

# Waikiki: Market in Transition

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Waikiki, located on the south shore of Oahu in the state of Hawaii, is a one-and-a-half-mile-long stretch of beach that is anchored by the A La Wai Canal to the west and the north, and the picturesque Diamond Head volcano to the east. Waikiki is considered to be the center of the tourism industry in Hawaii and has long been known as the gateway to the state. Every year since the early 1920s Waikiki has hosted scores of international and domestic travelers attracted to the white sand and calm waters of the famous beach, and has served as a home base for tourists interested in discovering Oahu's numerous attractions which include the USS Arizona Memorial at Pearl Harbor and Oahu's famous North Shore. In 2006, 62% of all visitors to Hawaii spent at least one night on Oahu, the majority of which stayed in Waikiki. Many of Waikiki's hotels date back to the early 20th century, and were built to accommodate Hawaiian royalty, visiting dignitaries, and wealthy tourists. To meet the growing "mainstream" tourist demand which began in the late 1960s, hotels were constructed in record numbers. By 1980, virtually the entire Waikiki area became developed with hotels of every class, brand, category, and style; by the mid-2000s, there were approximately 26,000 hotel rooms in Waikiki.

Table 1 presents supply and demand data from Smith Travel Research (STR) for all of the branded, full-service hotels located either directly on or across the street from Waikiki Beach between 1996 and 2006, and for the year-to-date periods through November 2006 and 2007.

**Table 1: Supply and Demand Trends – Waikiki Full-Service, Branded Hotels**

| Year                          | Occupied Room Nights (000s) | Change % | Available Room Nights (000s) | Change % | Occupancy % | Change % | Average Rate | Change % | RevPAR   | Change % |     |
|-------------------------------|-----------------------------|----------|------------------------------|----------|-------------|----------|--------------|----------|----------|----------|-----|
| 1996                          | 2,803                       | -        | 3,295                        | -        | 85.1        | -        | \$165.13     | -        | \$140.49 | -        |     |
| 1997                          | 2,649                       | (5.5)    | 3,295                        | 0.0      | 80.4        | (5.5)    | 176.17       | 6.7      | 141.62   | 0.8      |     |
| 1998                          | 2,462                       | (7.0)    | 3,295                        | 0.0      | 74.7        | (7.0)    | 173.92       | (1.3)    | 129.95   | (8.2)    |     |
| 1999                          | 2,445                       | (0.7)    | 3,295                        | 0.0      | 74.2        | (0.7)    | 166.52       | (4.3)    | 123.56   | (4.9)    |     |
| 2000                          | 2,632                       | 7.6      | 3,280                        | (0.5)    | 80.2        | 8.1      | 174.45       | 4.8      | 139.98   | 13.3     |     |
| 2001                          | 2,341                       | (11.0)   | 3,391                        | 3.4      | 69.0        | (14.0)   | 174.46       | 0.0      | 120.44   | (14.0)   |     |
| 2002                          | 2,495                       | 6.6      | 3,370                        | (0.6)    | 74.0        | 7.2      | 164.23       | (5.9)    | 121.57   | 0.9      |     |
| 2003                          | 2,532                       | 1.5      | 3,325                        | (1.3)    | 76.2        | 2.9      | 162.69       | (0.9)    | 123.90   | 1.9      |     |
| 2004                          | 2,773                       | 9.5      | 3,392                        | 2.0      | 81.7        | 7.3      | 168.73       | 3.7      | 137.91   | 11.3     |     |
| 2005                          | 2,871                       | 3.6      | 3,384                        | (0.2)    | 84.8        | 3.8      | 188.00       | 11.4     | 159.51   | 15.7     |     |
| 2006                          | 2,766                       | (3.7)    | 3,379                        | (0.2)    | 81.9        | (3.5)    | 208.55       | 10.9     | 170.75   | 7.0      |     |
| Average Annual                |                             |          |                              |          |             |          |              |          |          |          |     |
| Compounded Change:            |                             | (0.1)    |                              |          | 0.3         |          |              | 0.0      | 2.4      |          | 2.0 |
| 1996-2006                     |                             |          |                              |          |             |          |              |          |          |          |     |
| Year-to-Date Through November |                             |          |                              |          |             |          |              |          |          |          |     |
| 2006                          | 2,545,650                   | -        | 3,080,256                    | -        | 82.6        | -        | \$206.91     | -        | \$171.00 | -        |     |
| 2007                          | 2,444,764                   | (4.0)    | 3,185,218                    | 3.4      | 76.8        | (7.1)    | 217.97       | 5.3      | 167.30   | (2.2)    |     |

Source: Smith Travel Research

## Hotel Demand

### Summary

Over the past four years, the Waikiki lodging market has enjoyed tremendous prosperity. This article examines the factors that contributed to this prosperity and the changing landscape of Waikiki and its lodging market.

