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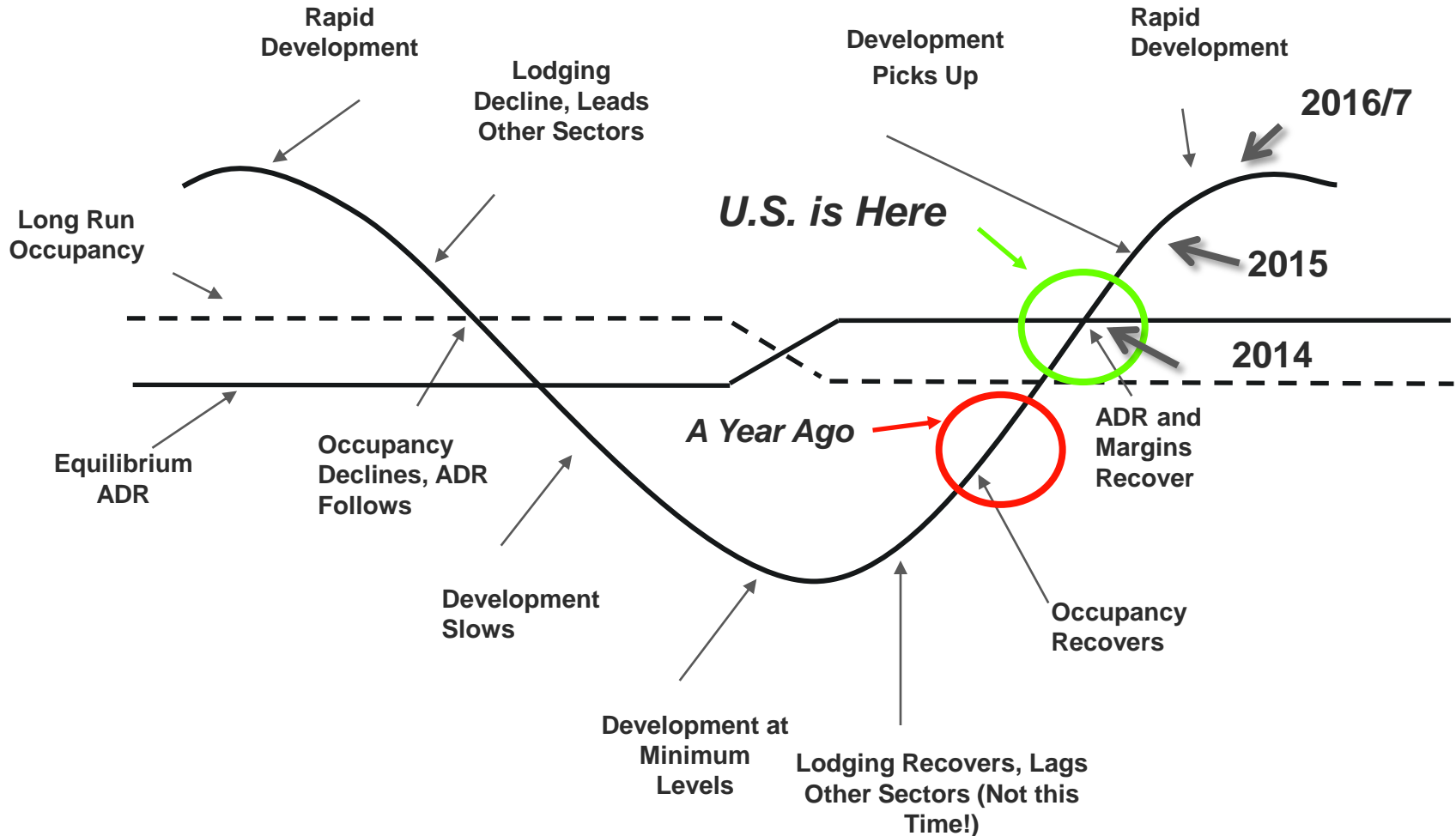
2014 Hospitality Summit

# The Path to the Peak

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May 8, 2014  
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# The Hotel Market Cycle

## Entering the Sweet Spot



# The Path to the Peak

- **The Economy**
- **Some Facts**
- **What to Expect**
- **Where are Cap Rates Headed?**



# *Hotel Horizons*® Forecasting Model

- **STR, Inc.**
  - Historical rooms occupied, room available, rooms revenue
  - Pipeline of future hotel construction
- **Moody's Analytics**
  - Economic forecasts

**May 2013**

# **What Did We Say a Year Ago?**



## United States

	<u>2013</u>		<u>2014</u>	
	March <u>2013</u>	STR <u>Actual</u>	March <u>2013</u>	Most Recent <u>Update</u>
Occupancy	61.9%	62.3%	63.2%	63.3%
ADR	5.3%	3.9%	4.8%	4.9%
RevPAR	7.3%	5.4%	6.6%	6.6%

**Stronger Demand  
Weak ADR**

**Will ADR's Catch Up?**

# Next Topic

# The Economy



# Leading Economic Indicator Index

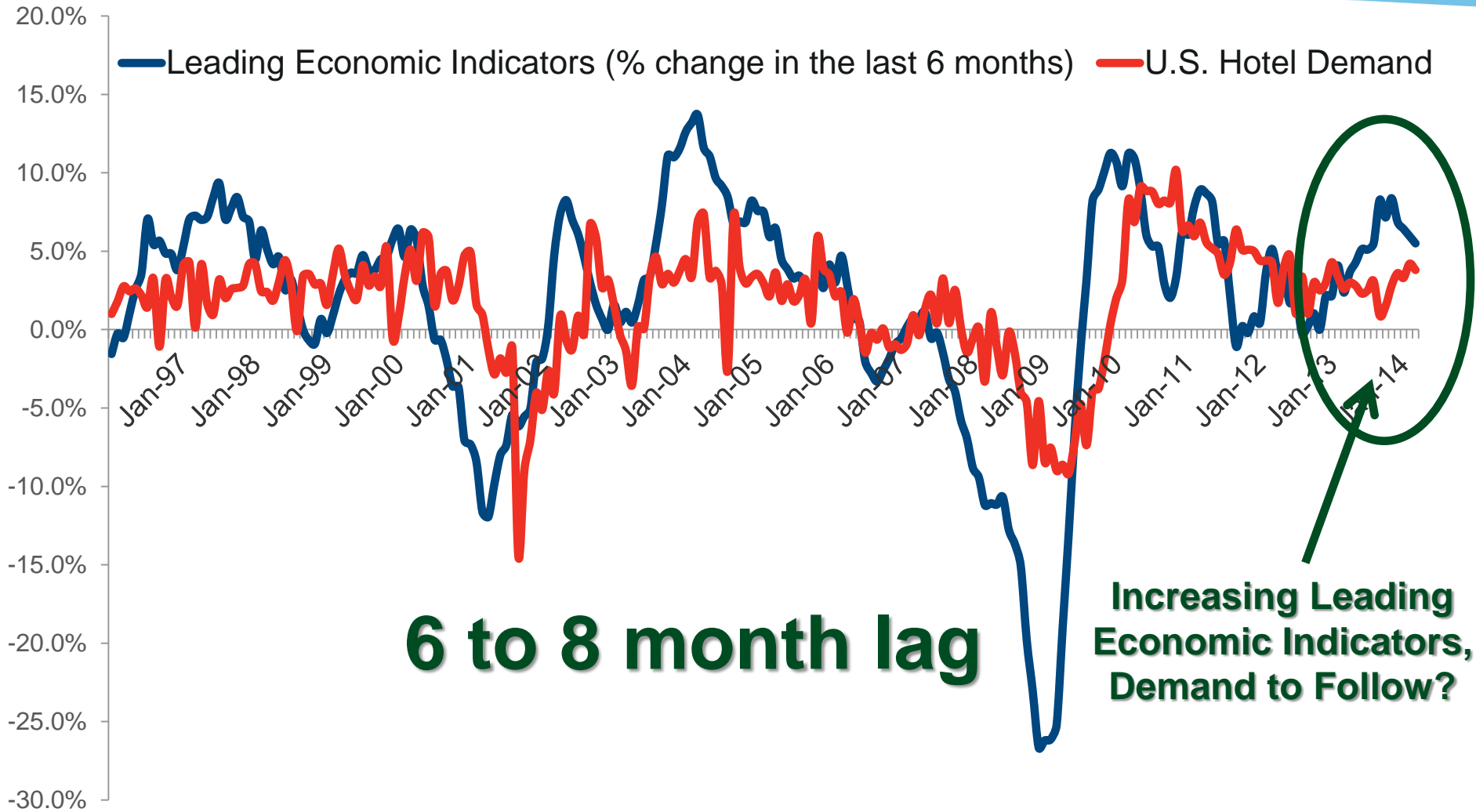
## The Conference Board

### Components of the Conference Board's Leading Economic Indicator Index:

- Average weekly hours, manufacturing
- Average weekly initial claims for unemployment insurance
- Manufacturers' new orders, consumer goods and materials
- ISM new orders index
- Manufacturers' new orders, nondefense capital goods excl. aircraft
- Building permits, new private housing units
- Stock prices, 500 common stocks
- Leading Credit Index™
- Interest rate spread, 10-year Treasury bonds less federal funds
- Avg. consumer expectations for business conditions



