U.S. Hotels To Bottom Out In 2009

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PKF Forecasts Two Years Of Declining Lodging Demand

A new study released today by PKF Hospitality Research (PKF-HR) reveals that demand for U.S. hotel rooms will contract for the next two years. Compounding the negative impact of declining demand is a projected concurrent increase in supply. PKF-HR is forecasting a combined net increase in 2008 and 2009 of nearly 275,000 new hotel rooms compared to year-end 2007. This represents a 6.2 percent jump in accommodations over this two-year period.

With supply and demand levels moving in opposite directions, occupancy rates are projected to decline in both 2008 and 2009. Considering the 0.3 percent occupancy decline reported by Smith Travel Research in 2007, the result is three consecutive years of fewer accommodated roomnights for the average U.S. hotel.

These findings are based on the recently released third quarter 2008 edition of Hotel HorizonsSM, PKF-HR's quarterly forecast report for six U.S. chain-scales and 50 major markets. The forecast was released at The Lodging Conference 2008 in Phoenix this morning.

'Because of the extended slowdown of the U.S. economy, compounded by the negative consequences stemming from airline capacity cutbacks, we are now forecasting a 0.2 percent decline in lodging demand in 2008, followed by another loss of 1.1 percent in 2009,' said Mark Woodworth, president of PKF Hospitality Research. 'According to data from Smith Travel Research, this is the first time since 1988 that the U.S. lodging industry will experience two consecutive years of decline in lodging demand.'

Slow ADR

Through the first half of 2008, the one saving measure for hotel owners and operators was the ability to maintain rate integrity. Despite a 2.5 percent decline in occupancy during the first six months of the year, managers were able to raise their average daily room rates (ADR) by 4.2 percent. Persistent yield management plus contractual rate agreements helped to buoy room rate levels.

'With supply and demand moving in opposite directions, the typical hotel manager will not be able to maintain their aggressive approach to raising room rates,' Woodworth commented. 'Accordingly, we are forecasting ADR growth for the entirety of 2008 to be 3.6 percent, followed by a minimal 1.3 percent gain in 2009.' Looking forward, PKF-HR does not foresee ADR growth to exceed the pace of inflation until 2012, according to Woodworth.

Declining occupancy, plus slow ADR growth, combines for a dismal near-term outlook for revenue increases. PKF-HR projects RevPAR to increase a mere 0.8 percent in 2008, followed by a 3.2 percent decline in 2009. Given the strong contribution of rooms revenue, PKF-HR is forecasting total hotel revenues to remain virtually flat in 2008 (0.2 percent increase) and then decline in 2009 (negative 2.5 percent).

Expense Controls

'Historically, U.S. hotel managers have answered reductions in revenue with more vigilant cost containment. Fewer rooms occupied do lessen the need for staffing, plus inspire management to find expense reductions throughout the operation. Unfortunately, less controllable costs, such as utilities, property taxes and insurance, are on the rise,' Woodworth noted.

PKF-HR believes that average operating expenditures will drop 1.0 percent in 2008, thus allowing unit-level net operating income (NOI) to increase 3.1 percent. However, the forecasted 2.5 percent decline in revenue for 2009 will be too much to overcome. Despite another 2.3 percent reduction in operating costs, the average U.S. hotel is projected to suffer a 3.0 percent decline in NOI during 2009. For the purposes of this analysis, NOI is defined as income before deductions for capital reserve, rent, interest, income taxes, depreciation and amortization.

'Fortunately, the U.S. lodging industry was in good financial shape entering the current trough in the business cycle. Unlike other forms of real estate, lodging was not experiencing any material amounts of foreclosures,' Woodworth said. 'A sample of 1,500 hotels that participated in our annual Trends in the Hotel Industry survey generated sufficient cash from their operations to cover their reported interest payment by a ratio of 1.86. This implies that most U.S. hotels can withstand a fairly substantial decline in NOI and still have the ability to meet their debt service obligations.'

