FOCUS ON U.S. LODGING

RevPAR Growth Projected to Ease in 2001 and Rebound in 2002

by Bjorn Hanson, CRE

PricewaterhouseCoopers has been providing 12-quarter econometric forecasts of the U.S. lodging industry since 1991. The four million rooms counted in the lodging industry encompass the full range of property types from full service to limited service hotels to extended stay properties. The model consists of three stochastic equations: *demand* as a function of 4-quarter polynomial distributed lag of real GDP and real ADR with an adjusted R-squared of 0.99; *room starts*, with an adjusted R-squared of 0.89; and *room rate*, with an adjusted R-squared of 0.93, all significant at ρ=0.5. Following is a summary of the lodging forecast through 2002.

The continued strong U.S. economy has supported high levels of lodging demand so far this year. Confident consumers and expanding businesses continue to keep travel activity high despite rising oil prices. In the first five months of 2000, room supply grew at 3.3 percent, but demand expanded at a much faster pace of 3.8 percent. This translates into a 0.4 percentage point rise in the occupancy rate to 61.9 percent from the comparable five-month period in 1999.

U.S. RevPAR growth will continue to rise in 2000 alongside expectations of stronger U.S. economic growth. RevPAR growth is expected to rise to 3.9 percent in 2000 from 3.1 percent the previous year. *(Table 1.)* In fact, data from Smith Travel Research (STR) indicate that RevPAR is growing at 4.8 percent for the first five months of the year, supported by strong average daily rate (ADR) growth of 4.2 percent.

MODERATING U.S. ECONOMIC GROWTH IN 2001

Following a strong first quarter with real GDP growth of 5.5 percent, the U.S. economy is expected to slow from its current exceptional pace over the next six quarters. Macroeconomic Advisers expects a moderate slowdown in real GDP from 4.4 percent in the year 2000 to 2.8 percent in 2001 and 3.1 percent in 2002.[1] Recent data show that consumer spending growth slowed in the second quarter of 2000. Moreover, housing starts have eased and survey data for the manufacturing industry indicate that activity is expanding at a slower pace than in 1999. Since June 1999, the Federal Reserve has increased the target fed funds rate by a cumulative 175 basis points, with the aim of containing inflationary pressures. Macroeconomic Advisers forecasts modest inflationary pressures of 2.6 percent in 2000; 2.5 percent in 2001; and 3.1 percent in 2002.

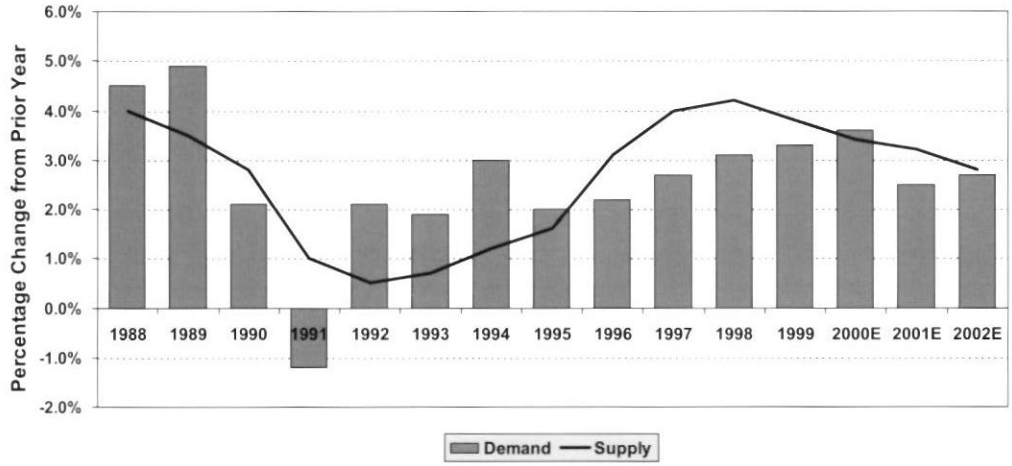
SUPPLY GROWTH WILL DECLINE FURTHER AS DEMAND GROWTH PICKS UP IN 2002

For the year 2001, lodging demand growth will slow to 2.5 percent from 3.6 percent in 2000, mirroring the tempering of overall economic growth. By 2002, demand growth will recover modestly to 2.7 percent.

Meanwhile, end-of-year room supply growth is forecast to decelerate through 2002, after posting a record pace of 4.2 percent in 1998. Supply growth is expected to taper off to 3.2 percent in 2001 and 2.8 percent by the end of 2002.

