greater and more convenient hotel capacity, and the second is the competitive impact on the local hotel industry. In addition, it will generate construction and long term employment impacts as well. The analysis will focus on the differences in primary impact of three convention hotel development alternatives:

- Construction of a new 600-room convention hotel,
- Construction of a new 800-unit convention hotel, and
- Expansion and upgrading of an existing 476-room hotel by 300 rooms to become a 776-unit convention hotel.

In this analysis a number of variables that need to be considered are moving simultaneously, and these are discussed below.

Value of Convention Hotel Correlates to Strength of Market

When local occupancy rates and room rates are high and climbing, local hotels will resist committing large room-blocks to the convention center well in advance at discounted room rates. These hotels expect to be able to secure higher room rates from commercial and independent travelers when the market is firm and tightening. Therefore, during strong market conditions, the incremental value of the new large convention hotel is greatest because it provides the hotel capacity needed by the convention center to bring conventions and delegates that otherwise would not come to Portland.

In contrast, when the local hotel market is soft and occupancy rates and room rates are falling, existing hotels will be more willing to provide larger room-blocks. ERA confirmed this premise in interviews with the managers of a number of hotels that have not recently offered room-block but are considering doing so as the market has continued to soften in recent months. With more room-blocks available, fewer conventions will be

prevented from coming due to the lack of hotel capacity or due to the need to scatter the delegates in a large and unmanageable number of properties. Therefore, during weak market conditions, like the Portland market is expected to be in over the next two to three years, the incremental visitor attraction impact of a large convention hotel is actually lower because fewer conventions are prevented from coming to Portland due to the lack of hotel capacity. The economic impact value of a new convention headquarters type of hotel correlates with the strength of the local hotel market.

Impact of Convention Hotel on Competing Hotels

A new convention hotel has two types of impact on the other convention-grade hotel properties. First, by adding substantial hotel capacity adjacent to or near the convention center, it is able to attract larger groups that would not have selected Portland otherwise. It brings additional room-nights to Portland that would not have come without its presence; and since the larger of these groups tend to need many more rooms than even the 600- to 800-room convention hotel is able to accommodate, other convention-grade hotels benefit from the spill over impact.

Second, there will be many days during the year when the larger conventions are not in town, including days needed to set up or take down a convention. During those days, this large and well appointed convention hotel will compete with and capture room-nights from the other hotels for smaller group business, commercial travelers and tourists. The larger the new convention hotel, the greater will be its power to induce conventions and delegates to come to Portland that otherwise would not have come, generating economic impact for the region and new room-nights for other hotels. However, the larger the new convention hotel, the greater will be its competitive impact on the other convention-grade hotel during periods when large groups are not in town.

During conditions when the hotel market is soft, all convention-grade hotels will be offering large room-blocks, including the new convention hotel. Therefore, during weak hotel market conditions a higher percentage of the convention delegates induced to Portland will likely be accommodated within the new convention hotel itself. As the market firms, the delegates induced to Portland by the new convention hotel will more likely be scattered into more different hotels. This phenomenon reinforces the value of the convention hotel during strong local market conditions and the competitive impact of such a hotel during weak market conditions.

Expansion of an Existing Hotel to Become a Convention Hotel

This analysis is further complicated by the fact that an existing larger hotel in the Lloyd District (the Doubletree with 476 units) could be expanded and upgraded to become a viable convention headquarters hotel. While it is not adjacent to the OCC, it is within walking distance. By upgrading and expanding by 300 rooms to become 776 rooms, this hotel could have the attraction power very similar to a new 800-room hotel for larger conventions. Because it adds only 300 rather than 600 or 800 new rooms, its competitive impact on competing hotels would be much smaller.

New Capacity and Induced Demand

The statistical analysis that supports the above discussion is presented in Tables V-1 through V-5. In Table V-1, ERA superimposes a new 600-room convention-grade hotel, assumed to be in the immediate vicinity of the OCC, onto the convention-grade hotel supply versus demand outlook. Assumed to be completed in 2004, this hotel adds 219,000 room-nights of additional capacity to the supply side. It also induces new delegate room-nights into this market by attracting conventions that would not have decided to come to Portland. The estimated number of room-nights induced varies with local market conditions, growing from 85,000 when the market is soft to 175,000 when the market strengthens.

