FOCUS ON HOSPITALITY

Moderating Profit Growth Expected Until 2001

by Bjorn Hanson, CRE

After a slow second-quarter performance, growth of the U.S. economy accelerated in the second half of 1999. Real gross domestic product (GDP) grew at an annual rate of 4.1 percent in 1999, fueled by increased inventory buildup and export activity as well as continued robust consumer and business spending.

The pace of economic activity in the U.S. will continue to remain strong at least until 2001 as overseas economies gain momentum; Macroeconomic Advisers anticipates real GDP to slow slightly from 1999 to 3.4 percent in 2000 and 2.8 percent in 2001.

The anticipated solid performance of the U.S. economy in the next two years will stimulate lodging demand growth as well as encourage continued development initiatives. Room rate advances will continue, but there will be a tighter spread between average room rate growth and inflation in the next two years. Although profit margins are not expected to improve significantly going forward, aggregate industry profits will continue to rise at a compound annual growth rate of 8.3 percent.

MODERATING RevPAR GROWTH

After peaking at 6.1 percent in 1996 in the current cycle, the growth of U.S. revenue per available room (RevPAR) has been trending down as the high level of hotel construction has adversely affected occupancies and room rate growth in most lodging markets. Beginning in 1996, U.S. demand growth failed to keep pace with the supply expansion. The net increase in supply from 1996 to 1998 was almost 292,000 rooms, representing a compound annual growth of 4.1 percent. By comparison, the industry's historical supply growth average from 1975 to 1998 is 2.8 percent.

Occupancy dropped 1.2 occupancy points to 63.9 percent in 1998 from 65.1 percent in 1996. Room rate increases also slowed to 4.4 percent in 1998 from 6.5 percent in 1996. The combination of lower occupancy and modest average daily rate (ADR) gains caused RevPAR growth to slide from 6.1 percent in 1996 to 3.6 percent in 1998.

1999 PERFORMANCE

Statistics from Smith Travel Research (STR) show a continuation of these trends in 1999. The stronger supply gro wth (+3.9 percent) relative to demand growth (+3.5 percent) pushed down occupancy rates, thus limiting the industry's ability to raise room rates and RevPAR. The occupancy in 1999 fell 0.5 occupancy point to 63.4 percent, while ADR increased only 3.9 percent to $81.07 in the same period one year earlier. As a result, RevPAR advanced by only 3.2 percent. In inflation-adjusted terms, RevPAR increased 1.0 percent. *(Tables 1 and 2 summarize the 1999 performance indicators.)*

Tables 1 & 2

1999 U.S. Lodging Industry Statistics Segments & Regions Ranked by RevPAR Growth

Percentage Change from Prior Year (except for occupancy change)

	RevPAR Growth	Occupancy Point Difference	ADR Growth	Supply Growth	Demand Growth
Segment					
Budget	5.2%	-0.1	5.4%	0.4%	0.2%
Economy	4.5%	-0.3	5.0%	3.3%	2.7%
Luxury	3.2%	-0.6	4.0%	4.5%	3.6%
Midprice	3.1%	-0.7	4.2%	5.8%	4.5%
Upscale	1.2%	-0.8	2.4%	4.8%	3.6%
Census					
New England	8.4%	1.0	6.9%	3.1%	4.7%
Mountain	4.3%	-1.0	5.8%	5.4%	3.9%
Pacific	3.9%	-0.4	3.3%	2.6%	3.1%
Middle Atlantic	3.9%	-0.5	4.6%	2.9%	2.2%
South Atlantic	3.1%	-0.5	3.9%	4.6%	3.8%
East North Central	2.6%	-0.7	3.7%	4.4%	3.3%
West North Central	2.4%	-0.2	2.7%	3.5%	3.2%
West South Central	0.3%	-1.4	2.6%	5.4%	3.1%
East South Central	-0.3%	-1.7	2.6%	4.9%	2.0%
Location					
Resort	4.0%	-1.1	5.6%	3.0%	1.4%
Highway	3.3%	-0.5	4.1%	2.9%	1.9%
Urban	2.4%	-0.7	3.4%	5.1%	4.1%
Airport	2.0%	-0.6	2.9%	4.0%	2.9%
Suburban	1.6%	-0.7	2.7%	5.4%	4.2%