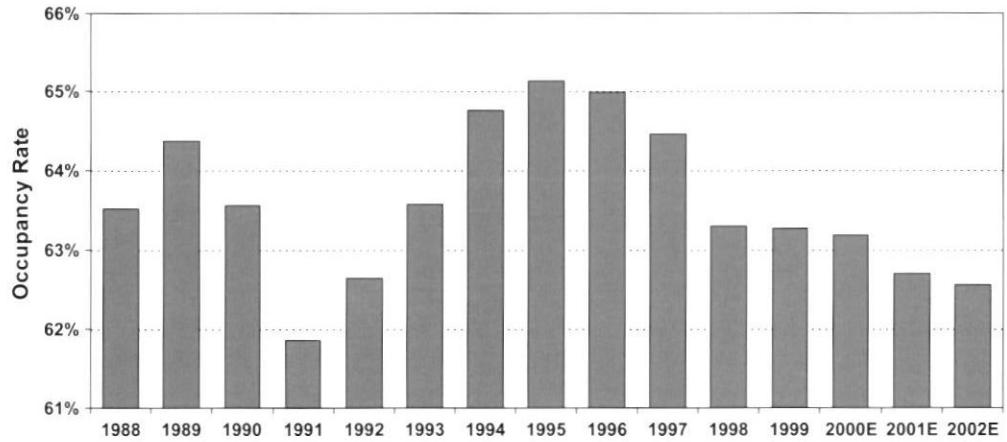
Figures 1 & 2

Figure 1
Gap Between Supply Growth & Demand Growth Expected to Narrow in 2002



Source: PricewaterhouseCoopers L.L.P. (2000 to 2002); Smith Travel Research (1988 to 1999)

Figure 2
Occupancy Rate Has Been Declining Since 1996



Source: PricewaterhouseCoopers L.L.P. (2000 to 2002); Smith Travel Research (1988 to 1999)

Therefore, in 2001, the occupancy rate is expected to decrease by 0.9 occupancy points to 62.7 percent as the gap between supply and demand growth widens. By 2002, the occupancy rate is expected to stabilize at 62.6 percent as demand growth rebounds modestly and supply growth slows further. *(Figure 1 & Figure 2.)*

ADR growth, which has been falling in line with occupancy rates, is predicted to fall to 3.6 percent in 2001 and rise slightly to 3.8 percent in 2002.

Easing demand growth and smaller ADR increases will lower RevPAR growth in 2001 to 2.8 percent. By 2002, RevPAR growth will climb to 3.5 percent as demand growth picks up and supply growth continues to decrease.

Tables 1 - 3

Table 1: PricewaterhouseCoopers U.S. Lodging Forecast, as of June 2000	Annual Figures				
	1998	1999	2000	2001	2002
Occupancy (Percent)	63.8	63.3	63.2	62.7	62.6
Average Daily Rate ($)	$78.14	$81.25	$84.51	$87.56	$90.86
Percentage Change from Prior Year	4.6	4.0	4.0	3.6	3.8
Annual RevPAR (Percentage Change from Prior Year)	3.5	3.1	3.9	2.8	3.5
Annual Inflation-Adjusted RevPAR (Percentage Change from Prior Year)	1.9	0.9	1.3	0.3	0.4
Average Daily Rooms Sold (000s)	2,358	2,436	2,523	2,586	2,657
Percentage Change from Prior Year	3.1	3.3	3.6	2.5	2.7
End-of-Year Supply (000s)	3,768	3,910	4,043	4,172	4,290
Percentage Change from Prior Year	4.2	3.8	3.4	3.2	2.8

Table 2: PricewaterhouseCoopers RevPAR Forecast for Chain Scale Segments, as of June 2000 Annual Figures Percentage Change from Prior Year				
	1999	2000	2001	2002
Upper Upscale	4.3	4.0	3.0	4.4
Upscale	0.4	1.3	1.2	3.2
Midscale with F&B	2.5	2.5	2.5	2.8
Midscale without F&B	2.3	4.0	2.1	4.5
Economy	2.8	4.4	2.7	4.2

Table 3: U.S. Lodging Industry Statistics Segments and Regions Ranked by RevPAR Growth (Year-to-date May 2000)	RevPAR Growth	Supply Growth	Demand Growth
Chain Scale			
Upper Upscale	6.0	3.6	4.5
Midscale with F&B	4.0	0.4	0.3
Midscale without F&B	3.6	10.9	10.0
Economy	3.4	4.9	5.7
Upscale	3.2	8.0	8.2
Region			
New England	12.8	2.2	6.9
Pacific	9.6	2.2	5.4
Middle Atlantic	7.8	2.5	4.0
West South Central	4.4	3.8	5.3
South Atlantic	3.1	3.9	3.4
West North Central	2.8	2.6	2.1
East North Central	2.6	4.1	3.0
East South Central	0.5	3.0	1.1
Mountain	-0.1	3.6	3.4
Location			
Urban	6.9	2.4	3.8
Resort	5.3	2.6	2.6
Highway	5.1	3.6	3.5
Airport	5.0	3.4	4.0
Suburban	4.6	3.6	4.8
U.S.	**4.8**	**3.3**	**3.8**

