Chicago Hotel Industry Outlook: 2008 – 2011

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Introduction

According to a recent article in Crain's Chicago Business[1] the Chicago area's gross metropolitan product declined both in the fourth quarter of 2007 and the first quarter of 2008, suggesting a regional economic recession is already occurring in the Chicago area. Interviews with hotel managers in Chicago also indicate that hotel demand declined significantly in the first quarter of 2008 compared to a year earlier. The slumping economy, poor weather, and an Easter holiday that fell in March had significant negative effects on hotel demand during the first quarter of 2008.

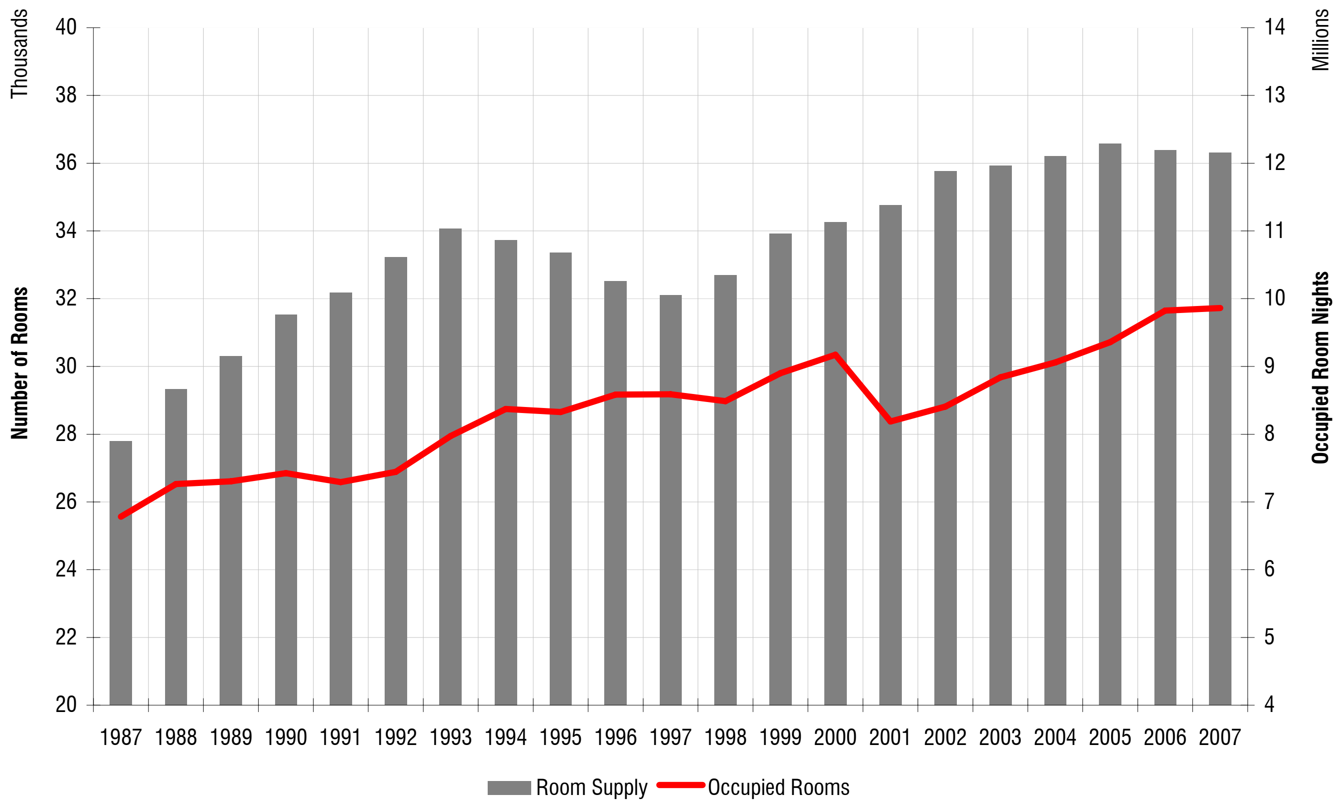
Despite continued signs of an economic slowdown, hotel demand has begun to rebound significantly in the second quarter of 2008 in Chicago. This suggests that factors other than the national and regional economy are affecting hotel demand locally. Major urban development projects, new convention business, strong performances by local sports teams, and continued excitement about the prospect of hosting the 2016 Summer Olympics helped demand rebound in the second quarter of 2008. This article examines several of the historical trends and future sources of supply and demand growth that are expected to shape the Chicago hotel industry's performance during the next three to four years. It concludes that the near-term outlook is mixed for Chicago's hotel industry, with hotel revenues expected to increase even as occupancies are likely to decline.

Historical Overview of the Chicago Market

Over the past 21 years, the number of rooms in Chicago has increased by approximately 9,900 units from 1987 through the present, or about 35.6%. Most of this development occurred in two distinct periods of industry expansion. Between year-end 1987 and 1993, the citywide hotel inventory increased by nearly 6,300 rooms, representing a supply increase of approximately 22.6% over the six-year period. The hotel room supply decreased by roughly 2,000 rooms between year-end 1993 and 1997. A slower, but longer-lasting, expansion period extended from year-end 1997 through 2005, when the hotel inventory grew by almost 4,500 rooms. Supply declined slightly between year-end 2005 and 2007; then several new hotels opened in 2008, increasing supply by nearly 1,400 during the first half of 2008.

The following chart sets forth room supply and room demand in the city of Chicago from 1987 through 2007, as reported by Smith Travel Research (STR)[2].