# % change in last 6 months – March 2014



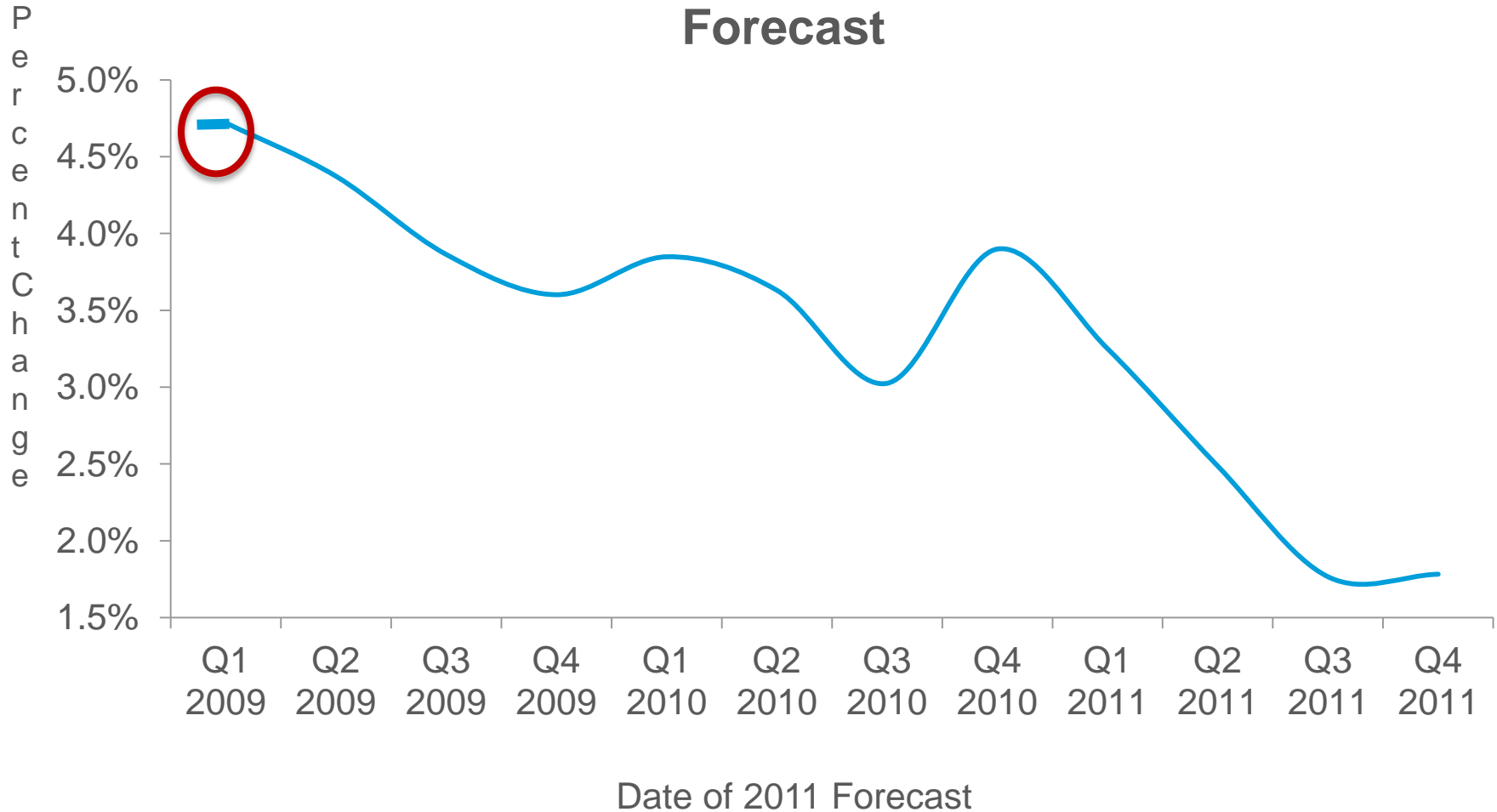
# Did You Know?

**Economists Are Always Wrong!**



# Economist are Always Wrong!

## 2011 Real Gross Domestic Product (GDP) Forecast



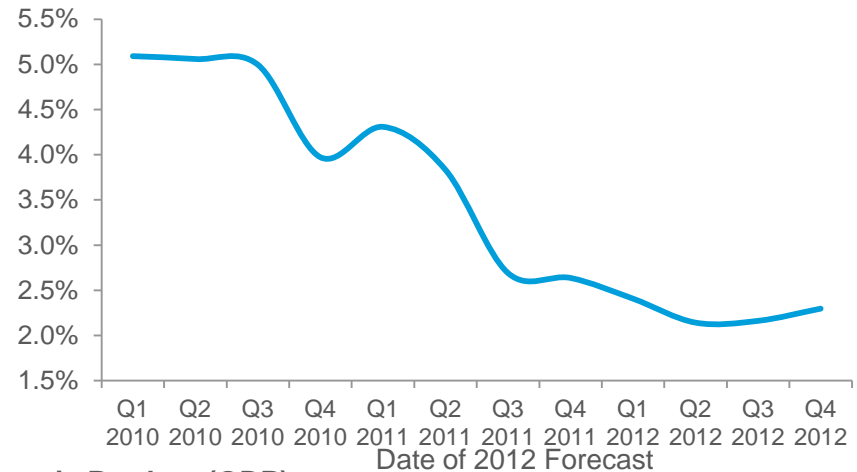
Source: Moody's Analytics

# Economist are Always Wrong!

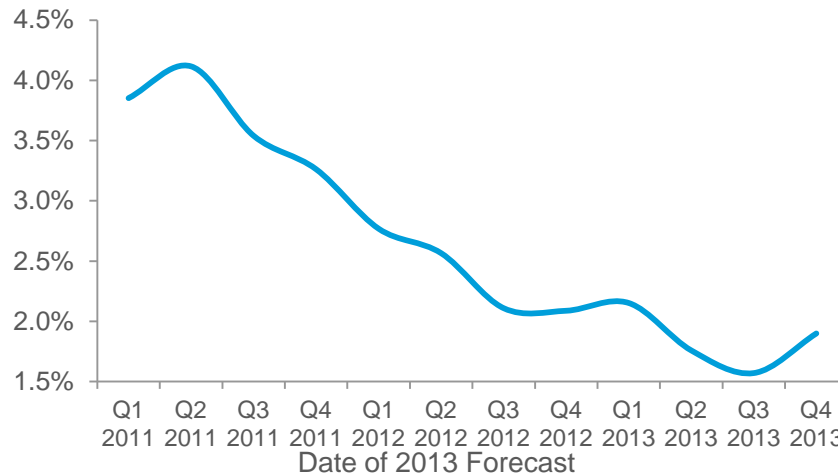
**2011 Real Gross Domestic Product (GDP)  
Forecast**