Sources:

Tables 1 & 2: PricewaterhouseCoopers L.L.P. (2000 to 2002); Smith Travel Research (1998 to 1999)

Table 3: Smith Travel Research, *Lodging Outlook*, July 2000; *Chain Scale Trends Reports*, July 2000

CHAIN SCALE SEGMENT FORECASTS

With the exception of the *Upper Upscale* segment, RevPAR growth is forecast to rise moderately in 2000 and fall in 2001 across the five chain scale segments. *(Table 2.)* The only exception is the *Upper Upscale* segment where RevPAR growth is projected to decrease by 0.3 percentage points in 2000 as ADR growth slows to 4.7 percent in 2000 from 5.5 percent in 1999. By 2002, a sharp decline in supply growth will have a sizeable positive impact on RevPAR growth across all five segments.

The *Upper Upscale* segment will continue to lead in terms of RevPAR growth. This segment also has the highest occupancy rate. In the *Upscale* segment, RevPAR growth, in inflation-adjusted terms, is expected to be negative, largely due to falling occupancy rates. The performance of the *Midscale with F&B* segment is expected to be relatively weak. Demand growth will continue to decline in this segment as newer Upscale and Midscale without F&B continue to gain market share. The outlook for the *Midscale without F&B* segment will improve substantially in 2002 as the occupancy rate is expected to increase in that year. In terms of absolute occupancy rates, the *Economy* segment remains the weakest among the five segments. However, it is the only segment in which the occupancy rate is expected to rise or remain unchanged during the period from 2000 to 2002. The *Economy* segment's RevPAR is also expected to grow at a pace close to that of the *Upper Upscale* segment.

Consistent with our forecast, the January through May 2000 data from STR show that *the Upper Upscale* segment has posted the highest RevPAR growth of 6.0 percent. This is followed by the *Midscale with F&B* and *Midscale without F&B* with 4.0 and 3.6 percent RevPAR growth, respectively. *(Table 3.)* Year-to-date supply growth is very strong in *the Midscale without F&B* at 10.9 percent, which is tracked closely by demand growth of 10 percent. This contrasts starkly with the *Midscale with F&B* segment, which continues to register close to zero supply and demand growth.

REGIONAL PERFORMANCE

On a regional basis, the New England, Pacific, and Middle Atlantic regions continued to outperform the industry with continued strength in RevPAR growth based on year-to-date STR data through May 2000. *(Table 3.)* In first five months, these regions have posted moderate supply growth in the range of 2.2 to 2.5 percent combined with robust demand growth ranging from 4.0 to 6.9 percent. The performance of the Pacific region is not surprising given the favorable trends in the Los Angeles-Long Beach and San Francisco markets which together account for 21.4 percent of room supply in the Pacific region. The worst performing regions were the East South Central and Mountain, with 0.5 and -0.1 percent RevPAR growth, respectively.

Among the top 25 markets in terms of room size, the leading performers with RevPAR growth far above the national average of 4.8 percent in the year-to-date period are San Francisco/San Mateo, Boston, New York, Los Angeles-Long Beach, and New Orleans. These trends are supported by strong growth in the ADR. Boston and New York are key lodging markets. Boston accounts for approximately 26 percent of room supply in the New England region, while New York accounts for more than one-fifth of total room supply in the Middle Atlantic region.

The underperformers with negative or less than 0.5 percent RevPAR growth are Seattle, Philadelphia, St. Louis, and Phoenix. These cities are plagued with ADR growth that is below the inflation rate. Generally, the poor RevPAR performance is due to declining occupancies and weak ADR growth as a result of strong supply growth.

By location, urban properties achieved the highest year-to-date May 2000 RevPAR growth of 6.9 percent. *(Table 3.)* This was followed by resort and highway properties. The worst performing location was the suburban properties where RevPAR growth was 4.6 percent.

In summary, 2000 will be a positive year with RevPAR growth recovering from a trough in 1999 (the actual trough was during the first quarter of 2000). RevPAR increases will slow in 2001 primarily because of room supply, creating another trough in 2001. The year 2002 will be a strong year with RevPAR growth rebounding. REI

NOTES

1. This macroeconomic scenario is based on assumptions developed as of March 2000.

ABOUT OUR FEATURED COLUMNIST

Bjorn Hanson, Ph.D., CRE, *New York City, is the global hospitality industry leader for PricewaterhouseCoopers. He is a recognized authority with his years of consulting, banking and research experience. He holds The Counselor of Real Estate (CRE); Certified Fraud Examiner (CFE); and Food Service Consultants International (FSCI) professional designations.*