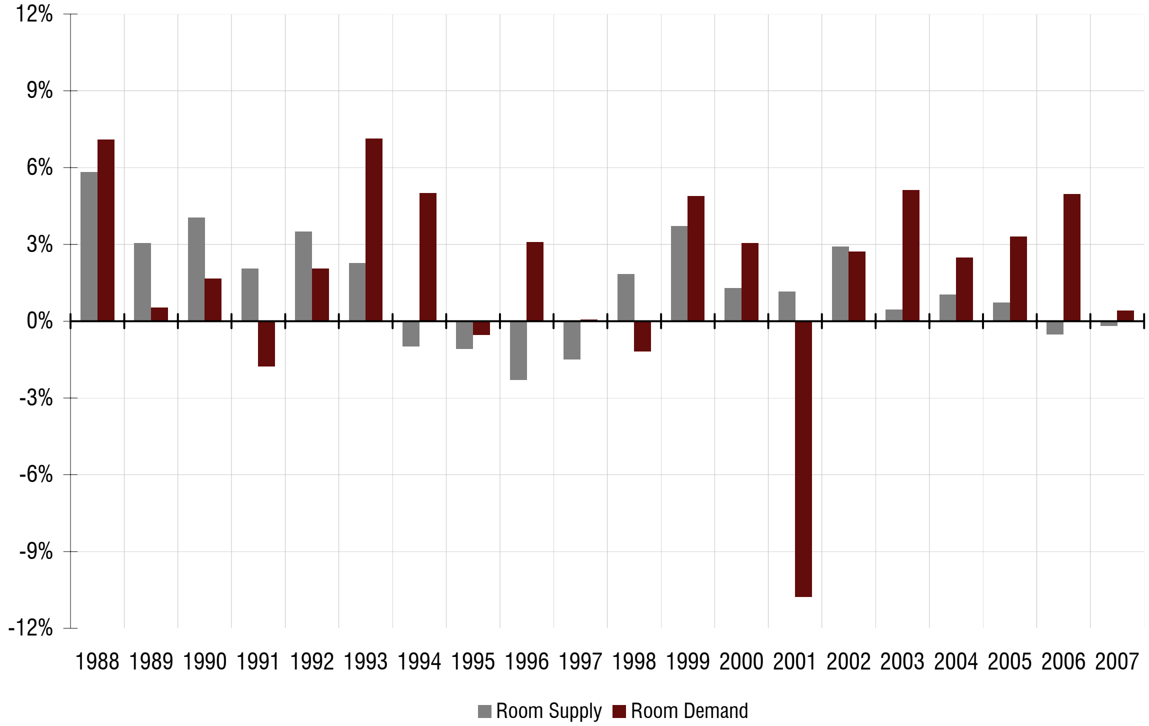
Historical Supply and Demand Trends



Over the long-term, supply and demand appear to move together. But supply trends are often related to the availability and cost of financing because financing is one of the greatest barriers to entry for new hotel development. For example, as interest rates decline throughout the late 1980s and early 1990s, supply grew rapidly. Supply then declined after an upward spike in interest rates in 1993 and 1994 before resuming growth in the late 1990s when interest rates began falling again. At year-end 2007 there were 36,309 hotel rooms in Chicago, reflecting a slight decline in supply compared to 2006.

Demand has increased in 17 of the last 21 years in Chicago. Supply has increased in 15 of the last 21 years. The following chart shows year-over-year changes in supply and demand between 1988 and 2007.

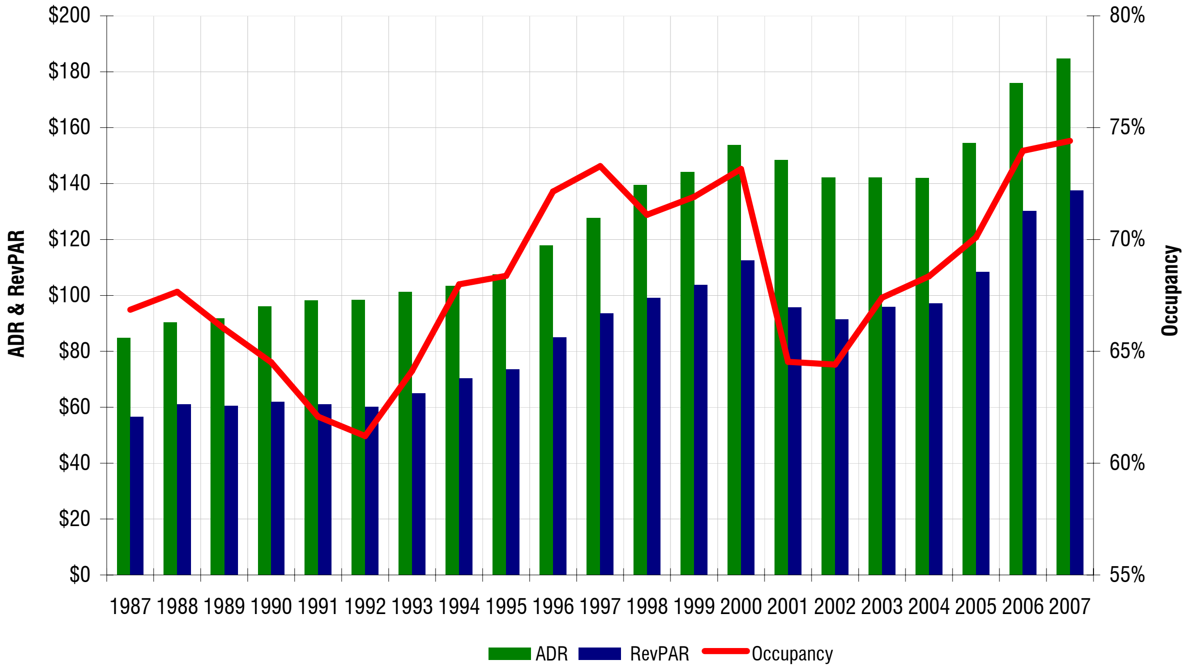
Year-Over-Year Changes in Supply and Demand



The largest year-over-year declines in demand occurred in 1991 and 2001, corresponding with the two most recent national economic recessions. In 2001 demand declined by 10.8 percent, reflecting a national downturn in travel due to economic conditions, geopolitical concerns, and the terrorist attacks that took place in September, 2001. Demand has increased each year since then. Supply decreased for four consecutive years between year-end 1993 and year-end 1997, reversing some of the rapid supply growth that occurred during the previous expansion period. Supply expanded each year between 1998 and 2005 before experiencing slight declines in 2006 and 2007.

Supply and demand have both exhibited trends of long-term growth in Chicago. The historical occupancy and average daily rate (ADR) levels in Chicago reflect the relationships between supply and demand. The measurement of revenue per available room (RevPAR) is a performance indicator that reflects trends in both occupancy and ADR. The following chart shows annual changes in occupancy, ADR, and RevPAR between 1987 and 2007. All three performance variables were at an all-time high in 2007.

Historical Trends – Performance Measures



The Chicago hotel market has experienced discernable business cycles since the late 1980s. A significant downturn in occupancy occurred in the early 1990s, reflecting the combined impact of supply additions and a national recession that slowed demand. RevPAR also declined slightly as a result of the significant declines in occupancy. A recovery began in 1993, as demand grew by 7.1% compared to a 2.5% increase in supply that year. This led to a 4.8% increase in occupancy in 1993, as the national economy began to grow.

By the end of 1994, it was clear that a dramatic improvement in the market was underway. Even as demand grew, supply decreased during the next four consecutive years between year-end 1993 and year-end 1997. During this period, ADR growth accelerated and occupancy continued to increase. This led to substantial increases in RevPAR, which continued through the year 2000, reflecting one of the nation's most sustained periods of economic expansion.