**2012 Real Gross Domestic Product (GDP)  
Forecast**



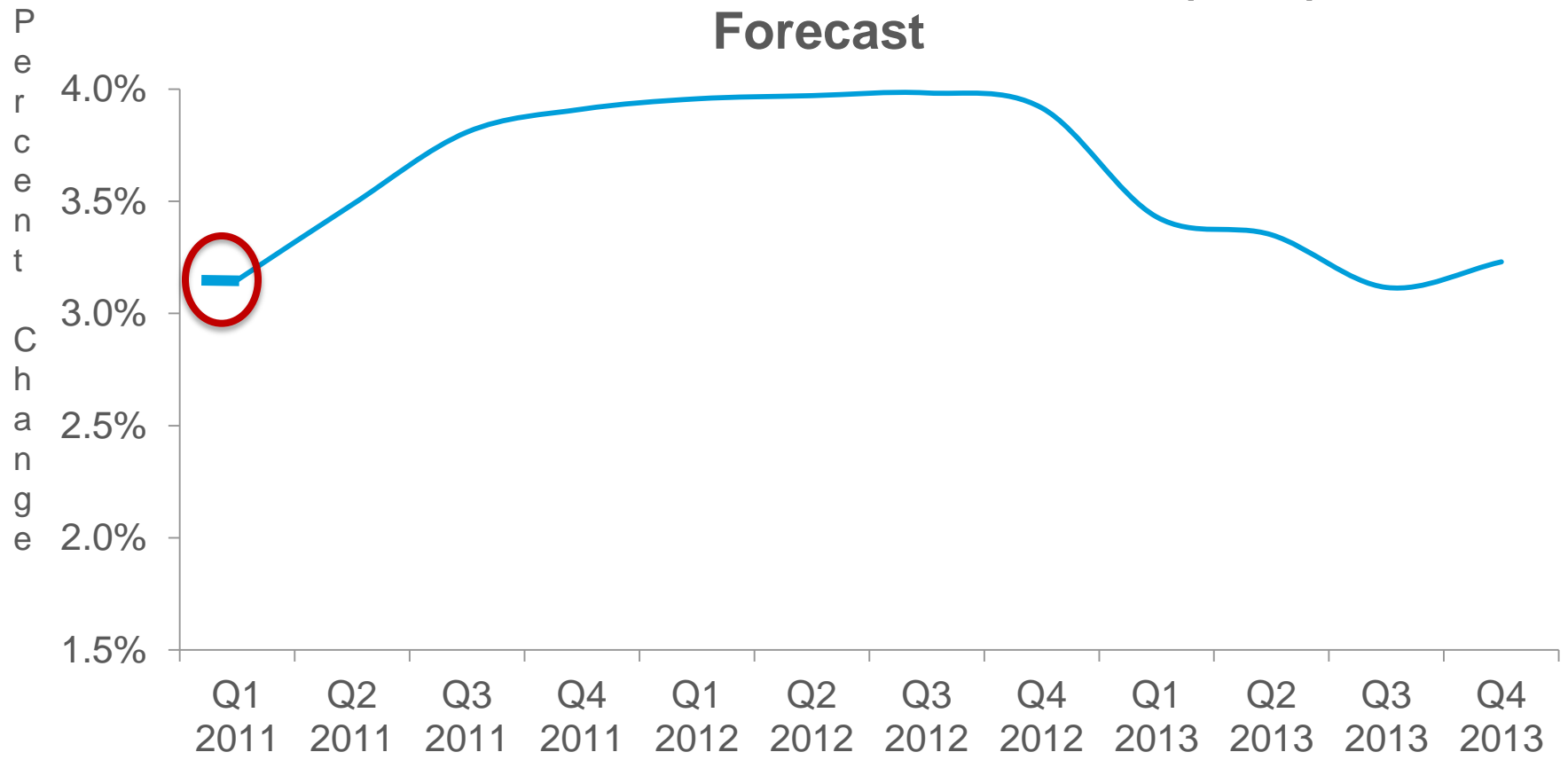
**2013 Real Gross Domestic Product (GDP)  
Forecast**



Source: Moody's Analytics

# Economists are **Sometimes** Wrong!

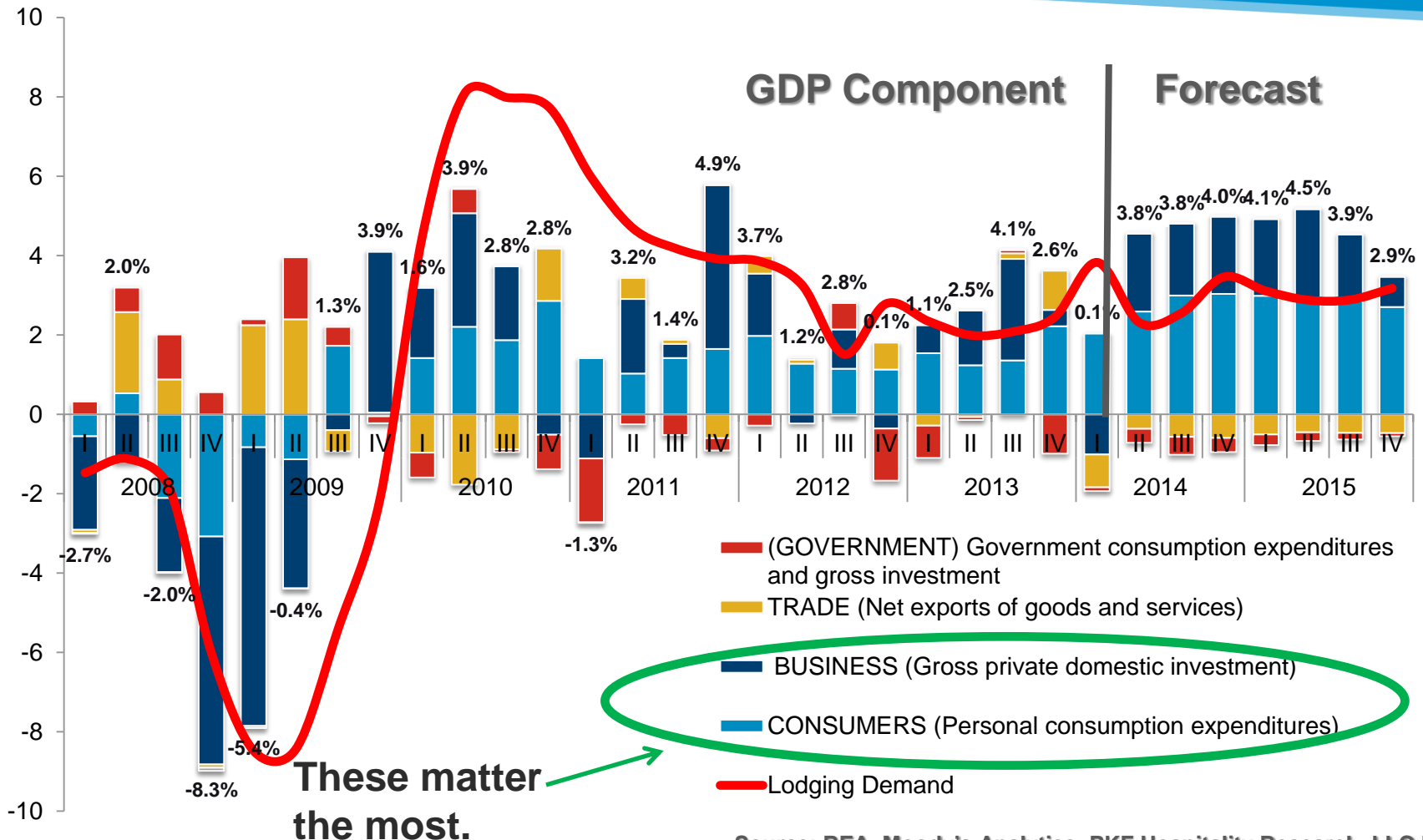
## 2014 Real Gross Domestic Product (GDP) Forecast



Date of 2014 Forecast

Source: Moody's Analytics

# The Outlook for the Drivers that are Most Important to Hotels Remains Favorable



Source: BEA, Moody's Analytics, PKF Hospitality Research, LLC Hotel Horizons: December - February 2014, Smith Travel Research

# What is Different Today?

- **Remember the:**
  - **Fiscal Cliff**
  - **S+P Downgrade**
  - **Government Shutdown**
  - **Greece, Cyprus, Spain, etc.**
- **Today:**
  - **Russia**
  - **I wonder what Monica Lewinsky is doing?**