On The Horizon

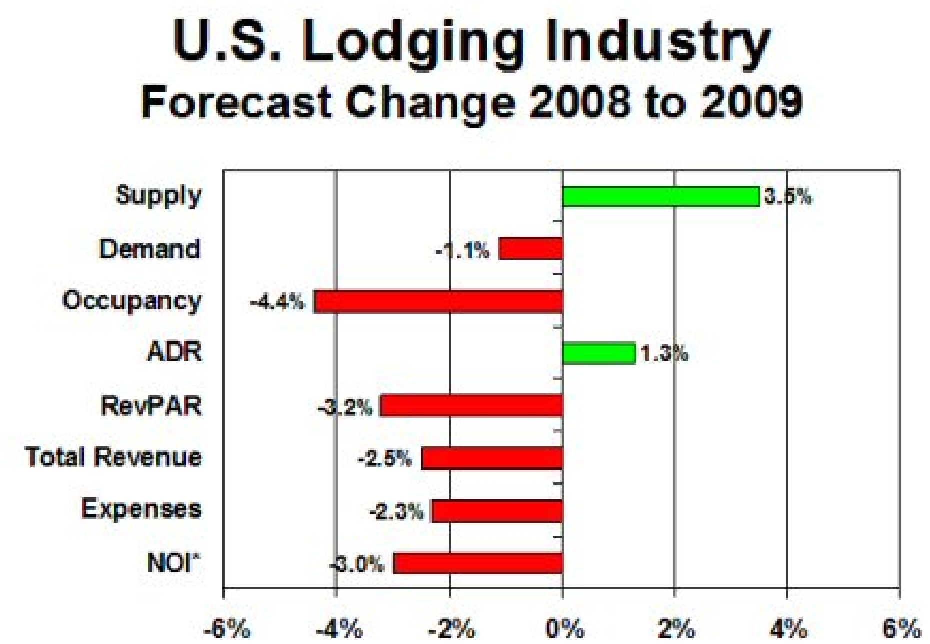
'The current credit crisis may be unfairly punishing developers with sound market and financially justified projects. However, the lodging industry will eventually benefit from the near-term development difficulties,' Woodworth noted. 'PKF-HR believes the existing restrictive financing environment will linger into 2009, thus delaying or preventing the start of hotel projects currently in the pipeline. Given the 12 to 24 month time needed to construct most hotels, PKF-HR projects a window of one to two years when the amount of hotel openings will be very limited. The pace of new supply growth is forecast to drop to 1.4 and 1.8 percent, respectively, in 2010 and 2011.

’By 2010, we will start to see a reversal of current trends. While the pace of supply growth will be waning, we will start to see a return in the demand for lodging accommodations,’ Woodworth said. PKF-HR is forecasting a 2.2 percent increase in demand for 2010, followed by another 3.1 percent gain in 2011. With growth in demand exceeding supply, national occupancy levels will begin to rise again in 2010 and continue to increase through 2012.

Despite the forecast of growth in occupancy from 2010 through 2012, the outlook for increases in ADR is somewhat constrained. ’As we have observed during the initial years of historical periods of recovery, occupancy gains precede ADR growth. Given the depth of the projected lodging industry slowdown in 2009, the newly built competitive properties added to most markets, and forecasts of below average CPI growth, we are forecasting average daily room rates to increase at a compound average annual rate of 2.7 percent, just equal to the long-term rate of growth for ADR,’ said Woodworth.

A Trough In 2009

’Seven years since the terrorist acts of 2001 - the primary event that led to the last low point in the U.S. lodging performance - a new, but familiar, set of circumstances is propelling the industry towards the next trough. Capital market turmoil is undermining asset values, a situation last seen in the late 1980’s and early 1990’s. The projected industry slowdown won’t be as deep as the ones observed in 1981 or 1991, but it may take a little longer to fully recover,’ Woodworth concluded.



Note: * Before deductions for capital reserve, rent, interest, income taxes, depreciation, and amortization.
Source: PKF Hospitality Research, Third Quarter 2008 *Hotel Horizons*SM Report

To purchase a third quarter 2008 Hotel HorizonsSM report for the United States, or one of 50 individual markets, please visit the firm’s online store at www.pkfc.com/hotelhorizons, or call (866) 842-8754.

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