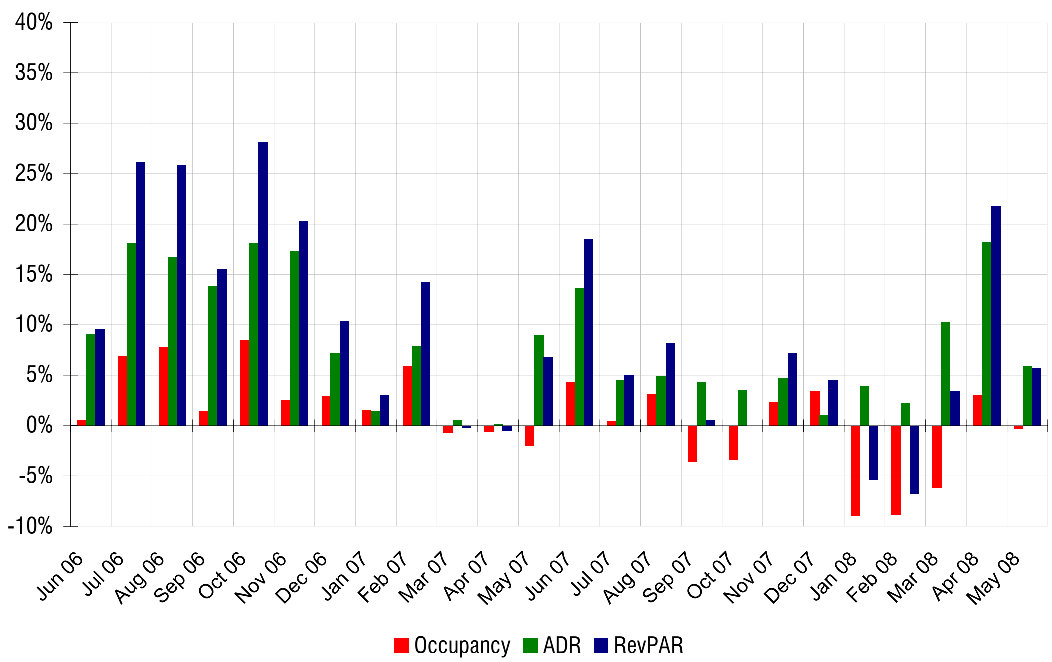
Demand declined sharply in 2001 as a result of a national economic recession and an overall decline in travel related to concerns about safety as well as concerns about the increasing inconvenience of air travel. These conditions led to declines in occupancy and ADR in 2001. During this period, supply continued to increase as projects that had been financed before the recession were already under construction and continued to add to the city's inventory of rooms. Demand rebounded modestly in 2002. But supply growth exceeded demand growth, which led to a further decline in occupancy and room rates. As a result, citywide RevPAR declined to $91.50 in 2002, which was the lowest level in six years.

During 2003 and 2004 demand growth exceeded supply growth, as an economic recovery was underway. This led to increases in occupancy, although rates remained relatively flat as hoteliers continued to focus on growing the occupancy levels at their properties. By 2005 it was clear that a strong recovery was occurring in the industry. Occupancies increased further in 2006 even as hoteliers increased room rates aggressively; ADR grew by 13.9% in 2006, the largest single-year increase in the past two decades.

In 2007 the hotel industry peaked, setting records for the highest occupancy, ADR, and RevPAR levels achieved since 1987, the earliest year for which citywide data records are available. Citywide occupancy among reporting hotels was 74.4% in 2007. The ADR was $184.73. RevPAR reached $137.45 for the year.

The past 24 months illustrates a change in the economic cycle. Hotel performance indicators have swung from consistent strong growth at the beginning of this observation period to a mixed performance during the last 15 months. The following chart shows year-over-year growth, as a percentage of the monthly figure in the prior year, measured by changes in occupancy, ADR, and RevPAR.

Year-Over-Year Percent Changes by Month – August 2005 through July 2007



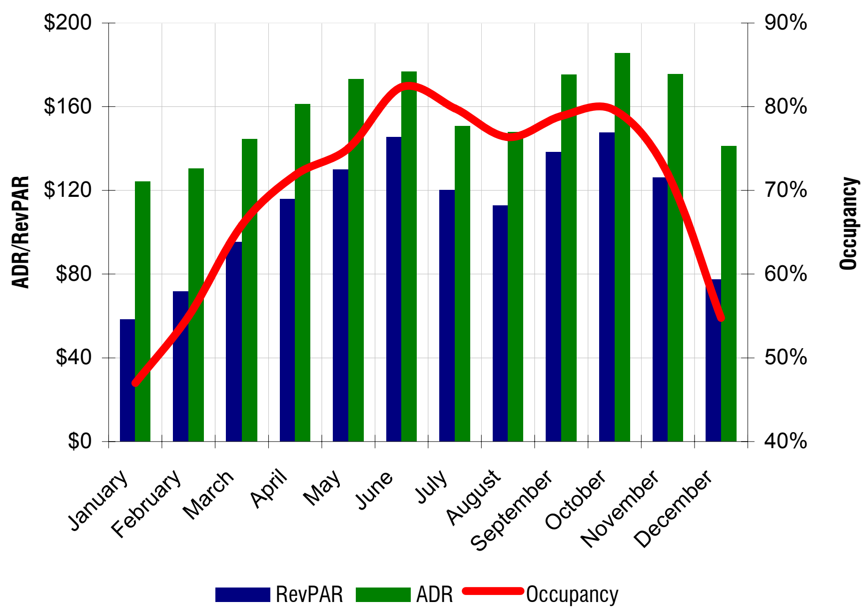
Occupancy has exceeded the previous year's level in 15 of the past 24 months, reflecting changes in the economic cycle. ADR has exceeded the previous year's level in each of the past 24 months, reflecting strength in the industry even in months when occupancy declined. As a result, RevPAR has exceeded the previous year's level in 19 of the past 24 months. Although

March and April of 2007 did not exceed the performance levels achieved in March and April of 2006, this is partly due to the exceptionally strong performance in March and April of 2006. The exceptionally strong performance in March and April of 2006 reflects the fact that two major groups, the American Academy of Orthopedic Surgeons and the National School Boards Association, relocated to Chicago from New Orleans as a result of the effects of Hurricane Katrina. The summer of 2007 continued to set historical records in occupancy, ADR, and RevPAR in Chicago. Then occupancy declined for two consecutive months in September and October of 2007. The national and regional economic downturn was clearly having a negative effect on the Chicago hotel industry by the first quarter of 2008, as occupancy declined in each of the first three months of the year. April illustrated a strong rebound in demand and RevPAR grew substantially in the second quarter of 2008.

Seasonal Patterns

As in many markets, the Chicago hotel industry experiences significant seasonality. Market demand fluctuates predictably in monthly and weekly patterns throughout each year. The following chart shows how occupancy levels, ADR, and RevPAR levels fluctuate from month to month, based on historical monthly average figures since 2002.

Seasonality Patterns by Month



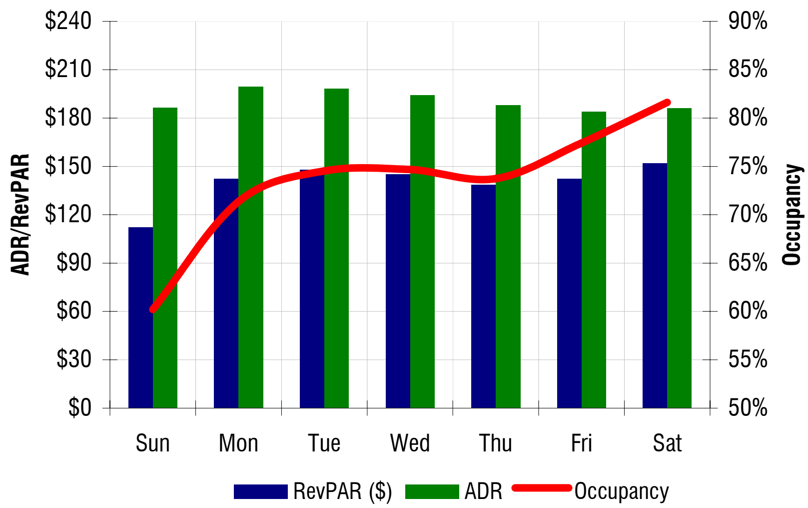
As the preceding chart shows, the late spring months of May and June and early fall months of September and October represent the high seasons for the Chicago hotel industry. During those times of the year, meeting and group demand often peaks, and both commercial and leisure demand levels are also strong. While high occupancies are also attained in July and August, ADR levels during that two-month period are well below those attained in the peak months.