The induced room-night estimates are based upon “The Reasons for Lost Business Occurring 1994-1999” compiled by POVA. For example, during the 1994 through 1996 three year period when the Portland hotel market was still fairly soft, the cited room-nights lost due to the lack of a convention headquarters hotel averaged 92,800 per year. However, during the following three years of 1997 through 1999, when the market was considerably stronger, the room-nights lost due to the lack of a convention hotel averaged a much higher 175,400. The peak year was 1998 when 184,300 room-nights were apparently lost due to the lack of a convention hotel, but by 1999 the number of room-nights lost had declined slightly to 167,300.

In Table V-2, we superimposed a new 800-room convention headquarters hotel on the local market in place of the 600-room hotel. This hotel adds 292,000 in room-night capacity and induces an estimated 90,000 to 189,000 in additional convention delegate room-nights. In Table V-3 we examine the room-night impact of the third alternative, that of a 300-room expansion plus upgrading of the Doubletree at Lloyd Center. In this scenario, the room-night

capacity added is only 109,500; and the number of induced delegates grows from 63,500 to 131,250 as the market strengthens over time.

Comparison of Alternatives – Weak Market Conditions

Because the variables shift relative positions as market conditions change, ERA compared the three convention hotel alternatives under two sets of market assumptions. The analysis under weak market conditions is presented in Table V-4, and a similar analysis assuming strong market conditions is presented in Table V-5. This analysis shows that under weak hotel market conditions, the expansion of the Doubletree provides approximately 70 percent of the economic impact of the new 800-room convention hotel (\$17.9 million versus \$25.3 million) but almost no competitive impact on the other convention-grade hotels in the Portland market. This is because the additional delegates attracted to Portland due to this 776-room hotel's ability to accommodate much larger room-blocks offsets the competitive impact of the 300-room expansion. The 800-room convention hotel, while providing somewhat larger economic impact on the region, will reduce the average occupancy rate of the other convention-grade hotels in Portland market by approximately four percent. With occupancy rates headed for 60 percent and possibly lower, an additional four percent of competitive impact will not be easy for local hoteliers to bear.

Comparison of Alternatives – Strong Market Conditions

As the market strengthens over time due to OCC expansion and continued economic growth, the conclusions shift more in favor of one of the new large hotels. As room-block from existing hotels shrink, the added capacity of the new convention hotel becomes more important. When compared to the 600-room alternative, the 800-room model provides slightly larger economic impact on the region (\$51.1 million versus \$47.3 million) and somewhat higher competitive impact on the occupancy rates of other convention-grade hotels (negative 1.6 percent rates versus positive 0.6 percent). With the industry operating at an average occupancy rate in the mid to high 70 percent range, a competitive impact of this magnitude would not be difficult to bear.

Comparison of Economic Impacts by Hotel Project

Relating back to the CIC Research work conducted for OCC, ERA estimates the additional delegate spending impact that a convention hotel would bring to be as follows. The low estimate represents weak hotel market conditions and the high estimate represents

strong hotel market conditions. The delegate spending impacts are millions of dollars per year for the entire Portland Metropolitan Area.

Additional Delegate Spending Impact (\$millions)	Low	High
Add 300 rooms and renovate existing 476 unit hotel	\$17.9	\$35.5
Build new 600 room convention hotel	\$23.8	\$47.3
Build new 800 room convention hotel	\$25.3	\$51.1

FINANCIAL FEASIBILITY AND NEED FOR SUBSIDY

The above analysis suggest that during weak market conditions expansion of the Doubletree is the appropriate convention hotel strategy, but during strong market conditions a major new convention hotel appears to be the most appropriate strategy. One more set of analyses needs to be completed before any final conclusions can be drawn, and that is the issue of financial feasibility and the need for subsidy.