# What's Different Now?

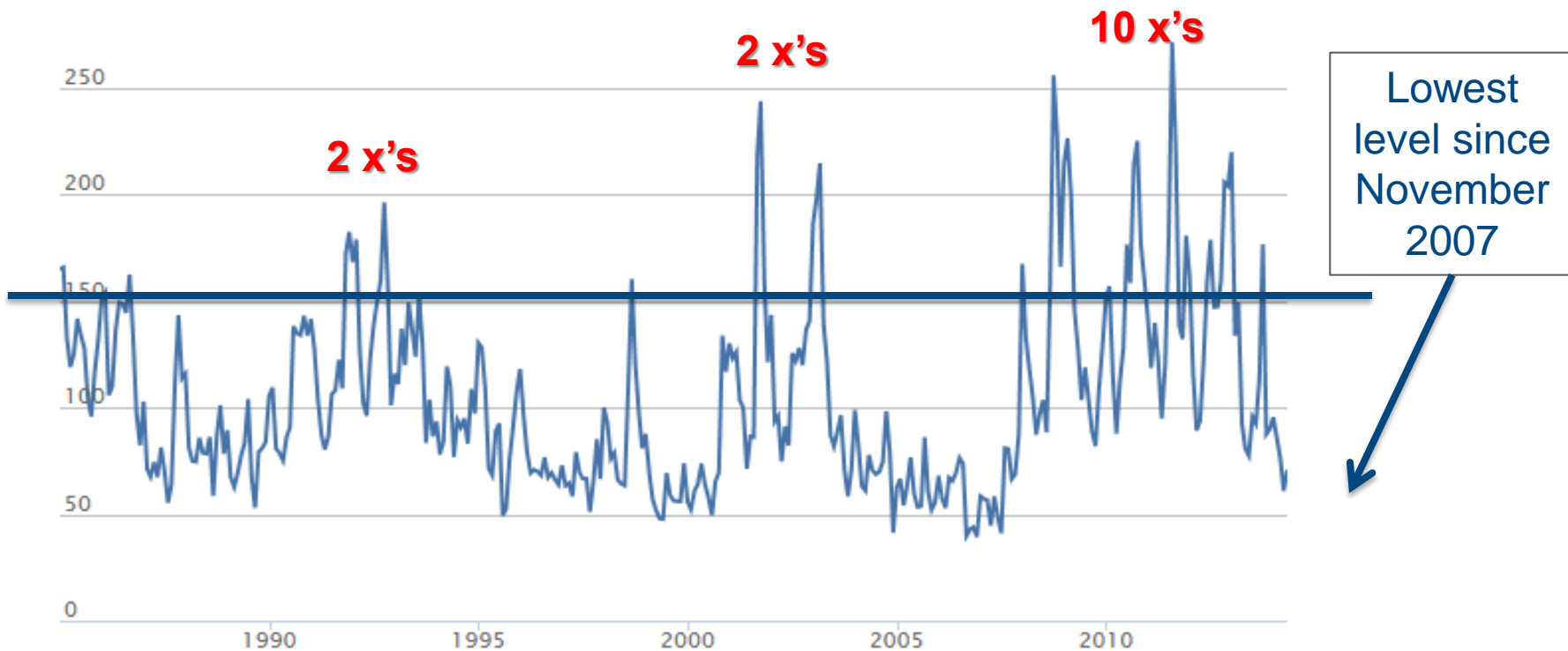
## Economic Policy Uncertainty Index

We develop indices of economic policy uncertainty for the world's major economies.

Daily News-based Economic Policy Uncertainty (7-Day Moving Avg)  

Zoom

From:  To:



Source: [policyuncertainty.com](http://policyuncertainty.com)

## Some Facts



# Some Happy Facts:

1. Demand has fully recovered.
  - Nationally and in 45 of 50 Top Markets.
2. 2013 Occupancy level was above the long run average.
  - Occupancy has increased four years in a row – 2014 will be a record 5<sup>th</sup>.
3. Limited supply growth persists.
  - Below long run average Nationally and in 47 of 50 top markets.
4. Urban locations at record occupancy levels.
  - To be followed by Airport locations in 2014.
5. Profits have increased > 10% per year since 2011.
  - A run that should last through 2015.

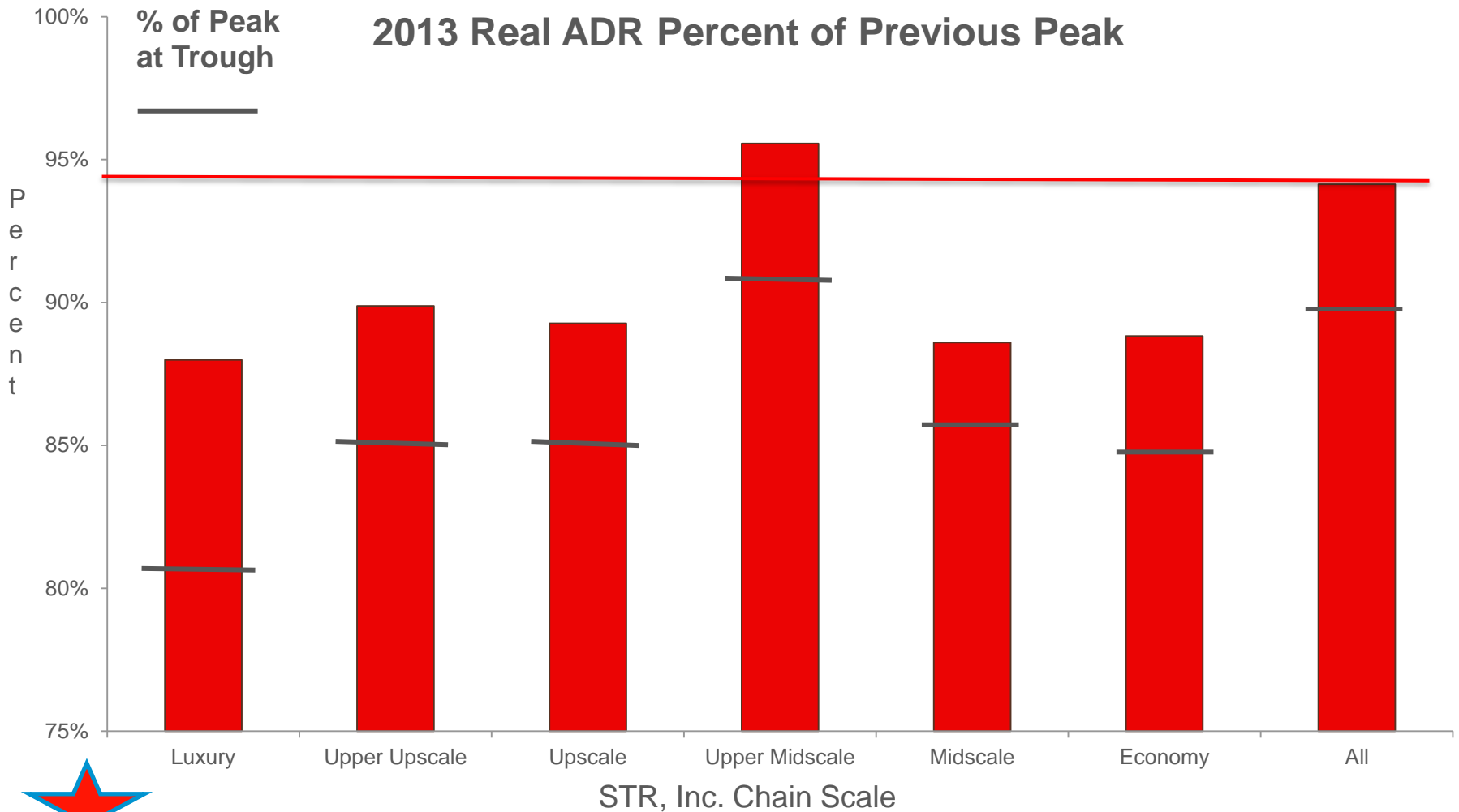
# Next Topic

## What to Expect

# A Not So Happy Fact:

1. Demand has fully recovered.
  - Nationally and in 44 of 50 Top Markets.
2. 2013 Occupancy level was above the long run average.
  - Occupancy has increased four years in a row – 2014 will be a record 5<sup>th</sup>.
6. Real average daily rates have a way to go.
3. Limited supply growth persists.
  - The industry is 95+% there.
  - Below long run average Nationally and in 47 of 50 top markets.
4. Urban locations at record occupancy levels.
  - To be followed by Airport locations in 2014.
5. Profits have increased > 10% per year since 2011.
  - A run that should last through 2015.

# Real ADR Recovery – Still a Way to Go



Source: PKF Hospitality Research, LLC, *March-May 2014 Hotel Horizons®*, STR, Inc..

# Troubling Signs in the Pipeline?

<u>Phase</u>	<u>2014</u>	<u>2013</u>	<u>% Change</u>
In Construction	102,855	72,509	41.9%
Final Planning	133,090	96,365	38.1%
Planning	145,558	151,876	<b>-4.2%</b>
Active Pipeline	<u>381,503</u>	<u>320,750</u>	18.9%

Total U.S. Pipeline, Number of Rooms by Phase, March 2014 and 2013

Source: STR, Inc.