The market's low season includes the winter months of December, January and February, when travel activity throughout all demand segments decreases.

According to STR data[3] from January 1987 through July 2007, the highest monthly occupancy level was achieved in June 2007, at 86.9%. The highest ADR was registered in October 2007, at $224.61. The lowest monthly occupancy was in January 2004, at 40.4%. The lowest average rate was recorded in January 1987 at $76.06.

The following chart indicates how occupancy levels, ADR, and RevPAR levels fluctuate from day to day throughout a typical week in the Chicago market. These figures are based on average performance data from the twelve month period between June 2007 and May 2008.

Day of Week Patterns



Chicago hotels attained the highest RevPAR levels on Saturday, reflecting a particularly strong leisure market during the past 12 months. Historically, RevPAR in the mid-week period, spanning Tuesday and Wednesday, has been relatively high when both commercial and group demand is strong. Chicago hotels typically exhibit their lowest occupancies on Sunday nights, when demand throughout all segments is weak.

Trends in Supply

Five new hotels opened in Chicago during the first half of 2008. The 339-room Trump International Hotel & Tower and the 216-room Hotel Dana are the newest entrants into Chicago's luxury hotel segment. The Blackstone Renaissance is a 330-room upper-upscale renovation project that opened on south Michigan Avenue in downtown Chicago. The 270-room Residence Inn by Marriott and the 253-room SpringHill Suites by Marriott both opened in March of 2008.

During the past five years, a total of 12 new hotels have opened or reopened in Chicago, representing 3,200 hotel rooms. During the same period, nine hotels have closed, representing

601 hotel rooms. Therefore, the net increase in supply was 2,599 rooms between July 2003 and June 2008. The following table lists the openings and closings identified in recent years.

Recent Changes in Chicago's Hotel Room Supply – Past 5 Years

Name of Hotel	Location	Type	No. of Rooms	Opening Date	Closing Date
Amalfi Hotel	20 W Kinzie	Independent	215	Jul-03	--
Courtyard Chicago Downtown	165 E Ontario	Upscale	306	Nov-03	--
Preferred Hard Rock Hotel	230 N Michigan	Luxury	381	Jan-04	--
Hotel Indigo	1244 N Dearborn	Upscale	165	May-05	--
Four Points Mag Mile	630 N Rush	Upscale	226	Jun-05	--
Hampton Inn Theatre District	22 W Monroe	Midscale	135	Apr-07	--
Trump International Hotel	401 N Wabash	Luxury	339	Jan-08	--
Renaissance O'Hare	8500 W Bryn Mawr	Upper Upscale	362	Feb-08	--
Renaissance Blackstone	636 S Michigan	Upper Upscale	332	Mar-08	--
Residence Inn	410 N Dearborn	Upscale	270	Mar-08	--
SpringHill Suites	410 N Dearborn	Upscale	253	Mar-08	--
Dana Hotel	660 N State	Luxury	216	Jun-08	--
Velmar Hotel	2120 W Washington	Independent	(80)	--	Jul-03
Turf Motel	3126 S Cicero	Independent	(43)	--	Dec-03
Marshall Hotel	4114 W Washington	Independent	(45)	--	Jan-04
Julian Hotel	924 W Belmont	Independent	(58)	--	Aug-04
Jonquil Hotel	1600 W Jonquil	Independent	(70)	--	Jun-05
Mystic Hotel	5522 S Indiana	Independent	(51)	--	Jul-05
Stars Motel	6100 N Lincoln	Independent	(54)	--	Mar-06
South Parkway Inn	2600 S State	Independent	(100)	--	Jul-06
Cedar Hotel	1118 N State	Independent	(100)	--	Sep-07
Net Change in Room Supply (past 5 years)			2,599		

Sources: CCTB, HVS, STR

As indicated in the preceding table, the development of new hotels does not always lead to a corresponding increase in overall room supply. As newer, better hotels enter a market, lower-rated or inferior hotels and motels may experience significant downward pressure on room rates. This can lead to the decision to close such properties, thereby reducing room supply in the market area. Alternatively, changes in the highest and best use of land can lead to conversions of hotels into other uses. Recent supply changes reveal a continuing move away from independent brands toward nationally branded hotel products. All of the hotels that closed during the past five years in Chicago were independently branded. Nine of the 12 new hotels that have opened have national brands. Three independent hotels have opened in the luxury and upscale boutique segments.

New Construction & Expansions Planned

The 215-room Affinia Hotel, formerly the Fitzpatrick Hotel, is planned to re-open in the fourth quarter of 2008. No additional hotel openings or closings are anticipated in 2008. Therefore, the overall hotel supply in Chicago is expected to increase by 1,987 rooms from year-end 2007 to year-end 2008.

Twenty-four new or renovated hotel properties are expected to open between July 2008 and year-end 2011[4]. The anticipated new supply represents a mix of luxury, boutique, full-service, and limited-service hotels. Significant barriers to entry, including increasing construction costs, a lack of available sites, and tightened credit markets continue to be key factors when considering construction of new hotels in Chicago. Thus, only the most financially feasible projects are likely to reach completion. The following table sets forth the number of new rooms that are anticipated to become available through year-end 2011.

Room Supply Changes Planned through 2010

Name of Hotel	Location	Type	No. of Rooms	Open Date	Development Phase
Affinia (Fitzpatrick)	166 E Superior	Independent	215	Nov-08	Under Construction
LaQuinta Inn & Suites	1 S Franklin	Midscale	233	Feb-09	Under Construction
Elysian	11 E Walton	Luxury	188	Feb-09	Under Construction
Wit - DoubleTree Hotel	505 N State	Upper Upscale	298	May-09	Under Construction
Grand Imperial Condotel	2014 S Clark	Condo Hotel	170	Jun-09	Planning
Four Points by Sheraton	8201 W Higgins	Upscale	287	Jul-09	Planning
element	8201 W Higgins	Upscale	320	Oct-09	Planning
Staybridge Suites	127 Huron	Upscale	206	Oct-09	Under Construction
Hyatt Place	Clark & Grand	Upscale	216	Dec-09	Planning
Fairmont Hotel Aqua	225 N Columbus	Luxury	200	Dec-09	Under Construction
Fairfield Inn and Suites	Clark & Grand	Midscale	180	Dec-09	Planning
Lakeshore East Tower	375 E Wacker	Independent	224	Jan-10	Planning
aloft Millennium Park	635 S Wabash	Upscale	165	Feb-10	Planning
Fairfield Inn and Suites	5900 S Stoney Island	Midscale	130	Mar-10	Planning
Comfort Suites	320 N Michigan	Midscale	119	Mar-10	Planning
Shangri-la Hotel	111 W Wacker	Luxury	222	Apr-10	Under Construction
Hotel Wacker	111 W Huron	Independent	231	May-10	Planning
JW Marriott Downtown Loop	208 S LaSalle	Upper Upscale	610	Jun-10	Planning
Mondrian Hotel	1118 N State	Independent	200	Dec-10	Planning
Waldorf=Astoria	North Water & Park	Luxury	325	Jan-11	Planning
aloft City Centre	Clark & Illinois	Upscale	250	Jan-11	Planning
Mandarin Oriental	215 N Michigan	Luxury	250	May-11	Planning
Graves Chicago	565 N Fairbanks	Condo Hotel	220	May-11	Planning
Edition Chicago	150 E Ontario	Luxury	325	Jul-11	Planning

Sources: Chicago Department of Planning and Development, CCTB, HVS, STR

Numerous additional hotel projects are in early planning phases or have not yet obtained financing. However, it is unlikely that such projects will be realized before the end of 2011. Rather, these projects will most likely appear in subsequent forecasts of supply changes that extend into future years beyond 2011. Moreover, some of the listed projects may experience delays, especially those in the planning stage that have not yet obtained financing.

