

## PKF-HR Revises 2008 Lodging Industry Outlook in New Report

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### Lower RevPAR Forecast Reflects Impact of Recession

PKF Hospitality Research (PKF-HR) today announced that it has lowered its 2008 forecast for a key hotel industry metric, revenue per available room or RevPAR, from up 4.5 percent to up a below-average 3.0 percent. The new RevPAR forecast appears in the firm's recently released first quarter 2008 Hotel Horizons(SM) report. The change was based on revised projections by Moody's Economy.com, PKF-HR's primary economic forecasting agency, which now is calling for a U.S. recession this year due to deteriorating economic fundamentals.

Declining economic fundamentals, fueled by the turmoil in the capital markets and the escalating price of oil, portend a much weaker domestic economy for the months ahead, according to Economy.com. Its 2008 estimate of Real Personal Income Growth, a key measure of lodging industry performance, now is only 1.6 percent, down from an estimate of 2.6 percent as recently as the fourth quarter of last year. While this is certainly not good news for lodging industry participants, PKF-HR still believes that the typical U.S. hotel will enjoy increases in both revenues and profits, but at a more modest pace.

"Our econometric forecasting model focuses on Real Personal Income and Total Employment as the primary indicators for lodging demand," said Mark Woodworth, president of PKF Hospitality Research. "These economic measures are forecast to exhibit minimal growth during the first part of 2008, but start to climb back to their equilibrium levels during the latter months of the year. Accordingly, we are forecasting the demand for lodging accommodations to inch up 0.9 percent in 2008. This pace of demand growth is approximately half of the long-term annual average, but still represents a net gain in accommodated room nights for the year. When looking at 2008, we believe that U.S. hotel owners and operators will struggle to grow their revenues and profits, but market conditions will not be as damaging as we saw back in 1991 or 2001."

Woodworth noted that the 2008 first quarter is expected to be moderately positive for hotels, but added that lodging performance will deteriorate as the year progresses. He suggested that the downswing should be relatively short-lived, however, with a turnaround expected in the 2009 first quarter.

### **Supply and Demand**

Unfortunately for U.S. hotels, the forecast of sluggish demand growth occurs during a period of increases, albeit modest ones, in lodging supply. In 2008, PKF-HR estimates that a net count of 115,000 new hotel rooms will become available. With the demand for hotel rooms lagging the supply of new inventory, the U.S. national average occupancy rate is expected to decline a full point, from 63.2 percent in 2007 to 62.2 percent in 2008.

"The pipeline for hotel development has swelled in recent years to extremely high levels, but the high cost of building materials and disciplined lending has limited the number of projects that actually made it to the construction stage. The increase in supply we are observing in 2008 and into 2009 is related to hotels begun prior to the onset of more restrictive lending practices," Woodworth said.

Further tightening within the lending community, combined with the continued strength in commodity prices, will once again be a formidable hurdle for developers in most markets in 2008 and 2009. Therefore, looking down the road, PKF-HR is projecting a lull in new supply openings from 2010 through 2012. "Forecasts of economic recovery, plus a slowdown in the pace of new supply, will lead to increasing occupancy levels beyond 2009," Woodworth explained.

### **Inflation**

Despite the increased competition and declining occupancy levels in 2008, PKF-HR is forecasting average daily room rates to rise above the expected rate of inflation. "After analyzing historic periods of economic recession and rising inflation, PKF-HR found that hotel managers have been able to pass along inflationary increases to their guests," Woodworth observed. "Accordingly, we are forecasting room rates to rise 4.7 percent in 2008. This exceeds both the 2.7 percent projected pace of inflation for 2008, and the 3.5 percent long-term annual average change in room rates."