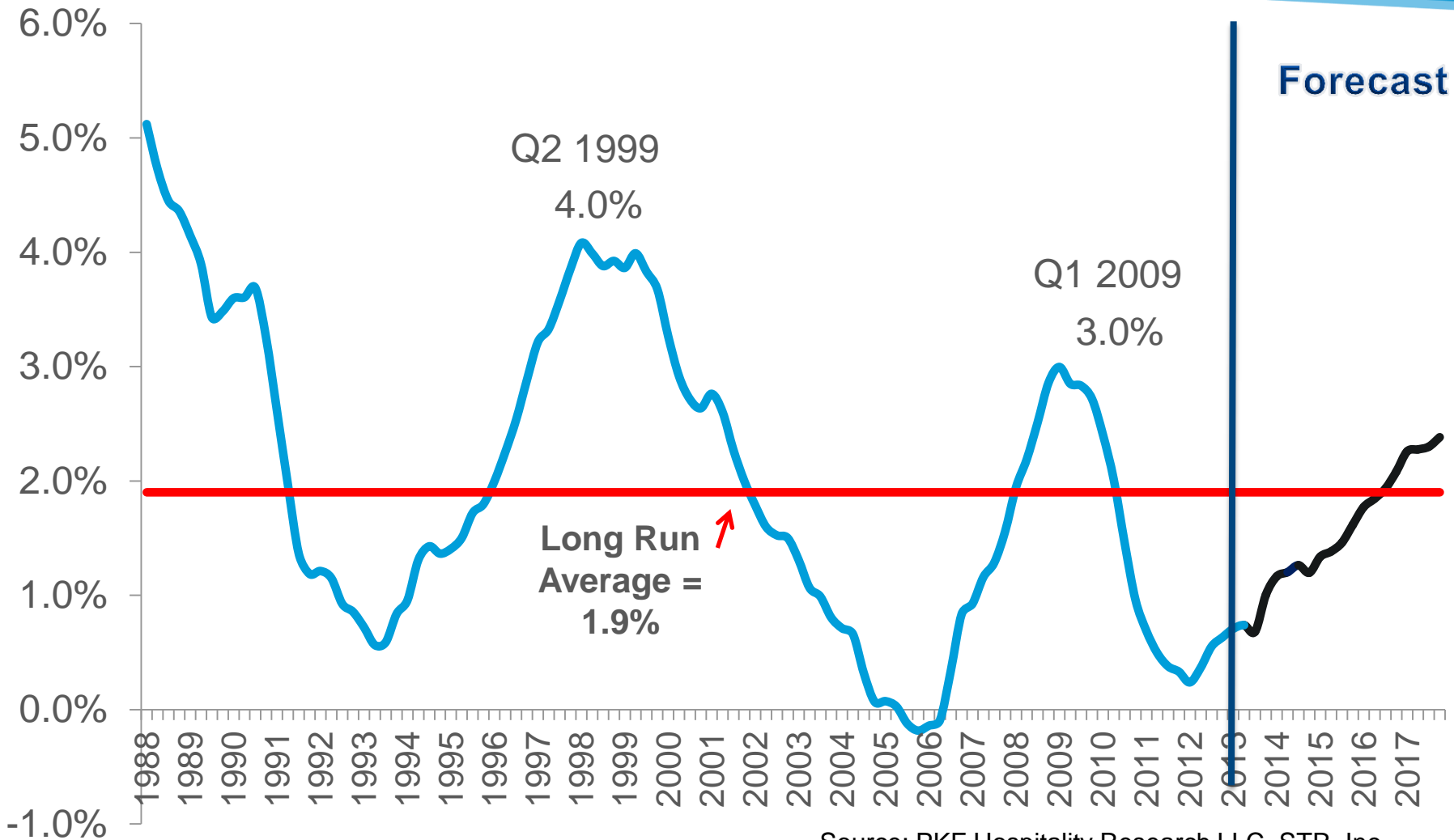


# Question:

**When Was Overbuilding  
Last an Issue?**



# U.S. Supply Change



Source: PKF Hospitality Research LLC, STR, Inc.

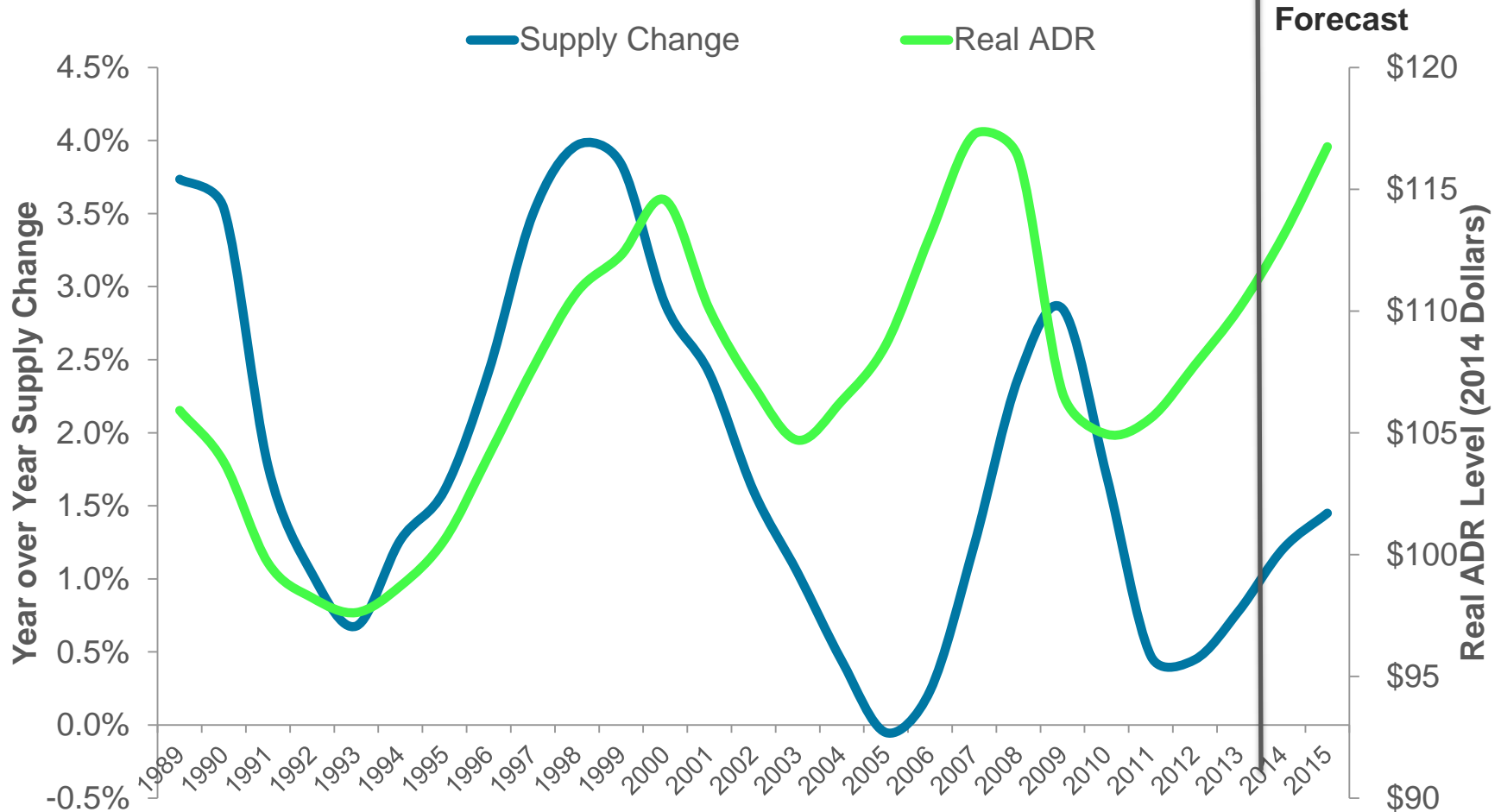
# Today vs. the Previous Peak of Construction Activity – Q1 2008

<u>Phase</u>	<u>2014</u>	<u>Q1/2008</u>	<u>% Difference Change</u>
In Construction	102,855	207,468	<b>-50.4%</b>
Final Planning	133,090	113,419	17.3%
Planning	145,558	344,363	<b>-57.7%</b>
Active Pipeline	<u>381,503</u>	<u>665,250</u>	<b>-42.7%</b>

Total U.S. Pipeline, Number of Rooms by Phase, March 2014 and March 2008

Source: STR, Inc.