Although supply growth during the next four years is expected to exceed demand growth, overall supply growth is anticipated to moderate after peaking in 2009. HVS projects a compounded annual growth rate in supply of between 2.5% and 5.0% during the four-year period between year-end 2007 and year-end 2011. Based on an evaluation of which projects are under construction or being planned, HVS provides the following forecast of supply changes in Chicago.

Supply Changes – Opened, Under Construction, or Planned

Year	Status	Total Rooms Available	New Projects Open/Under Construction	New Projects in Planning Phase	Room Supply Change	Percent Change
2003	Actual	35,933			—	—
2004	Actual	36,209			277	0.8%
2005	Actual	36,573			364	1.0%
2006	Actual	36,385			(188)	-0.5%
2007	Actual	36,309			(76)	-0.2%
2008	Forecast	37,915	6	—	1,606	4.4%
2009	Forecast	40,213	5	5	2,298	6.1%
2010	Forecast	42,114	1	7	1,901	4.7%
2011	Forecast	43,484	—	5	1,370	8.1%
Total Change (2003 - 2007)					377	
Total Change (2007 - 2011)					7,175	
Average Annual Compound Change (2003 - 2011)						2.4%

Sources: Smith Travel Research, Chicago Department of Planning and Development, HVS

Six new or renovated hotels have opened or are under construction and scheduled to open in 2008. Ten additional projects are scheduled to open in 2009, although only half of these hotels are currently under construction. Nominal supply growth is expected to peak in 2009, if all 10 projects open on time, leading to a supply increase of 2,298 guestrooms that year. Taking a longer view, the average change in supply from year-end 2003 through year-end 2011 is forecast to be approximately 2.4% annually.

This industry analysis focuses specifically on hotels in Chicago. There are several recent and upcoming hotel projects in suburban locations surrounding Chicago, such as the new 500-room Westin in Lombard, the proposed 500-room InterContinental Hotel in Rosemont, as well as a new Holiday Inn and a new Residence Inn by Marriott in Bedford Park near Midway Airport. However, this article specifically addresses supply, demand, and performance trends and projections for hotels located within the city.

Near-Term Demand Factors

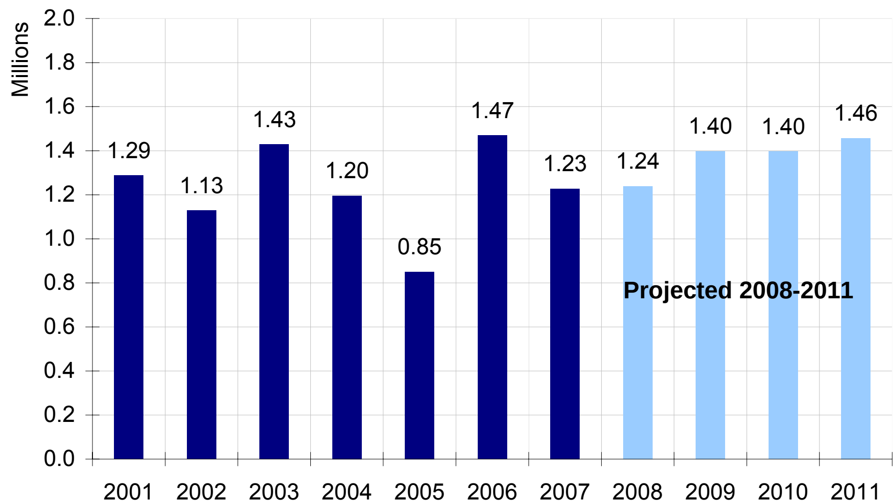
Several near-term demand factors will significantly affect the outlook for Chicago hotels during the next four years. Recently, HVS surveyed managers of several hotels throughout the city to determine which near-term demand factors they consider to be most important for the industry. The following factors were prominent in these discussions; however, this list is not intended to be comprehensive.

Chicago Convention and Tourism Bureau

The primary marketing organization for the Chicago hotel industry is the Chicago Convention and Tourism Bureau (CCTB). One of the organization's primary goals is to attract large out-of-town groups, requiring large blocks of hotel rooms, to the city. The Chicago hotel industry depends significantly on these "citywide" events and other group-oriented room nights sold by the CCTB. Even hotels that primarily target transient corporate or leisure travelers benefit from large volumes of demand in the group segment because fewer rooms are available to serve transient guests when certain hotels commit their rooms to large groups[5].

The CCTB tracks historical volumes of room nights they book each year. The following table shows recent annual room night bookings by the CCTB as well as our projection of near-term bookings likely to occur in future years.

Room Nights Booked by Chicago Convention and Tourism Bureau – Historical and Projected



Booking volumes have fluctuated between approximately 850,000 room nights and 1.5 million room nights in recent years, according to a recent report from the CCTB. Based on preliminary bookings for future years and historical booking paces, booking volumes are expected to increase modestly in 2008. We expect bookings will then increase significantly in the next three years as demand ramps up at the new McCormick Place West Building, which opened in late 2007.

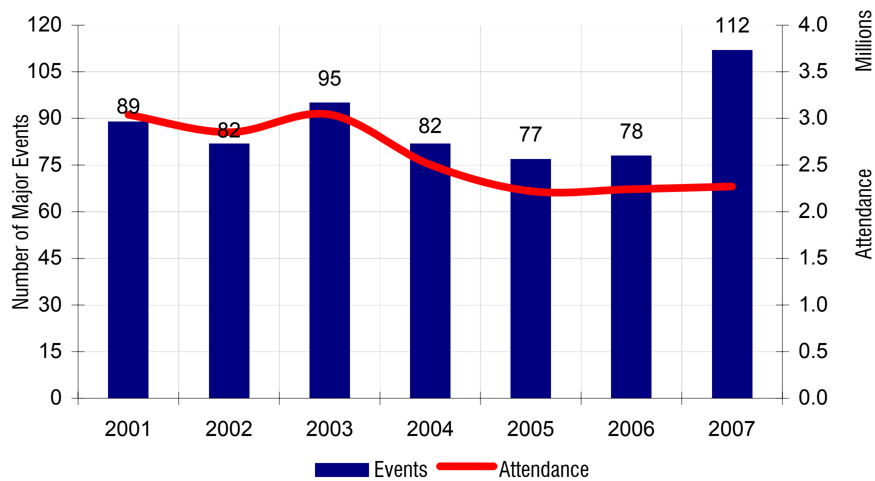
McCormick Place

McCormick Place is the largest convention center in the United States, offering 2.7 million square feet of exhibition space. The convention center consists of four major buildings: the North and South Buildings, the Lakeside Center, and the newly opened McCormick West Building. Originally built in 1960, McCormick Place has been an important factor in making Chicago one of the world's premier destinations for major conventions and tradeshows.

