

Napa Market Overview

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The Napa hotel market derives a large portion of its guestroom demand from throughout the greater San Francisco Bay Area. While the economic vitality of all nine counties in the San Francisco Bay Area has the most direct impact, Napa is also a regional, national, and international destination, attracting visitors from across the nation and other countries. Unlike the San Francisco hotel market, which slumped since the second half of 2000, throughout 2001, and is still slow in recovery, the hotel market in Napa has proven to be somewhat more resilient. Year-to-date data through April 2002 for a sample of selected hotels reveal an improvement in demand of roundly 13% over the same period last year. Located in Northern California, Napa is approximately 60 miles north of San Francisco. After the gold and local silver mines in the surrounding mountains became depleted in the late 1860s, farmers planted the first wine grapes. In the mid-1960s, the commercial and tourism opportunities associated with wine making and the culinary arts were further exploited; this spawned an industry that has since transformed the valley into a world-class wine-growing region and a popular tourist destination. Today, Napa Valley is often referred to as the “Food and Wine Capital” of the nation. Aside from the urbanized areas of downtown Napa, St. Helena, and other smaller communities, the Napa Valley region is dominated by its renowned vineyards and wineries. In addition, famous food establishments such as Auberge, Bistro Don Giovanni, Bistro Jeanty, Bistro Ralph, Brannon’s Grill, Brix, Bouchon, Brava Terrace, Celadon, Cole’s Chop House, Domaine Chandon, French Laundry, Julia’s Kitchen, Meadowood Restaurant, Mustards Grill, Pairs, Pinot Blanc, Terra, Tra Vigne, Trilogy, and Wappo Bistro, complement Napa’s rich wine-growing tradition. With the robust growth of the Bay Area economy in the late 1990s, primarily driven by the high-tech, Internet and tourism industries, most hotel markets in the Bay Area, including Napa Valley, experienced unprecedented growth. While the economic downturn that started in 2000 has impacted many cities in the nation, San Francisco has been one of the hardest hit due to area’s economic dependence on the high-tech and Internet industries. Several companies have laid off employees, unemployment level increased, and office vacancy rates reached all-time highs. The leisure, group and commercial segments of the lodging industry have all suffered. Napa is primarily a leisure destination and secondarily a group market. The decline in demand for hotel rooms in the San Francisco Bay Area has had ripple effects throughout the Napa region, primarily in the group market segment and to some extent the leisure segment. For a selected sample of hotels examined, hostelry demand in Napa dropped by an estimated 15% in 2001, after annual growth rates of roundly 5% in 1999 and 2000. Since 1996, annual occupancy levels ranged from 75% to 78% and attaining a peak of 81% in 2000. In 2001, occupancy dropped to roundly 66%. Some hotels in the city of Napa have had to discount rates in 2001; however, most hotels in the upper Napa Valley were able to maintain or increase their average rates by 3% to 5% in 2001. For the sample of hotels we analyzed, average rate in 2001 dropped by 1%, to \$146, after very impressive growth rates since 1996 (except in 1998 and 1999.)