# New Construction: Not a Near-Term Threat



# Real ADR Has Recovered in Six Markets

	2013-2015 Supply Growth
Market	Top 50 Rank
Austin	# 2
Nashville	# 3
Pittsburgh	# 4
New Orleans	# 13
San Francisco	# 45
Oahu	# 47

**New York = #1**

# 2011-2013 Leading and Lagging Markets

## Leading Markets

Historic Annual Average Change

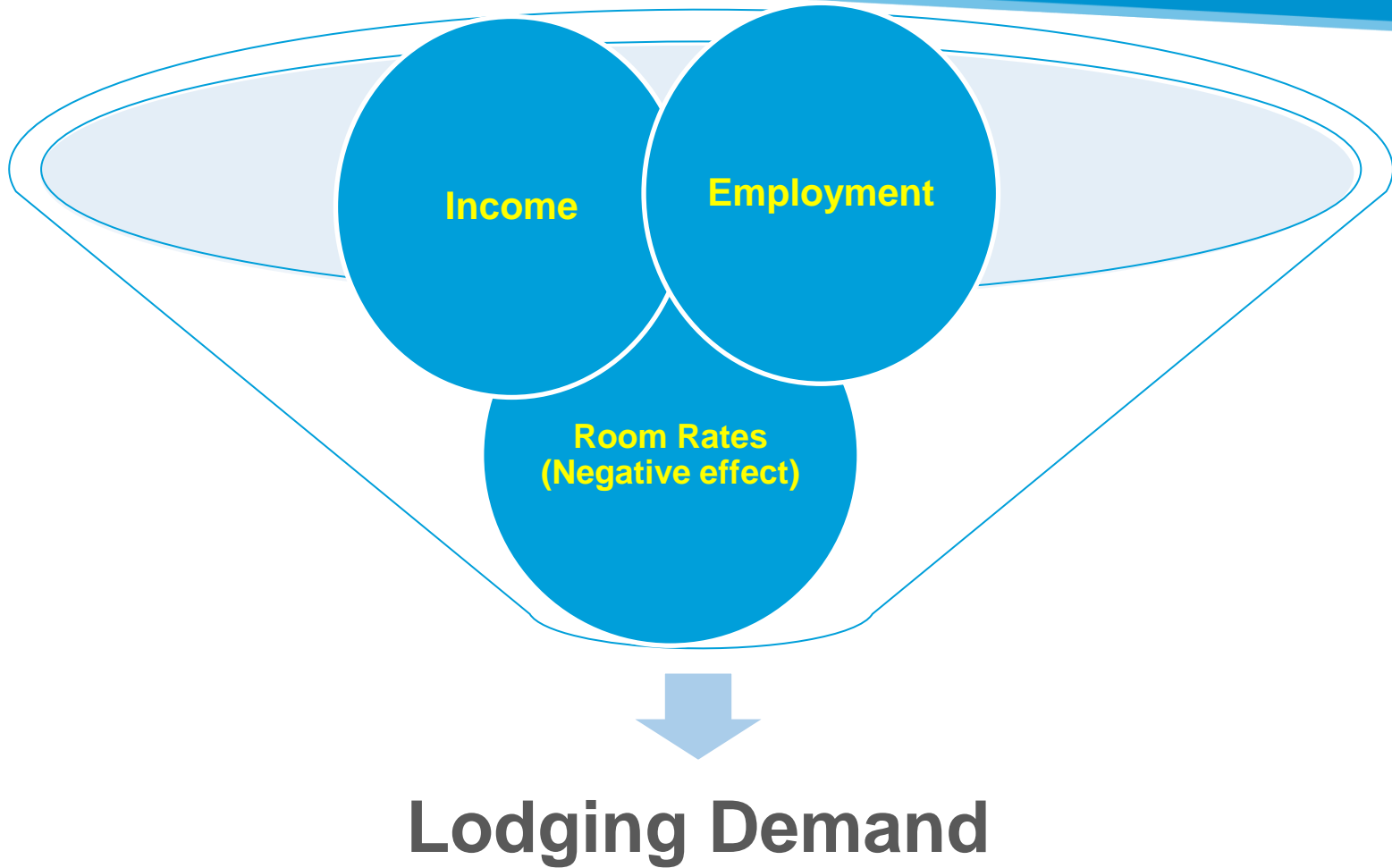
City	RevPAR Change	ADR Change
Oahu	15.4%	13.1%
Oakland	14.3%	9.0%
Houston	13.0%	5.7%
San Francisco	12.4%	10.1%
Nashville	10.9%	5.2%

## Lagging Markets

Historic Annual Average Change

City	RevPAR Change	ADR Change
Wash. DC	-0.4%	0.1%
Albuquerque	0.7%	1.1%
Baltimore	1.4%	2.0%
Tucson	1.5%	0.5%
Philadelphia	2.4%	2.7%

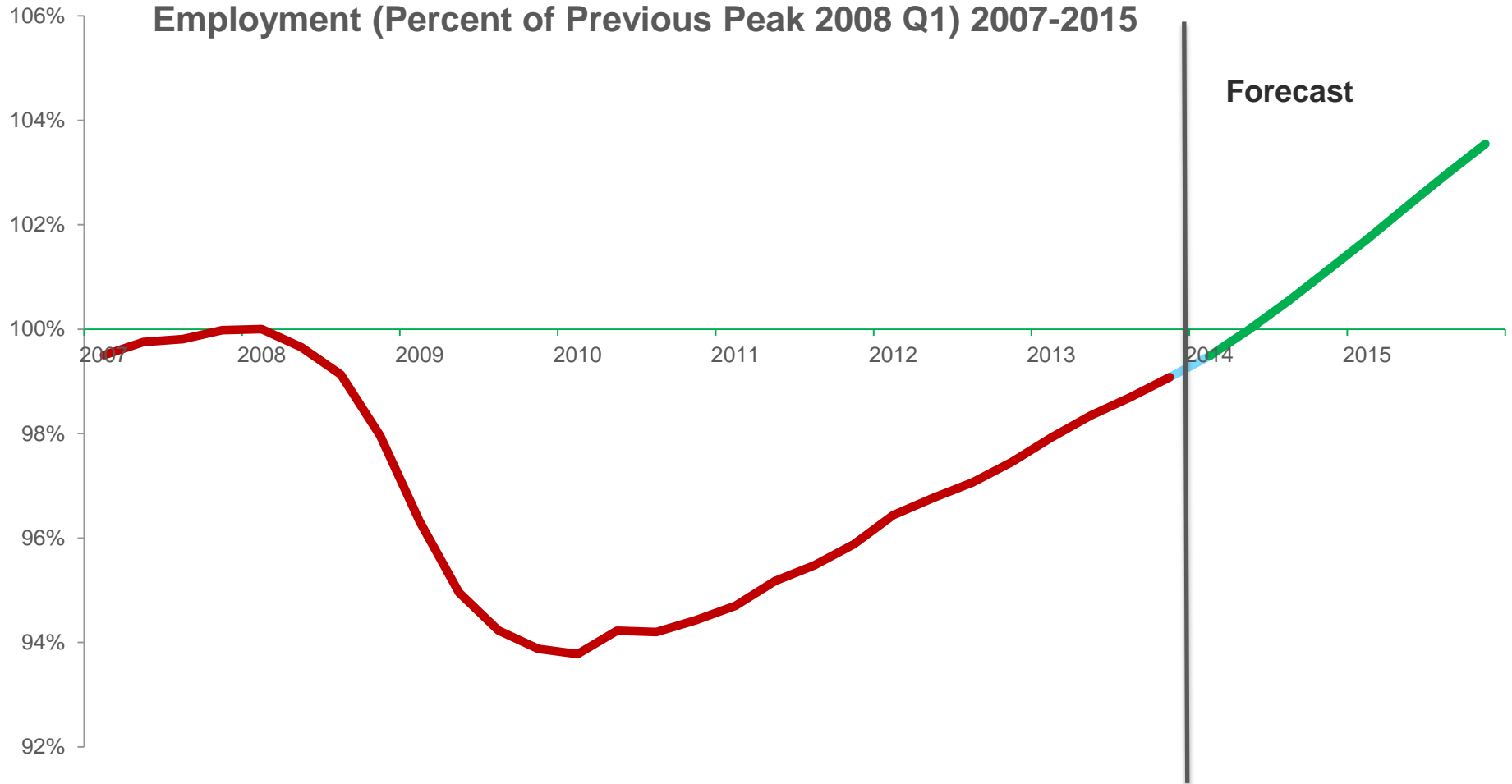
# Major Factors in the PKF Demand Equation





# Employment Recovery Nears

Employment (Percent of Previous Peak 2008 Q1) 2007-2015



- Some Types of Employment Matter More than Others.