The West Building opened in July, 2007. This most recent expansion of the convention center offers an additional 460,000 square feet of exhibition space, a 100,000-square-foot ballroom, and 250,000 square feet of additional meeting space in 61 rooms. The new facility will be used to target mid-sized conventions and tradeshows throughout the year. Moreover, it will allow Chicago to host multiple conventions simultaneously during periods of peak demand.

The following chart shows recent trends in demand, as measured by the number of major events and attendance, at McCormick Place.

McCormick Place – Events and Attendance



After the expansion of McCormick Place in 2007, the number of events hosted at the convention center increased significantly; the new West Building is suitable for attracting smaller conventions and meetings that historically have not been booked in Chicago. The number of events hosted each year is expected to continue increasing in the near-term as the new facility achieves a stabilized level of demand. Attendance may increase, corresponding with room night and event demand; however, if economic conditions worsen, attrition may place downward pressure on attendance as fewer delegates and exhibitors decide to attend conventions and shows that are already booked in future years. As these events draw delegates, attendees, event planners, and exhibitors from out of town, McCormick Place will continue to represent one of the biggest single demand generators for hotel rooms in the city.

O'Hare Modernization Program

The O'Hare Modernization Program will spend $6.6 billion to reconfigure the airfield to significantly increase capacity and reduce delays in all weather conditions at O'Hare International Airport. Federal approvals and funding are already in place for the program. Construction began in 2007 and three phases of development are planned through 2011.

Although several airlines have announced service reductions and other airlines have gone out of business during the past year, the mid-term and long-term outlook for air service in Chicago is positive. Chicago benefits from one of the world's busiest airports; O'Hare International Airport served approximately 76.2 million passengers in 2007. Year-to-date figures through June indicate a decline of about 6.0% in 2008 compared to 2007. Midway International Airport, on Chicago's southwest side, served an additional 19.4 million passengers in 2007. Year-to-date figures indicate a decline of about 4.2% this year at Midway. The O'Hare Modernization Program should allow significant future growth in passenger volume during the next decade.

Olympic Games

Chicago's bid for the 2016 Summer Olympics has significantly increased Chicago's presence in numerous media. National and international print, radio, and television media have covered the selection process, in which Chicago has repeatedly been mentioned. Although we have not estimated the direct impacts of this media attention on the hotel industry in Chicago, local area hoteliers believe it has been a significant positive factor affecting overall hotel demand in the city during the past year.

On April 14th, 2007, the United States Olympic Committee (USOC) selected Chicago as the U.S. application city. In 2008, Chicago submitted its completed official bid files. The final host city selection will be made by the full International Olympic Committee (IOC) on October 2, 2009, in Copenhagen, Denmark. Ongoing campaigning and planning efforts are expected to continue augmenting Chicago's presence in national and international media; hoteliers expect this to have an ongoing positive impact on hotel demand in the foreseeable future.

Top Attractions

Chicago benefits from numerous major tourism attractions, cultural attractions, sporting events and festivals. These attractions generate tourism and hotel demand throughout the year. The following table identifies the top 20 attractions in the city, ranked in order of estimated annual attendance. Crain's Chicago Business was the primary source for attendance figures at most of these attractions.

Top 20 Attractions in Chicago – Ranked by Attendance

Rank	Name of Attraction	Attendance*
1	Navy Pier	8,420,000
2	Taste of Chicago	3,600,000
3	Millennium Park	3,500,000
4	Chicago Cubs	3,252,462
5	Chicago Trolley & Double Decker Co	3,096,000
6	Lincoln Park Zoo	3,000,000
7	Chicago White Sox	2,684,395
8	John G. Shedd Aquarium	2,012,417
9	Chicago Air and Water Show	2,000,000
10	Museum of Science and Industry	1,675,109
11	Bank of America Chicago Marathon	1,500,000
12	Art Institute of Chicago	1,331,000
13	Field Museum	1,327,810
14	Sears Tower Skydeck	1,300,000
15	Chicago Bulls	901,502
16	Chicago Cultural Center	821,000
17	Chicago Children's Museum	772,455
18	Chicago Botanic Garden	760,000
19	Venetian Night	675,000
20	John Hancock Observatory	650,000

** Most recent annual data available.*

Sources: Crain's Chicago Business, Individual attractions

Many visitors experience or participate in more than one attraction while in Chicago. Together, these and other attractions represent an extensive combination of cultural, entertainment, and sports tourism offerings for visitors.

Millennium Park

Millennium Park is the newest addition to the preceding list of top attractions in Chicago. The 24.5-acre park opened in July 2004; the park's famous Cloud Gate sculpture was completed in April 2006. Since then, the park has become one of Chicago's top tourist destinations. Many downtown hoteliers single out Millennium Park as one of the most important factors contributing to recent trends of increased room night demand in the leisure segment.

Industry survey data from priceline.com supports the importance of Millennium Park as a destination. Every year before the Memorial Day holiday, priceline.com releases the results of a survey of customers booking hotel rooms through its website. The survey indicates which neighborhoods are the top destinations for travelers using priceline.com to search for hotel rooms. The following table shows the top five destinations from the past four years.

Top Five Memorial Day Destinations on priceline.com

Rank	2005	2006	2007	2008
1	Las Vegas Strip	Millennium Park	Millennium Park	NYC Times Square
2	NYC Upper Midtown	Las Vegas Strip	Las Vegas Strip	Las Vegas Strip South
3	Chicago Michigan Ave.	Chicago Michigan Ave.	NYC Upper Midtown	Millennium Park
4	NYC Midtown West	NYC Upper Midtown	Chicago Michigan Ave.	Las Vegas Strip North
5	NYC Upper West Side	NYC Midtown West	NYC Downtown/Soho	Chicago Michigan Ave.

Source: Annual survey by priceline.com

In 2006 and 2007, Millennium Park became the top neighborhood destination for the Memorial Day holiday weekend, based on priceline.com survey data. These rankings are consistent with survey data available for other holiday periods; however, we show the Memorial Day survey data because it has been conducted each of the past four years. In 2008, Millennium Park dropped to third place in the rankings. But, for the past three years, Millennium Park and Michigan Avenue have both ranked in the top five Memorial Day destinations identified by priceline.com, reflecting Chicago's increased destination appeal.