While inflation will help to boost room rates, it also will play a role in the rise of hotel operating costs. With fewer occupied rooms, hotels will not benefit from the ancillary revenue generated in the restaurant, lounge, retail shops, and recreational facilities. Dampened revenue growth, combined with rising operating costs, will result in a fairly dramatic slowdown in the pace of profit growth. "The forecast RevPAR gain of 3.0 percent should translate into an equal 3.0 percent gain in total revenue for the average U.S. hotel in 2008. Hotel managers will do their best to control costs, but we are projecting operating expenses to rise 3.5 percent on average. The net result will be an anemic 1.7 percent increase in unit-level profits for the year," Woodworth said. "Owners are not going to be happy with such listless gains in their bottom line, but the current downturn actually looks rosy when compared to what was experienced during the past two economic recessions."

### **Winner and Losers**

In the lodging industry, performance is heavily influenced by local economic conditions, as well as the segment orientation of properties. Therefore, it is not surprising that the outlook for major cities across the U.S., as well as the different chain-scale segments, varies greatly.

Of the 50 major U.S. markets for which PKF-HR prepares a Hotel Horizons(SM) forecast report, the properties in 29 of these cities are expected to achieve RevPAR growth in 2008 at or above the pace of inflation. On the other hand, hoteliers in 21 of the nation's largest market areas will struggle to achieve profitable gains in revenue. "We realize that news of national gains in demand and profits will not appease the owners of hotels in competitive markets like Fort Worth or Long Island. However, if you are a lodging investor in Austin or Phoenix, strong increases in ADR should lead to profitable gains in revenue," Woodworth pointed out.

Among the different industry chain-scale categories, properties in the popular Midscale without Food and Beverage segment are forecast to achieve the greatest increases in revenue. "Properties in the Midscale without Food and Beverage chain-scale possess both market and operational characteristics that we believe enhance their ability to withstand an economic recession. Modest room rates will be attractive to travelers looking to control their travel budgets. In addition, the limited scope of operations makes these properties less vulnerable to increases in labor and commodity costs," Woodworth observed. PKF-HR forecasts RevPAR for the Midscale without Food and Beverage segment to increase 3.4 percent in 2008.

At the top end of the market, luxury hotels are forecast to suffer the greatest decline in occupancy, but benefit from the strongest increase in room rates. "Companies will be looking to control their travel costs and, therefore, will institute policies that may prevent their employees from staying at luxury hotels. However, this segment has some of the most loyal guests that will only settle for five-star service. These people typically have the personal or professional wealth to pay the price, so management can continue to increase room rates even in times of an economic recession," Woodworth noted. PKF-HR forecasts that a 5.8 percent increase in average daily room rates will offset a 3.8 percent decline in occupancy within the Luxury segment.

"From a market and financial perspective, we believe the U.S. lodging industry is in a healthier position entering this economic recession than prior recessions marked by sliding income and employment. External factors such as inefficient tax legislation or lax underwriting standards have not spurred excessive new construction, and hoteliers in most markets have, and will continue to, benefit as a result. Therefore, we believe the underlying foundation for the solid market and operational conditions that exist in the industry today are steadfast enough to withstand this recession," Woodworth concluded.

U.S. Hotels	
Forecast Change - 2007 to 2008	
Supply	2.6%
Demand	0.9%
Occupancy	-1.6%
ADR	4.7%
RevPAR	3.0%
Unit Level Total Revenue	3.0%
Unit Level Operating Expenses	3.5%
Unit Level NOI*	1.7%

Note: \* Before deductions for capital reserve, rent, interest, income taxes, depreciation, and amortization.

Source: PKF Hospitality Research, March 2008 Hotel Horizons Report

Hotel Horizons reports are prepared for 50 major U.S. markets, as well as six national chain scales. Each report contains a six-year forecast of supply, demand, occupancy, ADR, and RevPAR, as well as other valuable economic and hospitality information. To purchase Hotel Horizon reports, visit the PKF-HR website at [www.pkfc.com/store](http://www.pkfc.com/store), or call (866) 842-8754.

PKF Hospitality Research (PKF-HR), headquartered in Atlanta, is the research affiliate of PKF Consulting, a consulting and real estate firm specializing in the hospitality industry. PKF Consulting has offices in Boston, New York, Philadelphia, Washington DC, Atlanta, Indianapolis, Houston, Dallas, Bozeman, Sacramento, Seattle, Los Angeles, and San Francisco.

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