

Lodging Econometrics' Forecast for Moderate Supply Growth in '07 and '08 Remains on Track

2007-04-19

Construction Starts are Quickening, up 22% Year Over Year

Lodging Econometrics (LE), the Global Authority for Hotel Real Estate, in its 1Q report to the Lodging Industry indicated that its forecast for New Hotel Openings in '07 is 1,031 hotels having 103,367 rooms, a slight adjustment downward after fewer hotels than expected opened in the 1st Quarter.

Patrick Ford, President of LE, said. 'This is a gross growth rate of 2.2%, down one tenth of a percentage point and will net to approximately 1.6% after accounting for guestroom closings. '07 will see the first surge of Condo Hotel units coming online. 50 hotels having 8,857 Condo units are scheduled to open, amounting to 9% of all New Openings for '07.'

Ford continued, 'For '08, we raised our forecast for New Openings by 6,500 rooms to 135,779. That's a 2.9% gross growth rate, up two tenths of a point. The increase is directly related to the acceleration of New Project Announcements over the last nine quarters, which has quickened the pace for Construction Starts. For the last four quarters Construction Starts were reported at 138,590 rooms, up 113,710 rooms or 22% from a year ago.'

Indications point to a pick up in the pace of New Openings beginning this fall with a further acceleration expected in '08 and continuing into the next decade.

New Project Announcements continue to accelerate as developers report a slowing in the rate of construction cost increases brought about by decreases in new home construction and less price pressure for building materials.

Ford stated that the Total Construction Pipeline escalated forward to 4,281 projects having 568,318 guest rooms at the end of 1Q. The Pipeline is now about 15% higher than the peak reached in 1999. Some tightening of lending terms, as reported by the Federal Reserve over the last year, have not as yet, had an affect on lodging development. Without any tightening in the capital markets, the Total Pipeline may well grow beyond 600,000 guestrooms in '07.

An Acceleration in Economic Growth Would Lift Hotel Demand

The public discussion about the future direction of interest rates seems interminable. Will the Fed raise rates to offset threats to inflation or will they lower rates to stimulate the economy? Or, are we in a Goldilocks situation: the economy's ok, not too hot, not too cold? The discussions have been on going for months. With GDP slowing, there is little question that our full employment economy is at a pause and is in need of stimulus. So too is hotel demand.

Somewhat surprising, the rate of demand growth slowed to 1.1% in '06. 2001 and '02 are the only two years out of the last 14 with lower growth rates. Of specific concern, four of the last eight months experienced negative demand growth. The short falls are impacted to a degree by 'hurricane related comparisons'. Gateway cities are experiencing declines in international travel, but hotels with solid group bookings have been somewhat able to offset those declines.

The Top Markets are of Growing Concern

The Top 25 Markets have one third of all Open and Operating guest rooms and account for approximately ±43% of the industry's revenue. In the compilation of industry-wide operating statistics these markets are truly the industry's bellwether.

At 1Q there are now 10 markets with more than 50 construction projects in the Pipeline, up two projects, quarter over quarter (QoQ). 10 markets have more than 8,000 rooms in the Pipeline, also up two QoQ. 16 of the markets have greater than 10% of their current census room count under development. Four high growth markets exceed 20% of their census count: San Antonio, Phoenix, San Diego and Washington.

From a demand perspective, 12 of the 25 markets showed actual declines in demand in '06, as reported by Smith Travel. In '07, 14 markets started the first two months with negative demand.

Lodging demand is also in a pause and is in need of stimulus to reverse declining demand trends that have already set in and to provide some buffer for the Construction Pipeline that is just beginning to unfold.

It seems early to be seeing these demand declines. If trends hold it would mean occupancies are topped out for the cycle, and that room rate and RevPAR growth will moderate as well. Room revenue and profitability should continue to improve in '07 and '08, but we might be seeing an early indication that this will be an eight year peak-to-peak lodging cycle rather than a 10 year cycle that an economic burst could generate.

Development Risks are Elevated

Development is driven by the capital markets. Both debt and equity have been readily available at attractive rates. Lenders are aggressively competing for development loans. There is a flood of capital in the market looking to be placed.

It may seem an attractive scenario, but it is also a time to be cautious. Developers need to be very discriminating moving forward. Go/no go development or acquisition/reinvestment decisions should not be made without a thorough review of Pipeline projects for the market under consideration.

A forecast for New Openings three years forward should be studied to determine whether there is room in the market for a new project. An assessment of New Openings over this past two years should be made to see if there is already an absorption problem. A meticulous project-by-project inspection seems essential before making investment decisions this late in the cycle.

In just a few short months demand growth has decelerated. We are in a late cycle slowdown looking for economic stimulus to accelerate us forward. A boost in GDP growth in the second half of '07, extending into '08, would provide the spark in demand the industry is looking for. A return to lower, more traditional, but more stable patterns is the desired result.

Lodging Econometrics (LE) of Portsmouth, NH is the global authority for hotel real estate. LE conducts Supply Side research for all markets, developers and brands and companies in: U.S.; Canada; Mexico, Central America and the Caribbean; Europe; Asia; Middle East; South America; and Africa.

This article comes from Hotel News Resource

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