Capital Improvements

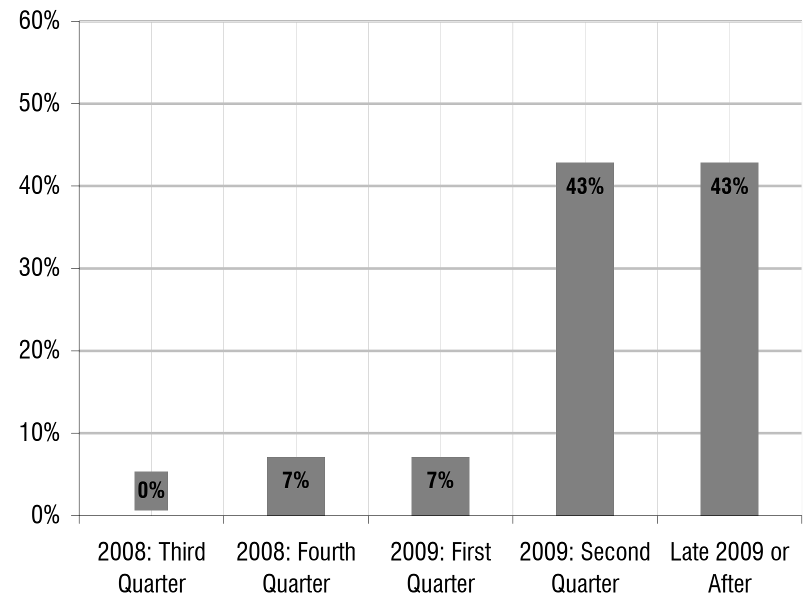
Hotel ownership groups have embarked on a major upward trend in capital spending at many of the city's oldest and top-rated hotels. Recent capital improvement projects at hotels such as the Hilton Palmer House, the Allerton Hotel, Hotel Allegro, Hotel Monaco, Four Seasons Chicago, Swissotel Chicago, Hotel Sax, and the Millennium Knickerbocker Hotel have led to a capital infusion of several hundred million dollars for recent or ongoing capital improvement projects. Numerous other hotel capital improvement projects have recently been completed or are planned in the near future throughout the city.

Hotel managers believe this level of investment in the city's hotel supply, in conjunction with the opening of several upscale and luxury hotels, has the potential to improve Chicago's standing and reputation as a major international destination with a world-class hotel inventory.

Industry Outlook

Amid signs of a local economic recession, we surveyed hotel managers to obtain insights about when they believe the local economy will resume significant growth. The following figure illustrates when most hotel managers believe economic growth will resume.

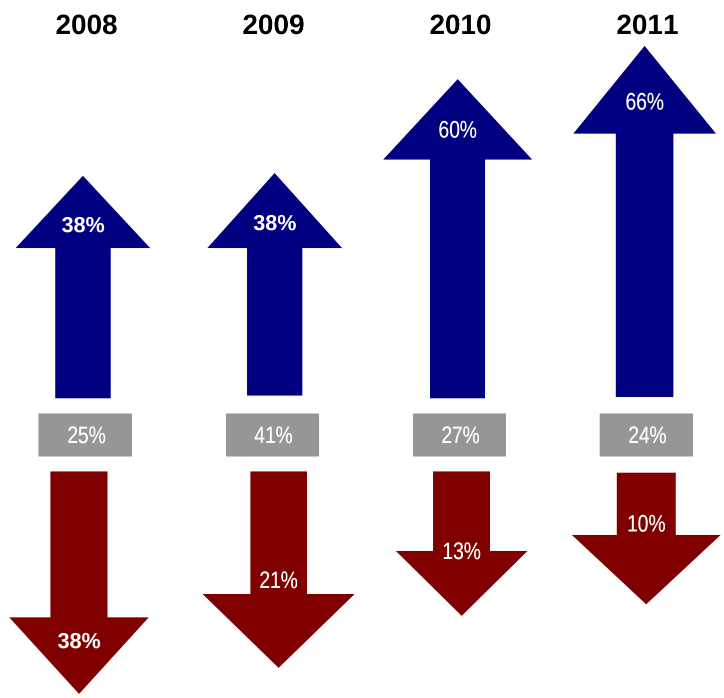
Timing of Local Economic Recovery



A small minority of hotel managers believe economic growth will resume in the fourth quarter of 2008 or the first quarter of 2009. The majority of local hoteliers believe economic growth in the Chicago area will not begin growing significantly until the second quarter of 2009 or later.

The following figure illustrates what percentage of hotel managers believe occupancies will increase, decrease, or stay the same during each of the next four years. Percentages are weighted to reflect the relative size of each survey respondent's hotel.

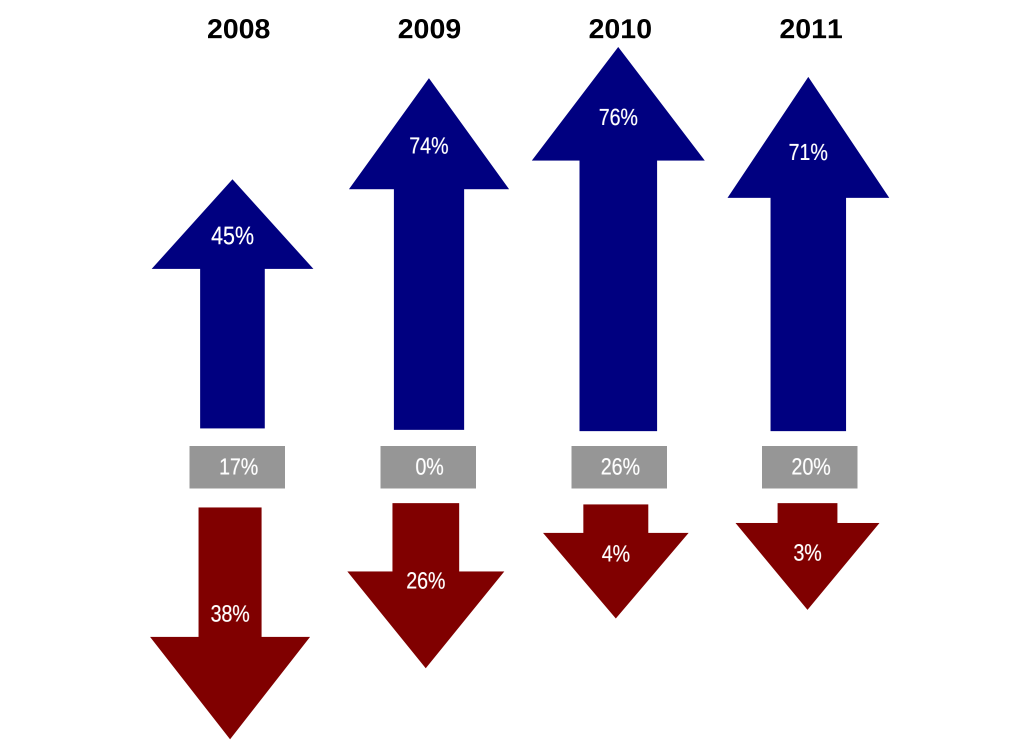
Occupancy Outlook



Hotel managers are evenly split between optimism and pessimism for 2008. Roughly 38% believe occupancies will increase and 38% believe occupancies will decrease, while 25% believe occupancies will stay the same as last year. Hotel managers are slightly less pessimistic about 2009. Not until 2010 and 2011 do the majority of local hoteliers believe occupancies will begin increasing in Chicago.

The following figure illustrates what percentage of hotel managers believe average daily rates will increase, decrease, or stay the same during each of the next four years. Percentages are weighted to reflect the relative size of each survey respondent's hotel.

