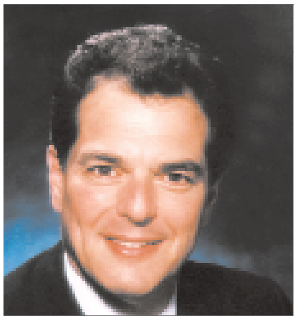

By Rick Swig

Recent Occupancy, ADR Growth Still Do Not Spell Post-9/11 Relief

THE HOTEL REAL ESTATE SECTOR IS ABUZZ WITH enthusiasm about year-over-year growth in occupancy and average daily rate. Many are acting as if the recovery is reaching a climax, as rumors persist that the nation's economy is far improved. Although there are some grounds for optimism, let's not get carried away with excitement.

Demand for hotel rooms was slipping well before 9/11. Through June 2001, Smith Travel Research reported that occupancy on a year-to-date basis had dropped by 2.7%, while ADR levels had shown a modest gain of 2.3%. Major markets were showing far greater annual occupancy declines, including San Francisco (-13.9%), New York City (-8.3%), Boston (-7.9%), Dallas (-7.7%), Chicago (-7.6%) and Orlando (-7.1%). What's more, this was only the beginning of the down cycle. Hotels then began the process of discounting room rates in an effort to either stimulate non-existent demand or poach market share.

Total 2% revenue growth over four years has not kept up with national annual average inflation growth of 2.5%.

Midyear 2004 presents a benchmark to assess the damage and the recovery trend in comparison to three years ago. After the first six months of this year, the national occupancy level sat at 60.5% versus 61.9% for the same period in 2001. With the exception of New York (74.9% through June 2001 versus 78.7% through June 2004) and Orlando, which had no change at 71.6%, there were unfavorable comparisons for Chicago (62.9% in 2001 versus 58.9% in 2004), Boston (66.8% versus 60.5%), Dallas (61.9% versus 57.2%) and San Francisco (69.6% versus 65.6%).

Comparisons in ADR performance over the two periods show an exacerbated situation. The national ADR after six months in 2001 was $87.67, while the ADR for the same period in 2004 it was $86.48. A review of the same major markets indicates the following ADR declines, paired with the percentage of the decline: Chicago (-$13.72/-12.2%), Boston (-$22.89/-16.3%), Dallas (-$7.80/-9.4%), New York City (-$18.14/-9.5%), Orlando (-$1.60/-1.7%), and San Francisco (-$34.21/-22.4%).

Smith Travel Research has forecast an overall revenue increase in 2004 from 2003 of 5.2% in the hotel sector. Coincidentally, total revenues this year are above levels of the banner year of 2000. This is seemingly great news and contrasts the trends noted above.

Even though revenues are back above the peak by nearly 2%, there are other issues, starting with supply growth of 4.4% since June 2001 versus average number of rooms sold increasing only by 3.3%. Furthermore, that total 2% revenue growth over four years (0.5% annually, if averaged) has not kept up with national annual average inflation growth of 2.5% during the same period.

The rallying call of "Stay Alive Until '05" remains applicable to current market conditions. Clearly, the leverage of compression in major markets due to high occupancy levels has not returned to benefit pricing strength. Statistics indicate that the business traveler, the bearer of pricing power to the market between 1998 and 2000, has still not returned in great numbers to major business centers.

Some trends forecast good opportunity in future years. Demand for hotel rooms is expected to exhibit year-over-year growth of 4% by year's end, while supply growth will trail at 1.2%. Most notably, the overall trend in the active development pipeline is down a significant 18.8% through the first quarter of 2004, according to STR and Dodge. An even more positive trend for the longer term is the 25.8% downturn of hotel projects in the pre-planning stage. This may have particular positive impact on future years, as less new supply coincides with a recovering and burgeoning economy to stimulate demand.

Hotel operators should focus on pricing power for the next 24 or so months until occupancy returns to pre-2001 levels and compression begins to build. At presstime, national consortium and high volume travel contracts are being finalized for 2005. Hotels will have to be successful in achieving significant rate hikes through these conduits, since the past two years of negotiations have yielded little or no rate increase as operating expense inflated.

Higher demand and limited supply increases will return the hotel real estate sector to good health. But it will be frustrating to remain patient until improved fundamentals stabilize. ◆

The views expressed in this article are those of the author and not Real Estate Media or its publications.

***Rick Swig** is president of RSBA & Associates, a hospitality industry consulting firm based in San Francisco. He may be contacted at rickswig@rsbaswig.com.*