ERA has used its convention hotel financial model to examine four new convention hotel construction scenarios:

1. A new 600-room hotel in weak market conditions
2. A new 600-room hotel in strong market conditions
3. A new 800-room hotel in weak market conditions
4. A new 800-room hotel in strong market conditions

We did not attempt to model the expansion of the Doubletree in detail because the actual financial performance of that new hotel will be intimately related to how the existing common areas are renovated and what operating efficiencies can be gained with a new tower addition. Because of their detailed nature, the financial analysis of the above four scenarios is presented in Appendix Tables A-1 through A-4 and discussed in summary form below. The major assumptions used in the financial analysis are highlighted:

- The site required is assumed to be 2.7 acres or 117,612 square feet for the 600-room hotel and 3.0 acres or 130,680 square feet for the 800-room hotel.
- The number of parking spaces provided is 0.8 spaces per room in an above grade parking garage.

- The average unit, including suites and hallways, is 515 square feet but common areas add an additional 75 percent to the total room square footage. This would include lobby areas, ballrooms, meeting rooms, restaurants, retail space, etc. The common area square footage is 43 percent of total hotel gross square footage.
- Depending upon the scenario, the initial year's (2004) effective room rate is estimated to range from \$110 to \$126 including group discounts, depending upon assumptions about market strength.
- The inflation rate for room revenue, other revenues and costs is assumed to be 2.2 percent per year.
- The direct building construction cost is estimated to be \$95 per gross square foot for the smaller hotel and \$96 per square foot for the larger hotel.
- The direct parking construction cost is estimated at \$18,000 per space for the smaller hotel and \$18,500 per space for the larger hotel. When indirect construction and interest during construction are added, the cost is more like \$22,500 to \$23,000 per stall. This cost assumes an above grade garage.
- Furniture, fixtures and equipment (FF&E) is estimated at \$20,000 per unit.
- Indirect construction cost is estimated as 21.5 percent of direct construction cost, and it includes all cost other than direct construction, interest, FF&E and land.
- Total construction cost including construction interest but excluding land is in the \$157,000 to \$159,000 per unit range. The large amount of common area inflates the per room cost in a convention type of hotel.
- The terms for long term financing are 8.8 percent annual interest and 30 year amortization.
- The construction financing rate is 9.8 percent.
- The occupancy rate build-up varies with the size of the hotel and the assumptions about market strength.
- The capitalization rate used is 8.75 percent on net income. In other words, the value of the project at any point in time is its net operating income divided by 8.75 percent. Or a buyer of the project will look for an operating income stream, which nets him or her 8.75 percent return on the purchase price.

- The food and beverage revenues reflect the group nature of this hotel. Meeting room revenue are included in miscellaneous because groups booking a large number of room-nights typically pay little extra for their meeting rooms.
- Due to the risks involved in building such a large hotel in market the size of Portland, we used a 15.0 to 16.5 percent internal rate of return for the strong market scenarios and a 17.5 and 20.0 percent internal rate of return for the weak market scenarios.
- The land value supportable is the present value of the annual cash flow stream for the ten to twelve year analysis period discounted at the internal rates of return cited above. It determines the amount a developer is willing to pay for land given his anticipated cost and revenue flows and the internal rate of return he or she needs to justify the risk of the investment.

Under these assumptions, neither the 600-room nor the 800-room hotels is able to support its full development cost let alone its land cost during weak market conditions. Including the burden of carrying an assumed land cost at \$55 per square foot, the feasibility gap is in the vicinity \$20 million for the smaller hotel and \$27 million for the larger hotel. If the parking must be placed underground, the gap would grow to an even higher number.

However, as the market strengthens over the next several years, rising room rates and occupancy rates will reduce those gaps in feasibility. With the market occupancy rate in the high 70 percent range, the feasibility gap would decline to \$4.3 million for the 600-room hotel and to \$6.3 million for the 800-room hotel. Since this project has not been designed and is not site specific, these gaps in feasibility should be viewed as “ballpark” estimates.

CONCLUSION

The impact and feasibility assessment presented in this section of the report indicates a clear set of conclusions. The value of large new convention hotel in Portland’s Lloyd District varies with the strength of the local hotel market. When room rates and occupancy rates are low and headed lower, existing larger hotels will be more willing to offer room-blocks to the convention center. This greater availability of room-blocks reduces the number of conventions deciding against Portland due to the lack of hotel capacity or the need to scatter the delegates in too many properties. Under weak market conditions, the new large convention hotel has relative low economic impact on the region and relatively high

competitive impact on local convention-grade hotels. At the same time, because of its own lower room rates and occupancy rates, the gap in feasibility or the need for subsidy is much greater.