ADR Outlook

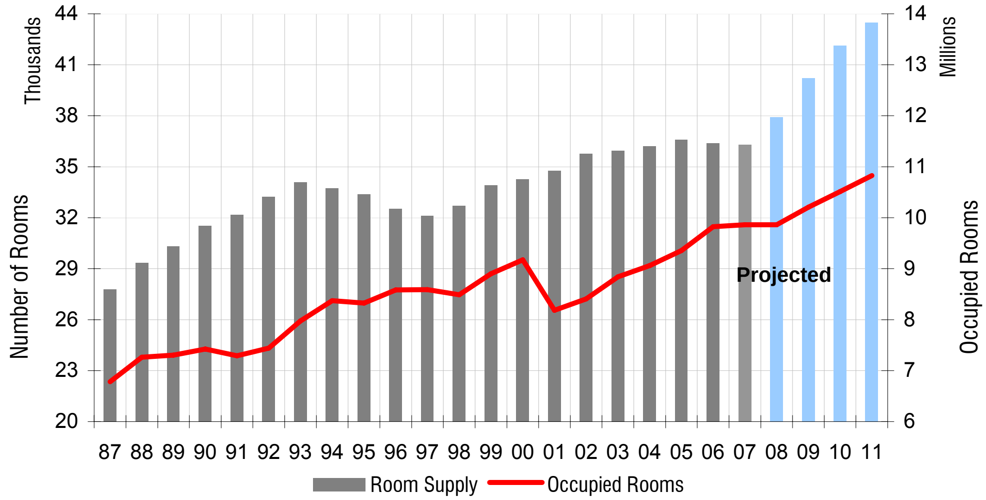


In 2008, approximately 45% of hotel managers believe average daily rates will increase compared to last year, while 38% believe rates will decrease and 17% believe rates will stay the same. A majority of hotel managers believe rates will be increasing each year between 2009 and 2011 in Chicago.

Based on the survey findings and additional market research, demand trends are expected to increase after flattening in 2008. Supply will continue to increase as several projects currently planned or under construction reach completion by the end of 2011. During the four-year period between year-end 2007 and year-end 2011, we anticipate an average annual supply growth rate of between 2.5% and 5.0%, depending on whether planned projects obtain financing and remain on schedule. During the next two years demand is expected to grow at a slower pace than supply. Therefore, occupancies are likely to decrease in 2008 and 2009. Survey data suggests that occupancies may not begin increasing again until 2010 or later. Nonetheless, hotel managers anticipate increases in average daily rates during each of the next four years.

The following chart presents historical trends and our near-term forecast of room supply and demand for the Chicago hotel market through 2011.

Supply and Demand Outlook



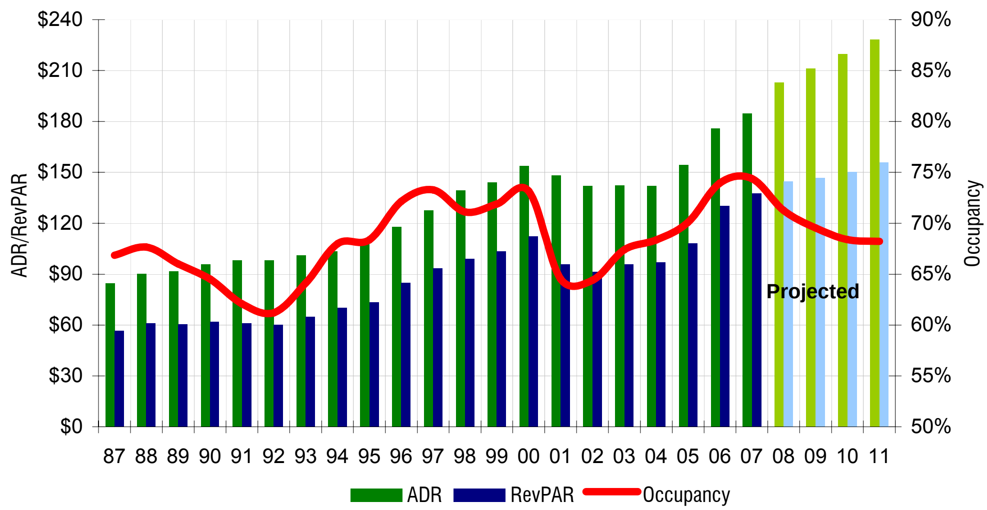
An evaluation of near-term projects indicates that hotel room supply in the city will increase from 36,309 rooms at the end of 2007 to approximately 43,484 by the end of 2011. During the same period, we project demand will increase from about 9.9 million room nights in 2007 to approximately 10.8 million room nights in 2011.

The hotel industry experienced rapid growth during the past three years, resulting in double-digit RevPAR increases in 2005 and 2006; RevPAR grew by 5.6% in 2007. A decline in demand during the first quarter of 2008, a slowing economy, increasing travel costs, and relatively large supply increases in 2008 and 2009 suggest that occupancies are likely to decline in the near future.

Despite the prospect of decreasing occupancies, RevPAR is expected to continue growing each of the next four years as average daily rates increase. The recent addition of local demand generators, major capital improvements at several Chicago hotels, and heightened media coverage of the city's Olympic bid and major league sports teams provide reasons for a moderately positive near-term outlook for the Chicago hotel industry. Although many hotel markets in other parts of the country peaked in 2005 or 2006, several unique factors are expected to have a positive impact on the Chicago hotel industry during the next few years.

The following chart presents historical trends and our near-term forecast of occupancy, ADR, and RevPAR for the Chicago hotel industry through 2011.

Performance Measures Outlook



After a peak in occupancy in 2007, continued supply growth and moderating demand growth are projected to lead to somewhat lower occupancies through the rest of the decade. Average rates are expected to continue increasing faster than occupancies decrease, thereby leading to continued growth in RevPAR through 2011.

During the past year, volatility in the equity and credit markets and slowed growth in the national economy has resulted in uncertainty about near-term economic conditions. The Federal Reserve recently engaged in numerous efforts to stimulate the economy and stabilize credit markets, but there is considerable uncertainty about whether economic growth and credit conditions will improve in the near-term. Although this increased uncertainty indicates the possibility of a prolonged economic recession, the Chicago hotel industry has demonstrated strength in the face of a modest local economic recession. Demand, supply, and performance projections may not be met if any significant shocks to the economy occur or if unforeseen changes affecting economic growth take place. Therefore, projections are subject to change.

About the Author

HANS DETLEFSEN *is Director of HVS Global Hospitality Services in Chicago. He holds a Masters Degree in Public Policy from the Harris School of Public Policy Studies at the University of Chicago, where he received the Harris Fellowship. He graduated magna cum laude from the University of Notre Dame with a Bachelor of Arts in Government and Economics. Email: hdetlefsen@hvs.com*

[1] "Recession Hits Home," Crain's Chicago Business 16 March 2008

[2] Charts throughout this report rely on data from Smith Travel Research (STR) or HVS surveys, unless otherwise noted.

[3] The subset of hotels that report to STR on a monthly basis represents approximately 80%-85% of the current hotel room supply in Chicago.
[4] HVS considers properties that are in advanced planning stages or are currently under construction.
[5] Hotel industry participants sometimes use the term “compression” to describe this phenomenon.