Source: Smith Travel Research, *Lodging Outlook, February 2000.*

Top 25 Markets' 1999 Performance - Markets Ranked by RevPAR Growth

Percentage Change from Prior Year (except for occupancy change)

	RevPAR Growth	Occupancy Point Difference	ADR Growth	Supply Growth	Demand Growth
Detroit, MI	7.8%	1.2%	6.0%	4.6%	6.6%
Miami-Hialeah, FL	6.9%	0.6%	7.8%	6.0%	5.1%
New Orleans, LA	6.4%	0.4%	5.8%	3.2%	3.8%
Washington, DC-MD-VA	6.1%	1.0%	4.7%	3.8%	5.4%
San Diego, CA	5.9%	-0.4%	6.4%	1.7%	1.2%
Los Angeles-Long Beach, CA	5.8%	0.9%	4.5%	1.2%	2.6%
Boston, MA	5.4%	-0.2%	5.7%	7.1%	6.7%
Tampa-St. Petersburg FL	5.4%	0.3%	4.9%	3.6%	4.0%
New York, NY	5.0%	-0.2%	5.2%	3.1%	2.8%
San Francisco-San Mateo	4.7%	-0.9%	5.8%	3.0%	1.7%
Atlanta, GA	3.5%	-0.3%	3.0%	5.5%	6.1%
Chicago, IL	3.0%	-0.6%	3.9%	4.4%	3.4%
Anaheim-Santa Ana, CA	2.9%	0.9%	1.5%	1.6%	3.1%
Norfolk-Virginia Beach	1.9%	-1.3%	4.1%	2.1%	0.1%
St. Louis, MO-IL	1.6%	0.7%	0.5%	4.6%	5.8%
Minneapolis-St. Paul, MN	0.1%	-0.8%	1.3%	4.3%	3.1%
Philadelphia, PA-NJ	0.0%	-0.9%	1.3%	9.6%	8.2%
Orlando, FL	-0.8%	-2.9%	3.1%	6.0%	1.8%
Seattle, WA	-1.3%	-3.4%	3.4%	8.4%	3.3%
Nashville, TN	-1.3%	-0.9%	0.1%	4.5%	2.8%
Oahu Island	-3.2%	-0.4%	-2.6%	-0.1%	-0.7%
Denver, CO	-4.4%	-3.0%	0.0%	12.0%	7.1%
Dallas, TX	-4.7%	-3.3%	0.3%	12.3%	6.7%
Phoenix, AZ	-4.7%	-2.2%	-1.3%	9.7%	5.9%
Houston, TX	-4.9%	-3.3%	0.3%	7.5%	1.9%

Source: Smith Travel Research, *Lodging Outlook, February 2000.*

The performance in 1999 was mixed within price segments. Both budget and economy segments achieved the highest inflation-adjusted RevPAR growth (+3.0 percent and +2.3 percent, respectively), benefiting from healthy ADR gains. On the other hand, luxury, upscale, and midprice properties sustained below-average inflation-adjusted RevPAR increases. Though room demand was exceptionally strong in these segments, room supply expanded even faster. These led to large occupancy declines, which in turn inhibited room rate increases among these properties.

By region, strong ADR growth allowed New England, Mountain, Pacific, and Middle Atlantic regions to outperform the overall industry in terms of real RevPAR growth (+6.2 percent, +2.1 percent, +1.7 percent, and +1.7 percent, respectively) in 1999. In contrast, hotels in the East South Central and West South Central reported declining real RevPAR growth as both regions suffered weak occupancies and ADR performance.

