Issue Paper

The Department of General Services, Statewide Travel Program is requesting to remove lodging rates from the Collective Bargaining process to facilitate the creation of a Managed Lodging Program that will match the Federal Government rates.

Background: Hotel rates for the State of California are established biennially by the California Department of Human Resources (CalHR) through the Collective Bargaining (CB) process. This cycle inhibits the state's ability to obtain competitive rates and to react quickly to lodging industry rate increases, market driven changes and major commercial developments. The State of California does not use lodging industry data analysis to set rates and as such sets an unreasonable expectation that hotels should offer and accept our rates regardless of their occupancy trends. As a result, problems with accessing and securing state rates at California lodging establishments are becoming more frequent and increasingly difficult.

Discussion/Analysis: The disparity between the Average Daily Rate (ADR) and the allowable reimbursement rate for state travelers makes it tremendously difficult to find rooms without sacrificing location, convenience or even security. The story is repeated in almost every major city center to which our employees travel. ADR, which is a widely accepted lodging-industry measure, is based upon a property's room rental revenue divided by the number of rooms rented. ADR statewide on an average has maintained double digit growth for the past five years while the State of California lodging reimbursement rates have remained stagnant for the past 15 years.

State travelers face the biggest challenge in the San Francisco and surrounding Bay Area market. Hotel room rates in San Francisco have increased 27 percent with an ADR of $257/night. This is almost two times the allowable rate under the current agreements. San Francisco is now the world's most expensive place for travelers to spend the night. It is a major hub for tech and biotech employment, a popular tourist destination, an important gateway to the Asia/Pacific region and one of the top three destinations for state and local government travelers. The city is also a considerable draw for group and convention guests. The surge in San Francisco room rates was the biggest among the lodging markets tracked by Bloomberg Business Journal in June 2015. The San Francisco lodging supply currently includes approximately 220 properties with nearly 34,000 guestrooms, a number that has remained fairly steady for the past decade. Supply constraints continue to present barriers to entry into the market, resulting from the limited number of available sites, high land costs, city restrictions and increasing development costs. The rising ADR is driven by all of these factors --- a combination that's allowing lodging establishments to be aggressive with their pricing.

Silicon Valley's lodging market continues to boom, reaching record levels. Despite the opening of a number of new hotels, with more under construction in the pipeline, lodging demand continues to outpace supply in the market. The demand is driven by tech companies with contracted lodging program rates that are far higher than the state rates. Corporate expansions will severely impact inventory as Facebook, Apple, Google and LinkedIn increase the demand within the Silicon Valley's lodging market. Silicon Valley's hotel inventory currently comprises roughly 30,000 rooms across nearly 240 properties. The market has achieved double digit ADR growth since 2010, benefiting from a strong and expanding tech industry with limited new supply that is showing no signs of slowing down. State employees will continue to be displaced and will be forced to move further and further away from their business destination.

Downtown Los Angeles (DTLA) is the central business district of the city of Los Angeles and many state agencies have a significant presence in the city center. DTLA currently has about 8,000 rooms of existing hotel inventory, however, the influx of people and development in DTLA has led to a dramatic increase in demand. The market is driven by corporate and meeting/group demand and with the higher corporate rates they can pay, state rates become more difficult to find. Tourism and the tech industry have driven the same boom in Santa Monica's lodging market. Santa Monica is often referred to as part of "Silicon Beach" and has quickly become the heart of Los Angeles' fast-growing tech scene, comprising 25% of Santa Monica's workforce. Corporate demand from the entertainment industry and "Silicon Beach" coupled with numerous tourist attractions continues to drive the Santa Monica market.

The San Diego hotel market benefits from the strong presence of maritime and defense industries and sees increasing demand from tourism, tech and healthcare sectors. The largest employer is the federal government with approximately 139,000 employees and over $24 billion in direct defense-related spending. The ADR in the San Diego area continues to increase and as a result, state travelers are being displaced and finding it more difficult to compete with federal government travelers. Only 985 rooms were added in 2014. Approximately 1,100 will be added before the end of the 2015 year.

