FOCUS ON HOSPITALITY ISSUES

U.S. Lodging Industry Update 2001-02

by Bjorn Hanson, CRE

According to Smith Travel Research (STR), U.S. lodging industry RevPAR (revenue per available room) grew between 4 and 6 percent for 2000. PricewaterhouseCoopers' (PwC) forecast was 5.5 percent. This strong growth in RevPAR, the highest since 1996, is supported by a healthy room demand growth of 3.7 percent. With increasing occupancies, the average daily rate is expected to finish 2000 at 4.9 percent, the fastest since 1997.

The very strong performance of the U.S. lodging industry is primarily the result of the strength in the overall U.S. economy over the first half of 2000. Quarter-over-quarter annualized U.S. real GDP growth averaged 5.2 percent in this period.

U.S. real GDP growth for 2000 is expected to be 5.0 percent according to the January 2001 Macroeconomic Advisers' forecast, the highest since 1994.[1] The year 2000 is expected to end with inflation of 3.4 percent, the highest since 1991.

Economic growth already started to slow in the third quarter of 2000 with real GDP growth of only 2.2 percent. The contribution to growth from fixed investment fell to 0.6 from 1.9 in the second quarter and 2.7 percent in the first quarter. Government consumption in the third quarter reduced real GDP by 0.2 percentage points, while it had added 0.9 percentage points in the previous quarter. The ratio of real inventories to real sales increased in the past two quarters. This implies that inventories have accumulated and production will have to slow, placing downward pressure on GDP growth.

However, there are emerging signs that the U.S. economy will recover beginning in the third quarter of 2001. Capital expenditures are expected to recover as firms internalize the interest rate cuts and as excess inventories are depleted. Benign inflationary pressures, excluding energy, will leave room for further Fed rate cuts if necessary to boost aggregate demand. Moreover, energy prices are expected to decline in the spring of 2001. Also, the continuing downtrend in the conventional mortgage rate will help bolster private fixed investment.

Given these, Macroeconomic Advisers forecast GDP growth of 2.4 percent in 2001 and 3.7 percent in 2002. Inflation is forecast to remain relatively tame over the next two years; 2.7 percent and 2.3 percent in 2001 and 2002, respectively.

U.S. LODGING INDUSTRY FORECAST

The performance of the U.S. lodging industry for the year 2000 reflected the remarkable pace of the U.S. economy. As of January 2001, PwC forecasts room demand growth for 2000 to be 3.7 percent, the highest since 1989. At the same time room supply growth has declined as construction activity has slowed. PwC forecasts RevPAR growth of 5.5 percent for 2000, the strongest since 1996. *(See Table 1.)* Occupancy is expected to rise in 2000 to 63.5 percent, marking the first gain since 1995.

For the year 2001, PwC forecasts room demand to grow by 2.1 percent. However, room supply growth is also expected to ease to 2.6 percent. PwC forecasts the average

Table 1

RevPAR Growth
(Percentage Change from Prior Year)

	RevPAR Growth (%)			
	1999	2000	2001	2002
U.S.	**3.1**	**5.5**	**3.1**	**4.3**
Upper Upscale	4.2	7.0	2.3	6.1
Upscale	0.4	4.8	2.4	4.2
Midprice with F&B	2.4	4.1	2.1	3.2
Midprice without F&B	2.2	4.1	4.2	5.0
Economy	2.9	3.1	2.9	3.7

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

daily room rate to rise by 4.0 percent in 2001. Overall our forecast calls for a slowdown in RevPAR growth to 3.1 percent in 2001.

In 2002, PwC forecasts growth in room demand to increase to 2.7 percent and room supply growth is expected to slow further to 2.3 percent. Therefore, occupancy is expected to rise close to 0.3 occupancy points to 63.3 percent. PwC forecasts room rates to increase by 3.9 percent and RevPAR growth is expected to regain some of its momentum in 2002 and reach 4.3 percent.

CHAIN SCALE SEGMENT FORECASTS

As of January 2001, PwC forecasts demand growth to decrease across all the five chain scale segments in the year 2001 compared with 2000, with the largest percentage point decrease occurring in the midprice without food and beverage (F&B) segment. Growth in room supply is also expected to fall in 2001 across all the segments, again with the sharpest decrease in the midprice without F&B segment. Therefore, PwC forecasts RevPAR growth in this segment to improve slightly in 2001 while occupancy is expected to be flat. In the other segments, RevPAR growth is expected to slow or remain flat for 2001. *(See Table 1.)* Occupancy gains are only expected in the economy and midprice without F&B segments as demand growth is expected to outpace supply growth in 2001.

PwC forecasts the year 2002 to be characterized by a moderate recovery in demand growth across all the chain scale segments. Supply growth is expected to pick up in the upscale and midprice without F&B segments. In 2002, occupancy gains are forecast for all segments with the exception of the midprice with F&B segment. RevPAR growth is expected to rise in all segments following the RevPAR growth slowdown in 2001.

