

Lodging Econometrics Industry Outlook for 2008 Reports a Record Construction Pipeline of 5,438 Projects with 718,387 Rooms
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Changing Economic Conditions to Impact Development in 2008

Lodging Econometrics (LE), the Global Authority for Hotel Real Estate, announced in its 2008 Outlook for the Lodging Industry that the Construction Pipeline stood at 5,438 projects and 718,387 guestrooms at the end of 4Q 2007, breaking through the 700,000 guestroom barrier for the first time.

'It represents an impressive 36% year over year (YoY) increase for both projects and guestrooms. Further, in 4Q guestroom counts increased 10% quarter over quarter (QoQ), the largest quarterly increase in almost three years,' said Patrick Ford, President.

	Construction Pipeline						
	At 4Q 07		At 4Q 06		Variance YoY		% Chg.
	Proj.	Rms.	Proj.	Rms.	Proj.	Rms.	Rms.
Under Construction	1,565	223,977	1,237	166,703	328	57,274	34
Scheduled Starts, Next 12 Months	2,563	315,995	1,769	228,556	794	87,439	38
Early Planning	1,310	178,415	987	134,679	323	43,736	32
Total Construction Pipeline	5,438	718,387	3,993	529,938	1,445	188,449	36%

Source: Lodging Econometrics, Portsmouth, NH, the Global Authority for Hotel Real Estate

According to Ford, 'The development boom is led by projects in the upscale and mid-market sectors, which together make up 83% of the non-casino projects and 76% of the guestrooms in the Pipeline. These chain scales include the high profile brands from the top franchise companies - Marriott, Hilton, InterContinental, and Choice, as well as Best Western. These companies had an outstanding year selling their family of brands both to developers for new construction and to investor groups interested in reflagging their open and operating hotels.'

In Q4, the number of New Projects Announcements reached a cyclical high of 951 projects/116,590 rooms, a clear reflection of optimistic developers who anticipate the lending markets will have stabilized and approached normalcy when they are ready to seek financing.

New Hotel Openings Are Increasing

In 2007, the expanding Pipeline began to unfold in earnest, with 985 hotels/100,507 rooms opening, a gross supply growth rate of 2.2%. This is the first year since 2001 that more than 100,000 newly constructed rooms opened.

	Forecast for New Hotel Openings		
	Hotels	Guestrooms	Gross Supply Increase (%)
'09 (E)	1,456	166,236	3.4
'08 (E)	1,208	133,628	2.8
'07 (A)	985	100,507	2.2
'06 (A)	735	78,949	1.7 %

Source: Lodging Econometrics, Portsmouth, NH, the Global Authority for Hotel Real Estate

LE's revised forecast for New Openings in 2008 changed little at 1,208 hotels/133,628 rooms, a 2.8% gross supply increase. The 2008 forecast is almost completely derived from hotels already under construction. The net supply increase should finish around 2.5%, as LE expects a decline in operating hotels going offline for alternative use.

The forecast for 2009 is 1,456 hotels/166,236 guestrooms, a 3.4% gross growth rate. While these projections already account for anticipated market conditions, 2009 could decline slightly if economic and lending conditions worsen more than expected.

The Fed Acts to Coax Lenders from the Sidelines

As late as Q4, developers hoped that the residential real estate mortgage and lending crisis would soon be resolved and not seriously interfere with lending for hotels going forward, nor slide over and affect the broader economy. That was not the case, as seen with the abrupt economic and lodging declines in December and January.

Unfortunately, the mortgage crisis lingers on, with the full impact on lender's balance sheets yet to be fully revealed. Investment and retail bankers think it's in their best interest to program write downs over several quarters in order to recapitalize at a more controlled pace. More write-off's and profit shortfalls are expected through early fall. To complicate matters, bad loans in other sectors - credit cards, auto loans, etc. - are surfacing. As a consequence, instead of lending, banks are conserving cash assets to cushion against future balance sheet shock brought by additional write-downs, the possibility of trouble in other debt instruments and their own profitability declines.

In an effort to temper the credit crisis, the Federal Reserve started a series of innovative auctions in December to infuse banks with capital at reduced rates. These emergency auctions are scheduled to continue into the Spring and are meant to encourage banks to be more proactive lenders.