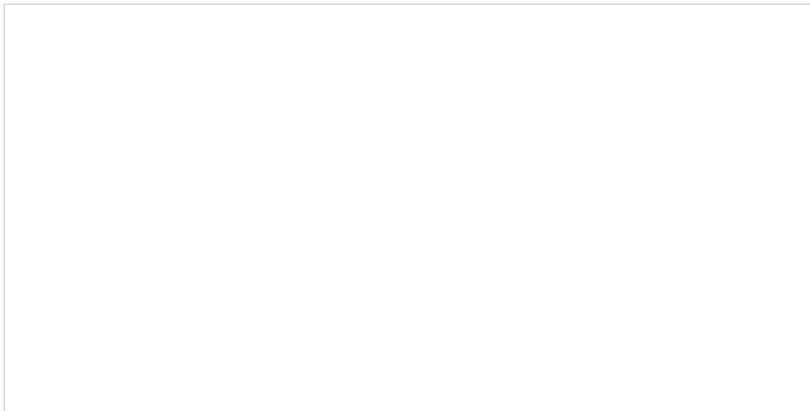
Summary

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It is important to note that Napa hotel market is made up of three submarkets, which can be geographically defined as the city of Napa, the mid Napa Valley submarket (Yountville), and the upper Napa Valley, which includes the communities of Oakville, Rutherford, and St. Helena. In 2001, average rates for the submarkets ranged from \$105 to \$205 for the city of Napa; from \$210 to \$260 for the mid Napa Valley hotels; and from \$290 to \$650 for the upper Napa Valley hotels. The market as a whole is generally seasonal. In the past, the Napa market had a six-month peak period. However, over more recent years, the market has evolved into a nine-month market, with the months of December, January, and February posting the lowest occupancy levels. In summer, from July to October, hotels run at their highest occupancies and highest rates, especially more so during the harvest season (September to October); except for the Christmas period, the winter season is generally slow. Historically, during the months of July through October, monthly occupancies are usually above 80% and peaking over the 90% range in the months of August through October. Throughout the year, Fridays, Saturdays, and holiday weekends are the busiest days and command higher rates, with some hotels imposing minimum two-day stays. According to Smith Travel Research, the Napa hotel market has 30 hotels totaling 1,933 rooms, with an average of 64 rooms. Of the 30 hotels, three properties have over 200 rooms each (the Marriott, the Embassy Suites, and the Silverado Resort), one hotel has a room count of 115, and the remaining 26 hotels are all under 100 rooms (averaging 41 rooms.) Further, there are only six branded properties in Napa: the Marriott, the Embassy Suites, two Best Western, one Travelodge, and one Hawthorne Inn & Suites, all located within the city limits. The remaining hotels, located in the mid and Upper Napa Valley are independently operated. While Napa appears an attractive market to operate in, especially in the mid and upper valley areas, development is generally constrained by very long approval processes and high cost of land. The mid and upper valley areas are primarily agricultural with high barriers to entry; commercial developments are generally rigorously opposed in these areas. With the exception of a 21-room property in 1995, there has been no addition to guestrooms in the mid and upper Napa Valley since 1985. Within the city limits, an 80-room Hilton Garden Inn is scheduled to open in August 2002 next to the Marriott, which was itself recently renovated for \$19 million with the addition of an additional 85-room wing, a spa, and more meeting space. The latest addition to the city of Napa is the 65-room Napa River Inn, a project that involved the restoration of the historic Hatt Mill. Additionally, an estimated additional 1,000 rooms are in various stages of the planning process within the city of Napa, including a possible expansion of the Embassy Suites. The area south of Napa, generally considered a less desirable location than upper Napa Valley, is the subject of development plans for approximately 1,500 rooms, which are in various stages of the development process. Major infrastructure and roadway improvement projects are currently underway within Napa Valley to improve the flow of traffic and mitigate the flood danger, which has historically disturbed commerce in downtown Napa during periods of heavy rainfall. Also, the American Center for Wine, Food & the Arts (COPIA), located in downtown Napa opened in November 2001. Envisioned by Robert Mondavi, the \$55-million, ±80,000-square-foot facility is expected to enhance Napa as a tourism destination. In addition to being strong during good economic times, Napa Valley visitation proved to be very resilient during the recessionary years of the early 1990s. During that recession, people traveled less and took driving trips close to home. Napa Valley benefited from this trend and is currently experiencing a similar demand pattern, with weekends experiencing strong drive-in leisure demand. The Napa hotel market is already showing signs of recovery. Further recovery should be spurred by a turnaround in the Bay Area's economy. While the national economy is reportedly already showing modest recovery signs, the San Francisco's economic recovery is lagging that of major cities due to its current weak convention calendar and the downturn in the technology sector. Nevertheless, it must be remembered that the Bay Area, as the fifth largest metropolitan area

(2000 ranking by population), is firmly established as a commercial, group meeting, and leisure destination, and will no doubt recover strongly in the future. Overall, the outlook for the Napa hotel market is optimistic.