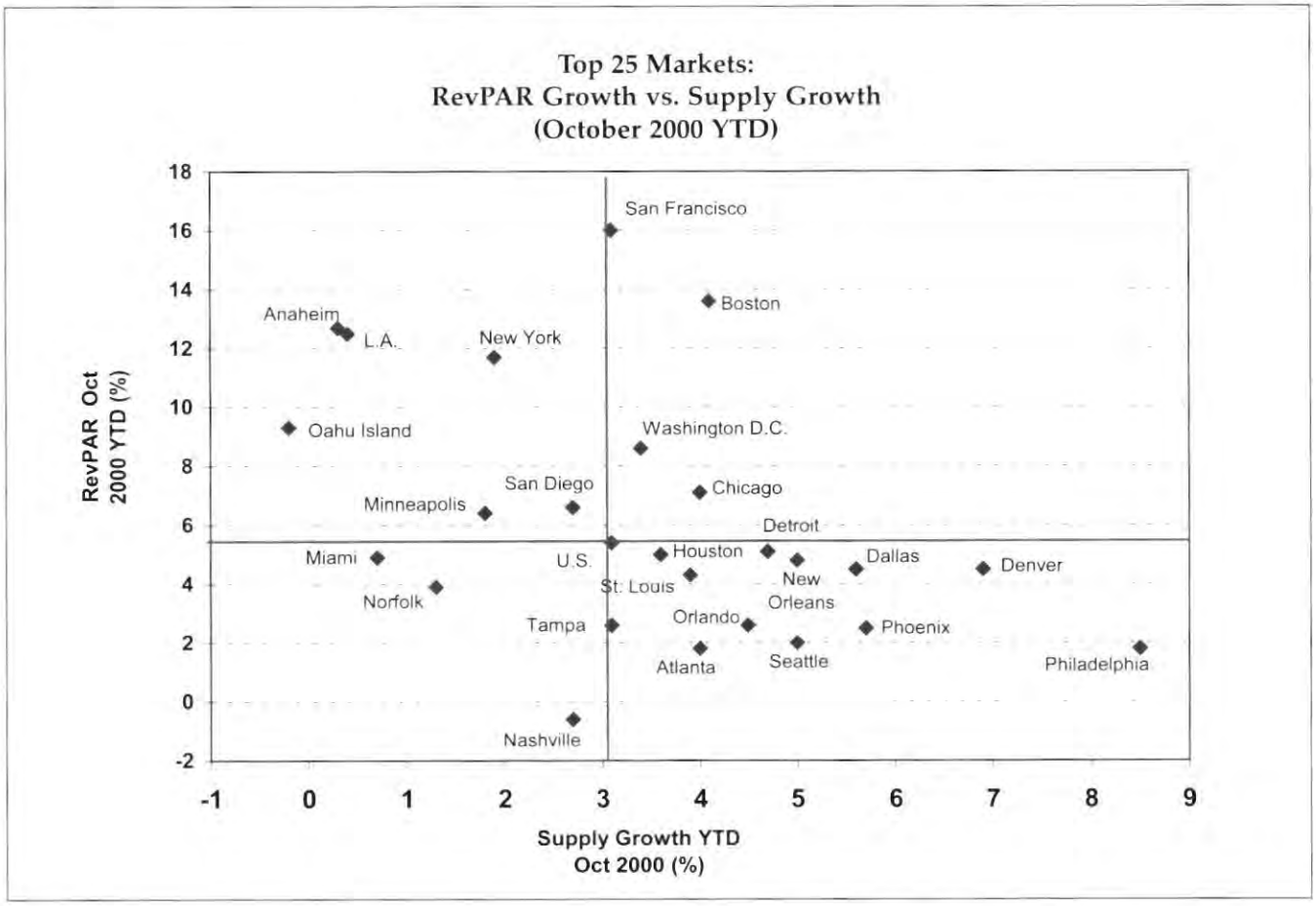
PERFORMANCE OF THE TOP 25 MARKETS

In the January to October 2000 period, among the 25 markets followed by STR, five posted "double-digit" RevPAR growth. Three are in California (San Francisco-San Mateo, Anaheim-Santa Ana, and Los Angeles-Long Beach) while two are in the Northeast (Boston and New York). *(See Chart 1.)* RevPAR growth in these markets was largely driven by strong growth in room rates, ranging from 5.7 percent in Anaheim-Santa Ana to 11.2 percent in San Francisco-San Mateo.

Seven MSAs (Nashville, Atlanta, Philadelphia, Phoenix, Orlando, and Tampa-St.Petersburg) experienced RevPAR growth below inflation of 3.2 percent, as of year-to-date October 2000. Nashville is the only market that recorded negative RevPAR growth (-0.6 percent). Most of these markets are characterized by relatively high room supply growth. For example, Philadelphia saw supply growth of 8.5 percent while Phoenix and Seattle posted 5.7 and 5.0 percent supply growth, respectively.

Over the next 12 months as the U.S. economy slows, the long-standing business centers are expected to fare better than the other smaller markets in general. Based on supply and demand trends, the outlook appears favorable for the New York, Washington D.C., San Francisco, Los Angeles, San Diego, and Tampa markets over the period 2001-2002. Most

Chart 1



of these markets are expected to see modest supply growth. With the exception of Los Angeles and Tampa, all of these markets have posted occupancy above 75 percent in the year-to-date ended October 2000.

The U.S. lodging industry is poised to finish 2000 at a record-setting rate. The PwC forecast calls for year-end RevPAR growth of 5.5 percent. However, a slowing U.S. economy in the first half of 2001 is expected to restrain RevPAR growth as room demand growth wanes despite slowing supply growth. In 2002, RevPAR growth is expected to regain some of its momentum as the U.S. economy improves and as supply growth continues to decelerate. REI25

NOTES

1. This forecast assumes another 25 basis-point cut of the federal funds rate target at the January 30-31 FOMC meeting in addition to the January 3, 2001 cut of its target rate by 50 basis points to 6.0 percent.

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.*