In terms of location, resort properties registered the highest real RevPAR growth (+1.8 percent) due to above-average ADR gains. Meanwhile, hotels in airport, suburban, and urban areas reported stagnant or declining real RevPAR. Hotel occupancy suffered material declines in these markets, resulting in ADR growth only slightly above inflation.

Among the top 25 metropolitan statistical areas, Detroit, Miami-Hialeah, New Orleans, Washington D.C., San Diego, Los Angeles-Long Beach, Boston, Tampa-St. Petersburg, New York, and San Francisco/San Mateo reported RevPAR growth significantly above the industry average in 1999. Robust lodging demand expansion allowed ADR in these markets to grow at least twice as fast as the rate of inflation despite significant drops in occupancy in many cases. In contrast, weak demand continued to drive down occupancy and room rates in Oahu Island. Meanwhile, Denver, Dallas, Phoenix, and Houston generated the most dramatic drops in real RevPAR growth among the metro markets due to rapid supply growth.

LODGING INDUSTRY OUTLOOK, 2000 TO 2001

PricewaterhouseCoopers expects room demand to increase 3.0 percent in 2000; and 2.7 percent in 2001. *(Table 3 presents the U.S. lodging industry forecasts.)*

As new development projects are expected to slow, PricewaterhouseCoopers expects a gradual decline in room starts through year 2001. From 151,866 rooms in 1998, annual room starts will decline at a compound annual rate of 6.4 percent through 2001, but will still remain at high levels (exceeding 100,000 rooms). By 2001, demand growth will catch up as room supply growth slows to 2.8 percent. As a result, occupancies will decline by 0.4 occupancy point to 62.7 percent in 2000 from 63.4 percent in 1999, and stabilize in 2001.

Table 3

PricewaterhouseCoopers U.S. Lodging Forecasts, 2000 - 2002

	1998	1999	2000	2001	2002
Occupancy (%)	63.9	63.4	63.0	62.7	62.7
Average Daily Rooms Sold	2,357	2,440	2,515	2,582	2,652
Change from Prior Year (%)	3.2	3.5	3.0	2.7	2.7
End-of-Year Room Supply					
Change from Prior Year (%)	4.2	3.9	3.5	2.8	2.6
Average Daily Rate ($)	78.01	81.07	83.99	87.10	90.40
Change from Prior Year (%)	4.4	3.9	3.6	3.7	3.8
Revenue per Available Room					
Change from Prior Year (%)	3.6	3.2	3.1	3.3	3.8

Source: Forecasts are from *PricewaterhouseCoopers Hospitality Directions*, December 1999/January 2000. Historical data are from Smith Travel Research.

Cumulative supply pressures will result in moderating real ADR growth. Nominal ADR will grow less than four percent in the next two years while annual inflation is expected to rise at least by 2.5 percent. In inflation-adjusted terms, PricewaterhouseCoopers expects ADR to increase 0.9 percent in 2000 and 0.8 percent in 2001.

Moderating ADR growth and declining occupancies in 2000 will lead to decreasing RevPAR trends. RevPAR is expected to grow 3.1 percent in 2000. RevPAR growth will improve slightly to 3.3 percent in 2001 as occupancy rate ceases its downward trend.

Despite the declining trend in RevPAR growth, industry profits will continue to climb, but at a decelerating pace. Hotels will increasingly rely on non-room activities to boost revenues and cut expenses to improve profit margins. PricewaterhouseCoopers expects aggregate profits to increase to $24.4 billion in 2000 and $26.5 billion in 2001. REI

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. Dr. Hanson is an author and frequent speaker who has been quoted in countless major business and industry publications. He is or has been an officer, board member, or faculty member of many industry, educational, and civic organizations including AH&MA, HS&MAI, Cornell University, and New York University. He has served as International President of the Cornell Society of Hotelmen and was the Cornell Hotelier of the Year in 1994.*