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With tourism at the heart of the Waikiki economy, the lodging market has historically been dependent on the economy and travel patterns of its two biggest sources of demand, the United States and Japan. Table 2 presents historic domestic, Japanese, and total arrivals for the Hawaiian Islands for the period from 1990 to 2006, and for 2006 and 2007 through November.

**Table 2: Hawaii Historic Arrivals**

| Year         | Domestic Arrivals | Percentage Change | Japanese Arrivals | Percentage Change | Total Arrivals | Percentage Change | Domestic Share of Total Arrivals | Japanese Share of Total Arrivals |  |
|--------------|-------------------|-------------------|-------------------|-------------------|----------------|-------------------|----------------------------------|----------------------------------|--|
| 1990         | 1,154,645         | -                 | 1,492,786         | -                 | 6,723,531      | -                 | 61.8 %                           | 22.2 %                           |  |
| 1991         | 1,116,966         | (0.9)             | 1,438,585         | (3.6)             | 6,518,460      | (3.1)             | 63.2                             | 22.1                             |  |
| 1992         | 1,647,764         | (11.4)            | 1,705,860         | 18.6              | 6,473,669      | (0.7)             | 56.3                             | 26.4                             |  |
| 1993         | 1,329,416         | (8.7)             | 1,666,275         | (2.3)             | 6,070,995      | (6.2)             | 54.8                             | 27.4                             |  |
| 1994         | 1,510,435         | 5.4               | 1,819,332         | 9.2               | 6,364,674      | 4.8               | 55.2                             | 28.6                             |  |
| 1995         | 1,492,937         | (0.5)             | 2,048,411         | 12.6              | 6,546,759      | 2.9               | 53.4                             | 31.3                             |  |
| 1996         | 1,588,663         | 2.7               | 2,146,883         | 4.8               | 6,723,141      | 2.7               | 53.4                             | 31.9                             |  |
| 1997         | 1,515,769         | (2.0)             | 2,216,890         | 3.3               | 6,761,135      | 0.6               | 52.0                             | 32.8                             |  |
| 1998         | 1,634,691         | 3.4               | 2,004,354         | (9.6)             | 6,595,790      | (2.4)             | 55.1                             | 30.4                             |  |
| 1999         | 1,910,074         | 7.6               | 1,825,588         | (8.9)             | 6,741,037      | 2.2               | 58.0                             | 27.1                             |  |
| 2000         | 1,145,156         | 6.0               | 1,817,643         | (0.4)             | 6,948,595      | 3.1               | 59.7                             | 26.2                             |  |
| 2001         | 1,960,234         | (4.5)             | 1,528,564         | (15.9)            | 6,303,791      | (9.3)             | 62.8                             | 24.2                             |  |
| 2002         | 1,069,477         | 2.8               | 1,483,121         | (3.0)             | 6,389,058      | 1.4               | 63.7                             | 23.2                             |  |
| 2003         | 1,263,219         | 4.8               | 1,340,034         | (9.6)             | 6,380,439      | (0.1)             | 66.8                             | 21.0                             |  |
| 2004         | 1,573,379         | 7.3               | 1,482,085         | 10.6              | 6,912,094      | 8.3               | 66.2                             | 21.4                             |  |
| 2005         | 1,961,786         | 8.5               | 1,517,439         | 2.4               | 7,416,574      | 7.3               | 66.9                             | 20.5                             |  |
| 2006         | 1,124,891         | 3.3               | 1,362,708         | (10.2)            | 7,461,299      | 0.6               | 68.7                             | 18.3                             |  |
| Year-to-Date |                   |                   |                   |                   |                |                   |                                  |                                  |  |
| Nov-06       | 5,007,334         | -                 | 1,236,079         | -                 | 6,793,915      | -                 | 73.7 %                           | 18.2 %                           |  |
| Nov-07       | 5,022,578         | 0.3               | 1,192,992         | (3.5)             | 6,718,889      | (1.1)             | 74.8                             | 17.8                             |  |