## Primary Sectors:

1. Natural Resources/Mining
2. Construction
3. Manufacturing
4. Trade
5. Information
6. Financial Activities
7. **Education and Health Services\***
9. Leisure and Hospitality

**Almost All Are  
Forecast to  
Grow at Above  
Average Rates  
through 2015**

\* Below Average Growth

# 2013-2015 Leading and Lagging Markets

## Leading Markets

Forecast Average Annual Change  
2013-2015

U.S. Average  
Employment  
Forecast = 2.5% per  
year 2013-2015

City	RevPAR Change	ADR Change	Employment Change
San Francisco	9.9%	9.1%	2.9%
Oakland	9.5%	8.9%	2.1%
Dallas	8.6%	7.3%	3.6%
Chicago	8.3%	6.7%	2.1%
Denver	8.1%	6.7%	3.2%

**Above Average Employment Growth** - **Below Average Employment Growth**

# 2013-2015 Leading and Lagging Markets

## Lagging Markets

Forecast Average Annual Change

2013-2015

City	RevPAR Change	ADR Change	Employment Change
Wash. DC	2.1%	0.6%	1.9%
Long Island	2.4%	4.3%	2.3%
New York	4.3%	4.6%	1.9%
New Orleans	4.4%	4.9%	1.2%
Philadelphia	4.7%	2.6%	1.8%

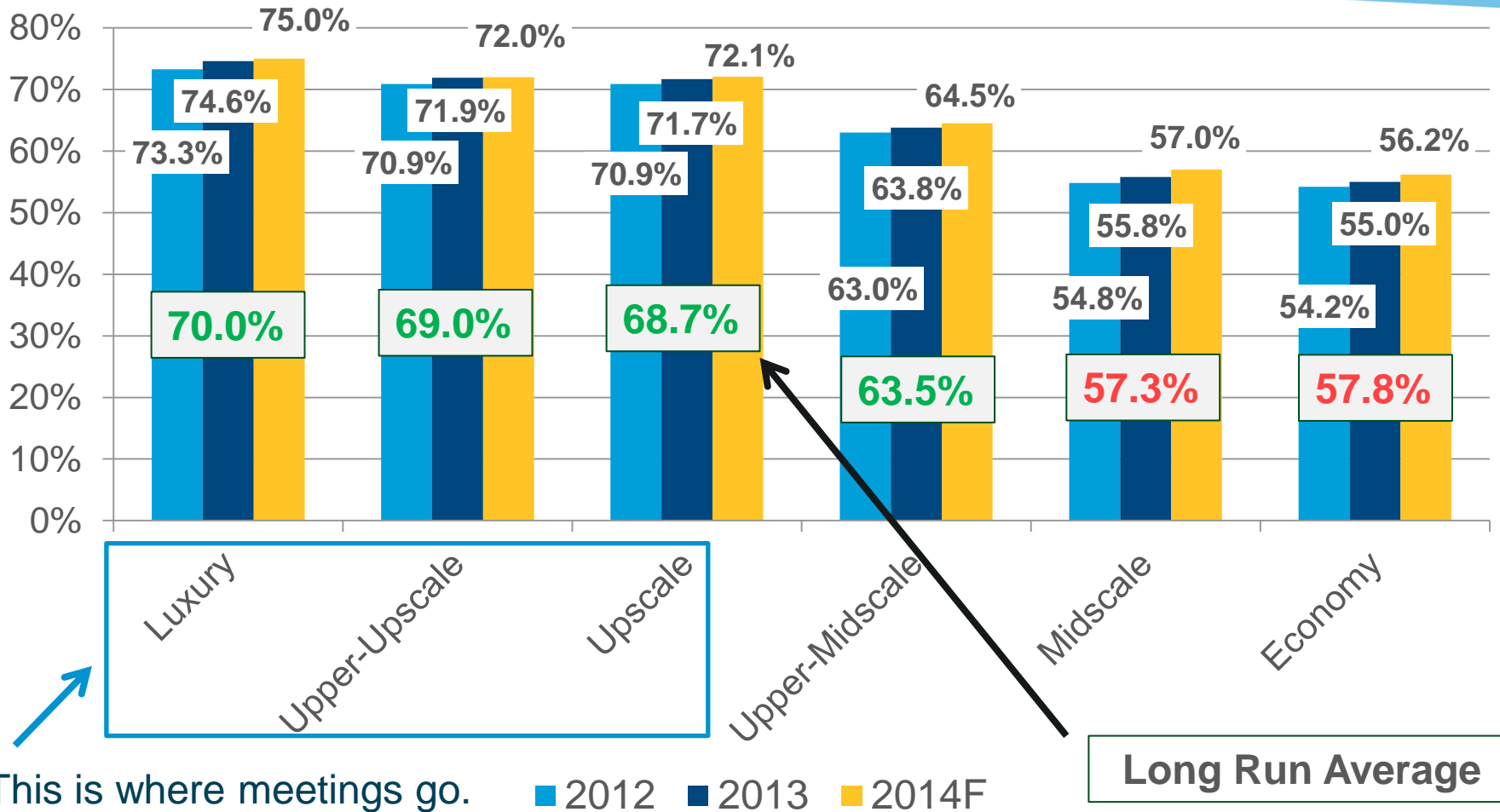
U.S. Average  
Employment  
Forecast = 2.5% per  
year 2013-2015

Supply Growth =  
5.7% per year



**Above Average Employment Growth** - **Below Average Employment Growth**

# Forecast Occupancy Levels By Chain-Scale

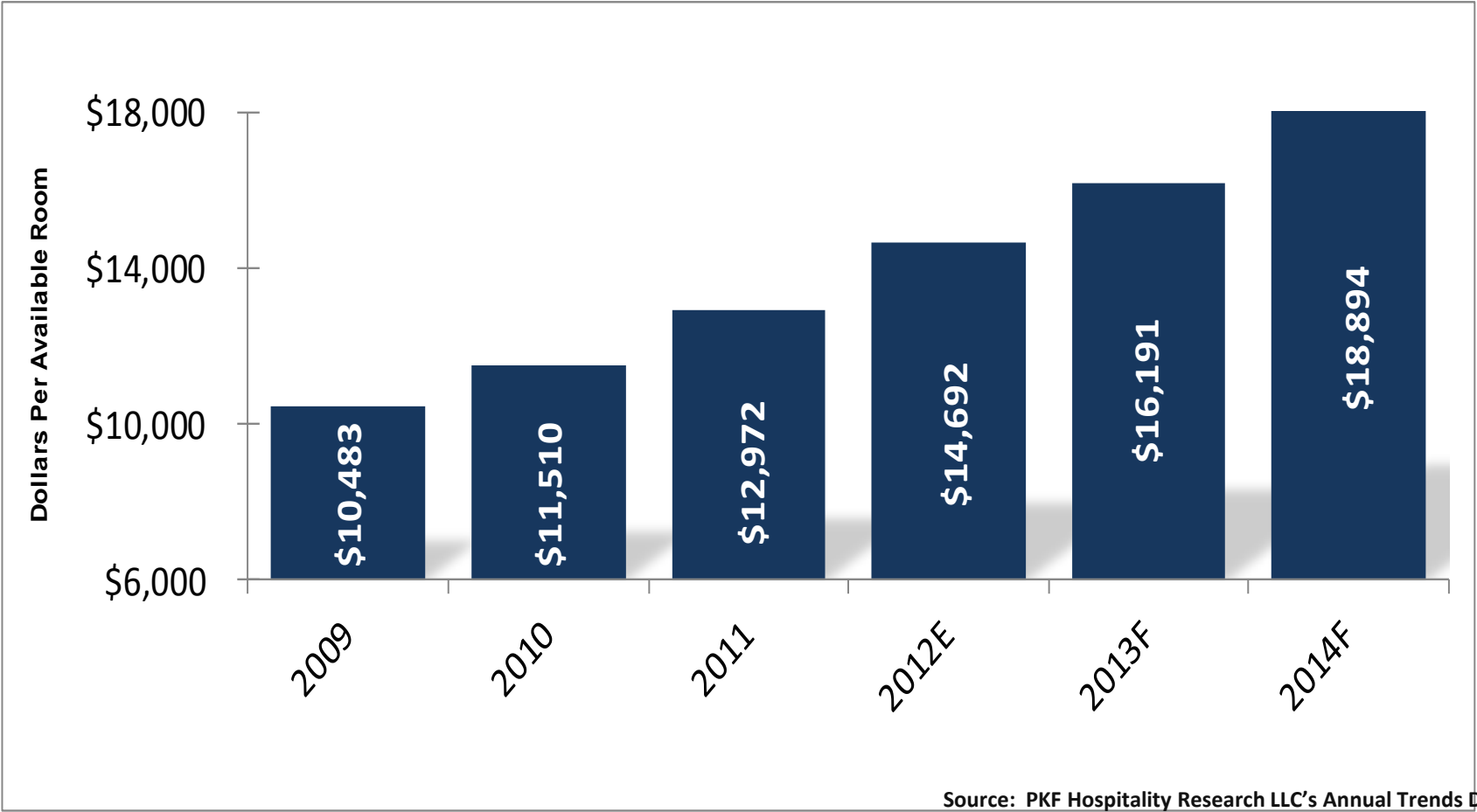


# RevPAR Forecast By Chain-Scale

## All U.S. Chain-Affiliated Hotels

Chain-Scale	2012	2013	2014F
Luxury (Ritz-Carlton, Four Seasons)	7.8%	7.5%	8.0%
Upper-Upscale (Marriott, Radisson Blu)	6.7%	5.9%	5.3%
Upscale (Courtyard, Radisson)	6.3%	5.4%	6.1%
Upper-Midscale (Hampton, Park Inn, C.I.)	6.6%	4.2%	4.3%
Midscale (Best Western, LaQuinta)	6.1%	4.1%	5.6%
Economy (Days Inn, Red Roof)	5.7%	4.9%	6.5%
<b>All Hotels</b>	<b>6.7%</b>	<b>5.5%</b>	<b>6.6%</b>