Sacramento hotel rates are following the Bay Area trend and are starting to soar according to a June 2015 article by Mark Anderson of the Sacramento Business Journal. The ADR for Sacramento increased to $114.60 in April, up 7.6% from the previous year. This increase in ADR continues a six-year trend seen in most of Northern California. With the upcoming arena and the collateral business growth within the downtown core, Sacramento can expect room availability to decrease and ADR to increase over the near term. The new arena will exacerbate an already acute problem facing our state and local government workforce. Any new supply coming online within the next few years is likely to be absorbed quickly as a result of the business boom.

All of these areas present a unique set of challenges with the state's static rates and our limited flexibility to respond to the higher room costs as a result of their leisure, conference and convention business. The state's top 10 business travel destinations are concentrated in ultra-high tourist and meeting/convention areas. With more conference/convention business, the cost of rooms will continue to increase and the state rate will be the first to be eliminated. A continued lack of new inventory in these compressed markets will continue to drive robust ADRs that will reduce/eliminate inventory in low-priced market segments like state and local government.

While the problem is acute in the San Francisco Bay Area, Silicon Valley, Los Angeles and San Diego, however, the problem has spread to Bakersfield, San Luis Obispo, Santa Cruz, Monterey and Santa Barbara and other areas in Central California.

Impact: The result is state employees are finding it increasingly difficult to find state rates in almost every major city center in California. An inordinate amount of time is spent researching alternatives, rescheduling meetings, incurring additional travel expenses and completing Excess Lodging Rate Request/Approval Forms (STD255C). With demand at record peak and a continued lack of new inventory in these markets, hoteliers have continued a rate-driven strategy and ADR's will continue their upward trajectory. In some of these areas, the state will eventually be priced out of the market and that will have an adverse impact on a Department's ability to complete mission critical travel.

Potential Solution: The Department of General Services (DGS), Statewide Travel Program (STP) proposes removing lodging rates from the CB process and allowing the state to match the federal government's rates as a baseline. The federal government's General Services Administration (GSA) methodology is a standard in the industry and considers a Standard Rate which is the base rate in the continental United States that applies to 2,600 counties. This rate is reviewed every three years and is adjusted based on an analysis of ADR lodging data. The Non-Standard Rate applies to 362 unique locations and is reviewed every year and includes most metropolitan areas in California. There is an established process for adjusting both rates if necessary during the interim years. Three factors influence the ADR and may result in the federal lodging rates being different from published market rates. Each factor's impact varies by market and by season. These three factors and their definitions are:

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- Property Selection Criteria - Criteria includes ZIP codes to which federal employees travel, fire-safe certification, and various property demographics. The goal is selecting properties best representing mid-range hotels in each market.
- Time Frame of Data – GSA used data from April 2014 to March 2015.
- Seasonality - To better represent seasonal rate fluctuations, GSA has created seasonal rate periods in many markets where there is a sustained period (two or more months in length) where rates (ADR) are different from the preceding or following period by at least 15%. If there is an ADR difference between 10 and 14% of a sustained period and the occupancy rate level for this same period is 70% or more, this period also becomes a season. Once a season has been defined, the ADR for all seasons is computed using the current lodging data ending in March. GSA uses the same properties for rates and seasonal determination; however, three years' worth of data is used to determine seasons.

Findings:

- The majority of states surveyed with managed travel programs match the federal government rates. Texas, Washington, Montana, Illinois, North Dakota, South Carolina, West Virginia, New York, Utah, Alaska, Oregon, Colorado and the majority of Colleges and Universities match the rates as well.
- New York was the only state with a managed travel program that negotiates lodging rates through CB.
- Most state travel programs do not set rates through CB due to the cyclical nature of contract negotiations, the rapidly changing environment, economic factors and the volatility of the lodging industry.
- Hotels are hesitant to offer different rates to members of each level of government.
- Hotels are reluctant to offer different rates to different unions within state government whose contracts are in the negotiation process.
- Hotel yield management systems are so advanced that rates fluctuate by the minute to compensate for fluctuations in supply and demand.
- A dollar difference in rate can mean the difference between getting a room and not getting a room.
- Federal rates are more reasonable in 80% of all major city centers where the state does business making them preferable to state rates in almost all markets. State employees are unable to get a room when competing in markets where the federal government has a significant presence.
- Hotels prefer a single "government rate" that can be loaded during the federal government procurement cycle to save them time, money, resources and

mitigate the rate confusion that is prevalent in the industry related to state, local and federal government lodging rates.