Source: Hawaii Department of Business, Economic Development & Tourism

In the mid-1990s, the strong American and Japanese economies caused travel demand in Hawaii to surge, leading to a record number of occupied room nights and record high marketwide occupancy of 85.1% in 1996. The onset of the Asian economic crisis and the economic recession in Japan in the late 1990s caused Japanese arrivals to decline; however, the booming United States economy caused domestic arrivals to increase and, by 2000, lodging demand had recovered with the result that Waikiki's marketwide occupancy attained levels above 80% again. The events of September 11, 2001, the nationwide economic recession in the United States, and the general fear of worldwide travel caused hotel demand to moderate significantly in 2001. In 2002, hotel demand recovered much more quickly than any expert had predicted. The perception of Hawaii as a safe yet exotic destination for Americans caused domestic arrivals to increase enough to counteract the significantly declining demand from Japan. At this time, Japanese travelers, ever conscious of safety, were wary to travel to international destinations.

The year 2004 marked the first time in six years that Japanese arrivals to Hawaii increased. Despite apprehension about America's involvement in the Iraq War and the SARS health epidemic, Japanese residents became anxious about traveling to international destinations other than Hawaii. For many, visiting Hawaii was like being at home because of the state's large Japanese population. The significant increase in Japanese and domestic arrivals in 2004 and 2005 contributed to Hawaii's total visitation recording a record-high 7.4 million visitors in 2005. With more than 55% of domestic visitors and 95% of Japanese visitors spending one or more nights on Oahu, the full-service, branded hotels in Waikiki were well-positioned to take advantage of the high demand levels. In

2005, marketwide occupancy reached 84.8%, average rate increased by an unprecedented 11.4%, and marketwide RevPAR finally exceeded its previous peak level, attained in 1997. Despite total visitation remaining in the 7.4 million range for 2006, marketwide occupancy moderated as area hoteliers raised their rates by a robust 10.9%, resulting in a further 7.0% RevPAR increase. With hotel rates reaching record highs, many travelers were forced to downgrade their hotel accommodations and, instead of staying at one of the branded beachfront hotels, chose to move to hotels two or three blocks back from the beach.

In the year-to-date period through November 2007, significant changes have taken place in the Waikiki lodging market. Due to recent declines in Japanese visitation and stabilized domestic visitation, hotel demand has moderated. Both occupied room nights and marketwide occupancy have declined in 2007 and, in an attempt to maintain the demand base at their properties, area hoteliers have begun discounting their rates for the first time in three years, resulting in a marketwide RevPAR decline.

## **Hotel Supply**

Due to restrictive zoning on the island of Oahu and in Waikiki, limited hotel development took place in the 1980s, 1990s and early 2000s. With little risk of new hotels being built, existing owners spent little on upgrading their hotels' physical product, leading to a hotel supply that by the early 2000s was largely dated and obsolete. Additionally, the majority of Waikiki's hotels were Japanese-owned and the bursting of the Japanese real estate bubble in the 1990s placed financial pressure on ownership groups. The changes in available room nights noted in Table 1 were due to refurbishments and renovations that took place at almost all of Waikiki's beachfront hotels between 2000 and 2006; as of January 2008, only one of the eight hotels included in the STR trend had not undergone a significant refurbishment. The increase in available room nights in the year-to-date period through November 2007 was due to the December 2006 opening of the 421-room Embassy Suites Beach Walk Hotel. Despite the recent loosening of the restrictive zoning, there is limited new hotel supply on the horizon for Waikiki. In 1996, the zoning code was amended to allow nonconforming properties to be rebuilt to their existing density or room count and in 2003, the zoning code was re-revised to reduce open-space requirements from 50% to 25% of property area, to eliminate parking requirements for many types of development, to allow sidewalk dining, and to permit buildings to retain their current height variances, and allow accent lighting. Despite these development friendly zoning amendments, the only current hotel development activity in the area is the construction of the 460-unit Trump Tower. This property is a condominium hotel in which its 460 units were sold to individual owners in November 2006. All 460 units were sold in less than eight hours, setting a world record for total dollars and number of units changing hand in a single day. The property is expected to be complete by the end of 2009, and it is only likely to impact the existing lodging market if the majority of individual owners choose to participate in the property's rental program.