As market conditions strengthen, room-blocks from existing hotels will become less available and more conventions will decide against Portland unless a new larger headquarters type of hotel is constructed in the vicinity of the convention center. When the hotel market is strong, the value of the new convention hotel in attracting delegates to Portland is much greater. Its competitive impact on other convention-grade hotels will be less and less noticed. Because it along with other hotels will enjoy higher room rates and occupancy rates, the gap in feasibility or the need for subsidy also will be much less. However, because of the large amount of common space needed in a convention headquarters type of hotel, it is unlikely that such a hotel in the 600- to 800-room range would actually be built by the private sector in the Portland market during the next decade without some type of financial inducement. Even in conditions of a strong hotel market, the private sector is not likely to build a hotel larger than 400 or 500 rooms in the Lloyd District in one increment. The constraint is the size of the Portland market and the fact that the larger and more lucrative commercial market segment prefers to be across the river in Downtown Portland. Because of the abundance of recent hotel construction and the expected completion of three more convention-grade hotels during the next two years, Portland is headed for several years of soft hotel market conditions.

STRATEGY OPTIONS AND MARKET RESPONSE

The foregoing analysis indicates that the City of Portland probably has three basic strategy options concerning convention hotel development, and the private sector response will depend upon the option selected:

Remain Ambiguous to Keep Options Open

If the City of Portland remains ambiguous about the possibility of a public subsidy for a convention hotel, the Doubletree will not likely upgrade or expand. Doubletree's financial risk of having invested heavily in expansion and upgrading only to see a newly subsidized competitor rise in a stronger location will simply be unacceptable. When the market rebounds, no new convention scale hotel development will occur in the vicinity of the OCC unless one is able to negotiate some type of subsidy.

A Strategy of No Subsidy

If the City adopts a firm strategy of no subsidy for hotel development other than convention center expansion itself, the Doubletree will likely expand and upgrade to become that convention headquarters hotel when market conditions justify. Because the Doubletree will be able to become the convention hotel with a 200- to 300-room expansion and some renovation, its risk is lower than that of a new 600- to 800-room hotel development. If the Doubletree invests effectively to become the convention headquarters hotel, it will likely preempt the development of a large hotel adjacent to the convention center for a decade or more.

While the Doubletree is not ideally located across the street from the convention center, its walking proximity allows it to function as a headquarters hotel without the need for bus transportation. For conventions held during the rainy season, an umbrella could be included in the promotional package provided to delegates.

Subsidy at the Appropriate Time

If a new 600- to 800-room convention hotel very close to the OCC is the City's objective, then the optimal strategy is to time the completion of the convention hotel for when the average hotel occupancy rate in the Portland market is both climbing and reaches the mid-70 percent threshold. Depending upon the strength of the national economy during the next decade, this will likely occur from three to six years after completion of the OCC expansion. Since the OCC expansion is scheduled to be completed in March of 2003, and recognizing that the Hilton Tower will be completed in 2002, the large convention hotel should be timed for completion within the 2006 to 2009 time frame. The deal structuring, planning, design and construction of such a large public/private development project is likely to require four years. If the current economic expansion continues well into the next decade, then the planning for this hotel should begin in earnest in 2002. If a recession intercedes during the next two or three years, then serious planning for this hotel should probably be delayed until mid decade.

Since the private sector in Portland has historically been able to develop hotels up to 500 rooms in one increment, the subsidy should be restricted to projects that provide in excess of 500 units. All hotel projects that are able to provide more than 500 rooms and are within walking distance of the convention center should be able to compete for that one-time subsidy. The competition might be like a "beauty contest" and the evaluation criteria could

include the following: 1) financial credibility of the developer and project, 2) proximity to the convention center, 3) quality of design and finish, 4) quality of the operator, 5) increasing hotel brand competition within the Portland market place, 6) amount of common and meeting space internal to the hotel, and 7) the size of the hotel in excess of 500 units. An overt policy of subsidy for the convention hotel will likely discourage other convention-grade hotel development in locations away from the OCC and create developer interest for the desired project. If the timing of this competition contest is correct relative to market conditions, the amount of subsidy needed should approximate the cost of the land parcel required for the convention hotel and its parking in a parking structure.