Environmental Scan/Future Construction
- For the third year in a row, San Francisco International Airport (SFO) has seen an increase in passenger traffic. Sacramento International Airport (SMF) has seen increases as well during the same time period.
- Travel and tourism is going through explosive growth in these same city centers, however new hotel construction has not kept pace.
- A proposed $500 million dollar expansion of the San Francisco Moscone Center that broke ground in 2015 will continue to exacerbate an already saturated conference/convention market.
- A proposed $520 million expansion of the San Diego Convention Center is moving forward which will give San Diego the West Coast's largest contiguous exhibit hall and ballroom, which will help it retain its jumbo annual Comic-Con and allow it to host new large events.
- The Sacramento market is poised to go through significant change with the opening of the upcoming arena and building boom in the city center.
- San Francisco estimates only 800 additional rooms will be added to the compressed inventory over the next 2 years.

Alternatives:

	#1 Remove lodging rates from the Collective Bargaining process and match Federal Room Rates	**#2 Business As Usual**
Pros	▪ Access to a huge amount of room inventory throughout California ▪ Simplified process of implementing a Managed Lodging Program the size and scope of what would be required to meet the state's unique and varied requirements ▪ DGS/STP could concentrate on negotiating money saving amenities, such as parking, internet access, breakfast and	▪ Reduction or outright elimination of state rates offered by our lodging partners due to the inflexible nature of our current processes ▪ Increased costs due to the unavailability of rates and space at desired properties close to our state business ▪ Addition of massive amounts of Excess Lodging Rate Requests as the San Francisco, San Diego, Los Angeles and Sacramento markets become

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	early check-in. As well as 6 pm day of arrival cancellation policies ▪ DGS/STP could focus on ADA, Fire and Life Safety requirements and other issues as we entered into contractual relationships with our lodging partners ▪ Simplified rate structure would eliminate rate confusion between all levels of government and our lodging partners ▪ Clear and consistent booking requirements and policies. ▪ Auditable data for future negotiations ▪ Enhanced reimbursement process with a clear list of contracted properties to choose from ▪ Vetted list of contacted lodging establishments for state sponsored meetings and conferences	more compressed and the state traveler gets priced out of the market ▪ Traveler frustration and confusion over the state's inability to address these issues and provide reasonable solutions
Cons	▪ Commitment of resources ▪ Three control agencies, 12 unions and 21 bargaining units must agree on joint process and procedures ▪ Timing is critical and we have to act fast---not something the state does well	▪ No commitment of resources ▪ Current process will continue to adversely impact state business with no relief in sight

Conclusions:

- Resources needed to establish and maintain a Managed Lodging Program with the federal rates as a baseline are substantial and achievable.
- Tech, tourism, sports events, healthcare, biotech and government will continue to compete for a finite number of hotel rooms in our major city centers.

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- State government rates will be drastically reduced or eliminated if we do nothing.
- It is premature to commit to a Managed Lodging Program if that problem may be resolved or reduced by implementing an internal process change such as removal of lodging rates from CB.
- The state will have to find a way to adjust rates in response to travel/tourism expansion and market changes without adding additional paperwork to the reimbursement process.

Recommendations:

- Meet and confer with all 12 unions and 21 bargaining units as well as all control agencies and those departments with a significant amount of lodging spend to discuss the possible change and the related pros and cons.
- Secure consensus from all stakeholders including, but not limited to the 12 labor unions, all agencies and departments, frequent travelers and the California Human Resources Department (CalHR) and State Controller's Office (SCO) to remove lodging rates from the CB process.
- Match federal rates in all markets nationwide.
- Issue a Management Memo to notify all agencies of the new policy.
- Update all travel related policies and procedures relating to lodging.
- Educate all users of the state's travel program.
- Proceed with targeted negotiations in the major markets to gain rates at or below the federal rates with added amenities.
- Adjust, redeploy or reallocate STP staff to support the new Managed Lodging Program.
- Adjust the online booking tool, Concur Travel to reflect the new rates.
- Train departments, CalTravelStore and our lodging partners on the details of the state's Managed Lodging Program.
- Work with our lodging partners to create a single rate code to provide consistency in the collection of our lodging spend data.
- Work with all stakeholders, including but not limited to members of the unions, state agencies and our partners in the lodging industry to continuously improve the program with their input.

Approved / Disapproved:		Approved / Disapproved:	
Deputy Director	Date	Director	Date