## **The Changing Demographic of Waikiki Tourism**

As noted throughout this article, Waikiki has historically been highly dependent on Japanese tourism which ebbs and flows with Japan's economic cycle. As shown in Table 2, at the height of the Japanese economic cycle in 1997, approximately 2.2 million travelers came to Hawaii from Japan, representing 32.8% of total Hawaiian visitation. Despite a strong Japanese economy in the mid-2000s and increased arrivals, Japanese arrivals fell far short of this number. The most troubling statistics are the 10.2% and 3.5% declines in Japanese arrivals in 2006 and in the year-to-date period through November 2007, respectively. Fortunately, increased domestic and other international arrivals made up for this decline in Japanese travelers; however, with the U.S. economy in a period of uncertainty and the possibility of a recession in 2008, the decline in Japanese arrivals takes on more severity. The decline in Japanese arrivals is not only troubling for Waikiki's hoteliers, but also for retail stores. The majority of the retail infrastructure in Waikiki developed in response to the Japanese love of shopping and because they could obtain the same goods at American stores for less than in Japan. Unfortunately, there are several indicators that Japanese arrivals are not likely to increase any time soon.

Since February 1, 2005, to combat rising jet fuel costs, Japan Airlines has levied a fuel surcharge on flights from Japan to international destinations. In December 2007, the surcharge for a roundtrip ticket from Tokyo to Honolulu amounted to \$164 per person and, as of January 1, 2008, the surcharge was increased to \$225 per

flight. With additional insurance charges, total surcharges on a roundtrip ticket now amount to approximately \$270. For a family of four traveling to Hawaii, the surcharge adds more than \$1,000 to the cost of plane tickets. Hawaii tourism officials fear that the surcharge has now reached a level where travel to Hawaii has become financially prohibitive.

The increased fuel surcharge has come at a time when other destinations are actively marketing to Japanese travelers. Japanese people typically spend more money per person while on vacation than other nationalities, and destinations such as Mexico, Guam, and other southeast Asian countries are trying to obtain a piece of the powerful Japanese tourist dollar. Additionally, Japan Airlines has no surcharge for domestic travel, so destinations such as Okinawa, which offer a similar tropical experience to Hawaii, are beginning to become more attractive.

In an attempt to combat the declining Japanese visitation, the Hawaiian Tourism Authority (HTA) has developed a marketing program titled "So Much More Hawaii" designed to appeal to targeted segments of the Japanese market to promote longer stays in the islands. For 2008, the Tourism Authority is also actively marketing Hawaii to other Asian markets, namely Korea, China, and Taiwan. The desire for citizens from these countries to travel to Hawaii is strong, and depending on the success of visa waiver programs, these three countries have the potential to make up for some of the recent decline in Japanese visitation. In 2008/09, the HTA estimates that Korean visitation will increase by 80% over 2007 levels, and that by 2010/11, there will be 225,000 annual Korean visitors to Hawaii. Since 2006, Chinese visitation to Hawaii has more than doubled, and the HTA estimates that there will be a 25% to 30% increase annually for the foreseeable future. In addition to marketing campaigns actively targeting other Asian countries, the HTA began significant marketing programs in 2006 in Europe and Oceania. These marketing plans largely began as familiarization programs but are proving successful. During the first half of 2007 arrivals from Australia and New Zealand increased by 12% over the same period in 2006, and arrivals from Europe were approximately the same as in 2006; however, visits from tourists from many countries which typically were not seen in Hawaii, such as Italy and France, are encouraging signs.

With the economy of the United States in a period of uncertainty and consumer spending currently at a five-year low, the chance of domestic tourists stepping in to fill the gap left by Japanese visitors in Waikiki is unlikely. The 2007 numbers indicate that domestic arrivals have stabilized and, as of January 2008, area hoteliers report that meeting and group business forward bookings are approximately 30% lower than at the same time last year. Citywide conventions have also been on a declining trend since 2006, while lucrative incentive meeting business inquiries and bookings are well below levels seen in the previous two years. With airlift from the U.S. mainland expected to stabilize and/or decline, combined with a predicted decline in corporate profits, along with many consumers bracing for recession, domestic leisure and group visitation is not likely to increase in the short term. Additionally, if the nation's airlines begin to fall into financial hardship, as they did in the early 2000s, airlift from the mainland could suffer, leading to further declines in domestic visitation.