In a surprise move on January 22, the Fed then reduced the Funds rate by three quarters of a point, the largest decrease ever. This unusual action, almost certain to be followed by further rate reductions, is aimed at stimulating lending and preventing the economy from fading into recession. The bottom line for the economy: Lenders simply have to resume lending.

While hotel developers might have successfully waited out a difficult, yet contained lending crisis, December and January statistics show that the crisis is no longer contained. The broader economy is now being seriously impacted by the reverberating credit crunch. In turn, the lodging industry's operating results have been impaired, providing developers with an additional concern.

Slowing Demand Could Pose a Challenge

Guestroom demand growth is the key metric to monitor. The consumer's confidence is shaken. He's beset all around by mortgage foreclosures and rising unemployment. His basic needs are rapidly inflating: food, energy, gas, medical and education. He's losing equity in his home. He's maxed out on credit cards, and now has declines in his stock portfolio. He has few places left to source liquidity.

This is where the hotel industry could be vulnerable, with consumers cutting back on vacations and getaways, and shopping aggressively for the best rates in only the hotels they can comfortably afford. Resort destinations, boutique hotels and hotels in CBD locations attracting heavy weekend business will be the first to feel the pinch.

Facing potential declines in profitability, business investment may slow. Layoffs are likely. Travel policies will tighten. Public companies face an additional burden, with a falling stock market and the attendant balance sheet disruption. Already down $\pm 13\%$ from October's highs, the stock market is officially in correction. Bear market territory is possible, a 20% drop from the highs, if the market continues to fall.

Declining Demand May Mean a Shortened Lodging Cycle

The Fed's rate reduction program coupled with the President's proposed \$150 B Stimulus package are clear indicators that the economy is faltering and may be in danger of falling into a recession.

December and January operating results may indicate that a turning point has been reached in the lodging industry too. Slower demand ahead would mean less ability to increase room rates and grow RevPar. The reality of a new operating landscape would likely call an end to this lodging cycle. And, if there is a shortened cycle, it could come with a bang not a whimper. Since the 2003 bottom, only 2004 and 2005 saw YoY demand grow in excess of 3%, while after the 1992 bottom, demand growth exceeded 3% in seven of the following eight years.

Critically important for the industry, a shortened cycle would mean lodging's recovery from the '03 bottom would be over before the Construction Pipeline could substantially unfold. Curtailed demand growth would not be sufficient to offset new supply growth coming online over the next three years, even though that growth would not be excessive by historic standards. It would be like calling off the ball game in the seventh inning because of rain.

Ramifications for Developers and the Construction Pipeline

From a developer's and real estate owner's perspective, a lot is riding on the further Funds rate reductions and the stimulus package. The strategies are designed to encourage more lending, stabilize GDP declines and prevent the economy from falling into a recession. However, the effects of the stimulus package may not be noticeable until late summer, while the Fed's rate cuts could take at least nine months to stimulate change.

As a result, there will be fewer New Project Announcements in 2008 across all chain scales. In particular, fewer Boutiques, unbranded hotels and mixed use CBD and Resort projects will be announced into the Pipeline, especially those with private residences. The Condo Hotel boom is over, while the number of new Timeshare announcements is certain to decline.

For projects already in the Pipeline, there could be an increase in cancellations, as developers continue to have difficulty sourcing financing. Projects not already Under Construction could be delayed, as both financing and the underwriting process take longer to complete.

Properties under 200 rooms, with the top brands and the most experienced developers - having conservative proformas that account for anticipated supply increases in the years ahead - will be the most attractive to finance during the current turmoil, either through local institutions or a declining number of national lenders. There will be little opportunity to finance larger hotels until the environment changes.

For an owner of an open and operating hotel who has a loan coming due in the near term, it will be difficult to access new financing, even more so if the property is over-leveraged and there is little equity in the investment. Renovation and repositioning programs will also be problematic, as lenders shy away from financing on forward projections in a softening market.

All in all, for developers of new properties and owners of open and operating hotels, 2008 is expected to be a challenging year. Most of the issues for lodging developers, investors and operators are in front of us:

The lingering banking and credit crisis

A declining economy, perhaps a recession

Softening guestroom demand, room rates, RevPar and operating profits

Fading real estate values

A lodging cycle cut short

If anything, it should be an interesting year. So much is yet to play out.

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.

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