It is important to note that despite the aforementioned storm clouds on the horizon for the Waikiki lodging market, its underlying fundamentals continue to be extraordinary. The favorable demand dynamics of an urban, resort beachfront location, coupled with supply constraints makes Waikiki a world class destination that will continue to have stellar performance.

### **The Renaissance of Waikiki**

In recent years, Waikiki has continued to evolve and develop. Several development and improvement projects are underway or have been recently completed which are part of Waikiki's renaissance. These projects are transforming the Waikiki landscape and will help maintain its status as one of the world's top tourist destinations.

Beginning in 2004, \$20 million was being spent on improvements to Kuhio Avenue that incorporated approximately 250 additional trees, benches, wider sidewalks and the creation of a median strip running much of the length of Waikiki. Kuhio Avenue is a secondary thoroughfare that runs parallel to Kalakaua Avenue that prior to the improvement program was blighted and unsafe at night.

The Outrigger Waikiki Beach Walk, located on eight acres along Lewers Street, adjacent to Waikiki Beach, is the

largest development project in the history of Waikiki. Upon completion, this redevelopment is expected to transform a previously dilapidated portion of Waikiki into the premier retail and entertainment area in Hawaii. The Beach Walk is expected to contain an outdoor entertainment plaza, 50 retail shops, 16 restaurants, and five hotels, including the recently opened Embassy Suites Beach Walk, the Trump Tower Waikiki, and three renovated and repositioned Outrigger-branded properties. The dining establishments are expected to contain such well-known names as Starbucks, Roy's of Hawaii, and Ruth's Chris Steakhouse. The retail shops will contain a mix of local and national retailers including ABC Stores, Maui Divers Jewelry, and Quicksilver. The entire development is expected to be complete by the end of 2009.

The ±293,000-square-foot Royal Hawaiian Shopping Center, located along Kalakaua Avenue, adjacent to the Royal Hawaiian Hotel, is undergoing a \$115-million renovation that started in late 2004. The shopping center was designed in 1979 and was constructed primarily of concrete. The renovation is designed to create more open spaces, showcase the 100-year-old banyan tree on the premises, and allow more direct access to the landmark pink Royal Hawaiian Hotel located beyond the shopping center along Waikiki Beach. The renovated shopping center is expected to contain 100 shops and restaurants, ranging from fine designer apparel to quick-service restaurants and be fully open early in 2008.

As mentioned earlier in this article, Waikiki's lodging product has improved. Since 2004, all of the full-service branded hotels have undergone some form of refurbishment. The Hyatt Regency Waikiki refurbished all of its 1,230 guestrooms in 2004 and 2005; the 1,310-room Waikiki Beach Marriott refurbished its public spaces and one of its guestroom towers; the 2,860-room Hilton Hawaiian Village has been consistently improving its guestrooms since 2004; and the 331-unit Grand Waikikian Hilton Grand Vacation Club tower is under construction and scheduled to be complete by the end of 2008. The biggest changes are likely to come from the four Starwood properties in Waikiki. In June 2007, the Sheraton Moana Surfrider hotel was rebranded as a Westin and shortly thereafter underwent a renovation of half its guestrooms and public spaces; currently a full-service spa and new food and beverage outlet are under construction and expected to be complete by the middle of 2008. The Sheraton Waikiki Hotel has renovated all of its guestrooms and the guestroom corridors and public spaces are in the process of being renovated. Additionally, the hotel's food and beverage outlets have been renovated to give them a modern and trendy feel, something currently missing from Waikiki. In June 2008, the Royal Hawaiian Hotel is scheduled to close for a property-wide renovation and will reopen in January 2009 branded as a Luxury Collection property. Plans for the redevelopment of the Sheraton Princess Kaiulani Hotel are reportedly underway to potentially include the development of timeshare in place of one guestroom tower.

## **Conclusion**

Despite the near-term prospect of visitation declines to Waikiki, area hoteliers are upbeat. The prospect of new Asian and European markets creating a more diversified demand base, combined with the significantly improved Waikiki lodging product and the renaissance of Waikiki are very positive for the long-term prognosis of the destination.