# Nominal Dollar Operating Profits\* Will Continue to Increase

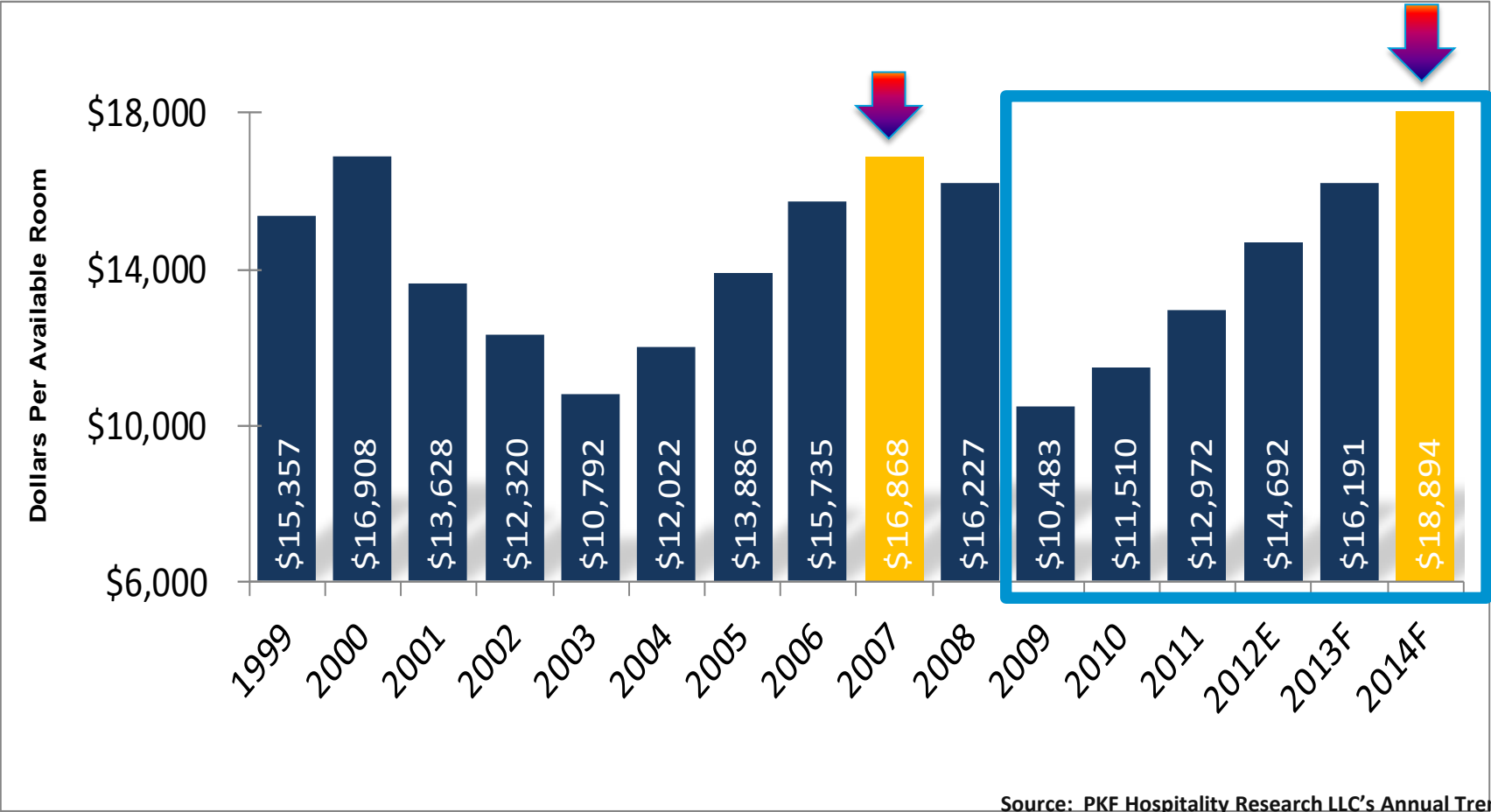


Source: PKF Hospitality Research LLC's Annual Trends Database

Note: \* Before capital reserve, debt service, rent, income taxes, depreciation, amortization.



# Nominal Dollar Operating Profits\* Surpass Previous Peak in 2014

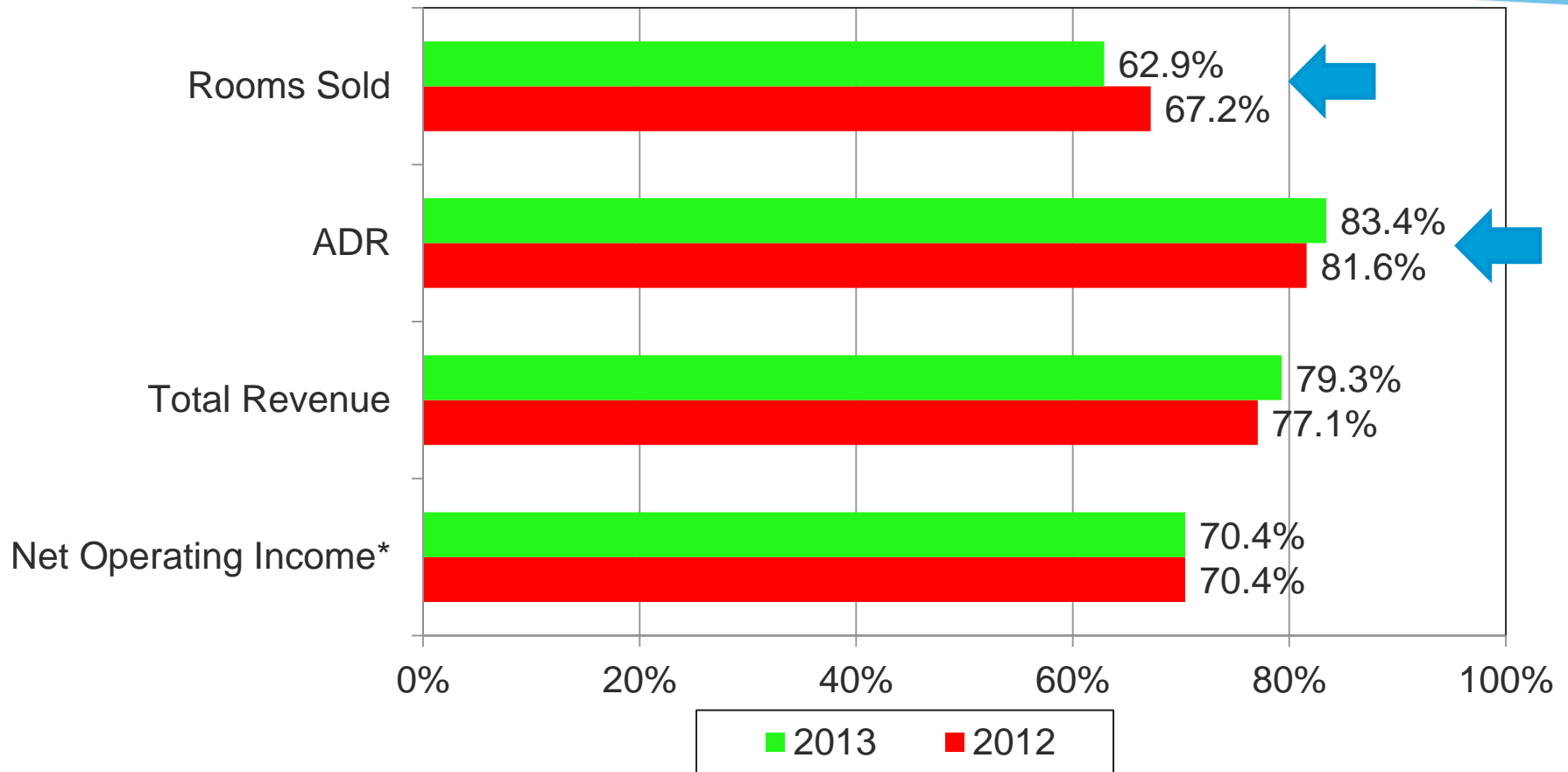


Source: PKF Hospitality Research LLC's Annual Trends Database

Note: \* Before capital reserve, debt service, rent, income taxes, depreciation, amortization.

# Stage In Cycle – ADR Driving Revenue

## Percent of Hotels\*\* Posting an Increase From Prior Year



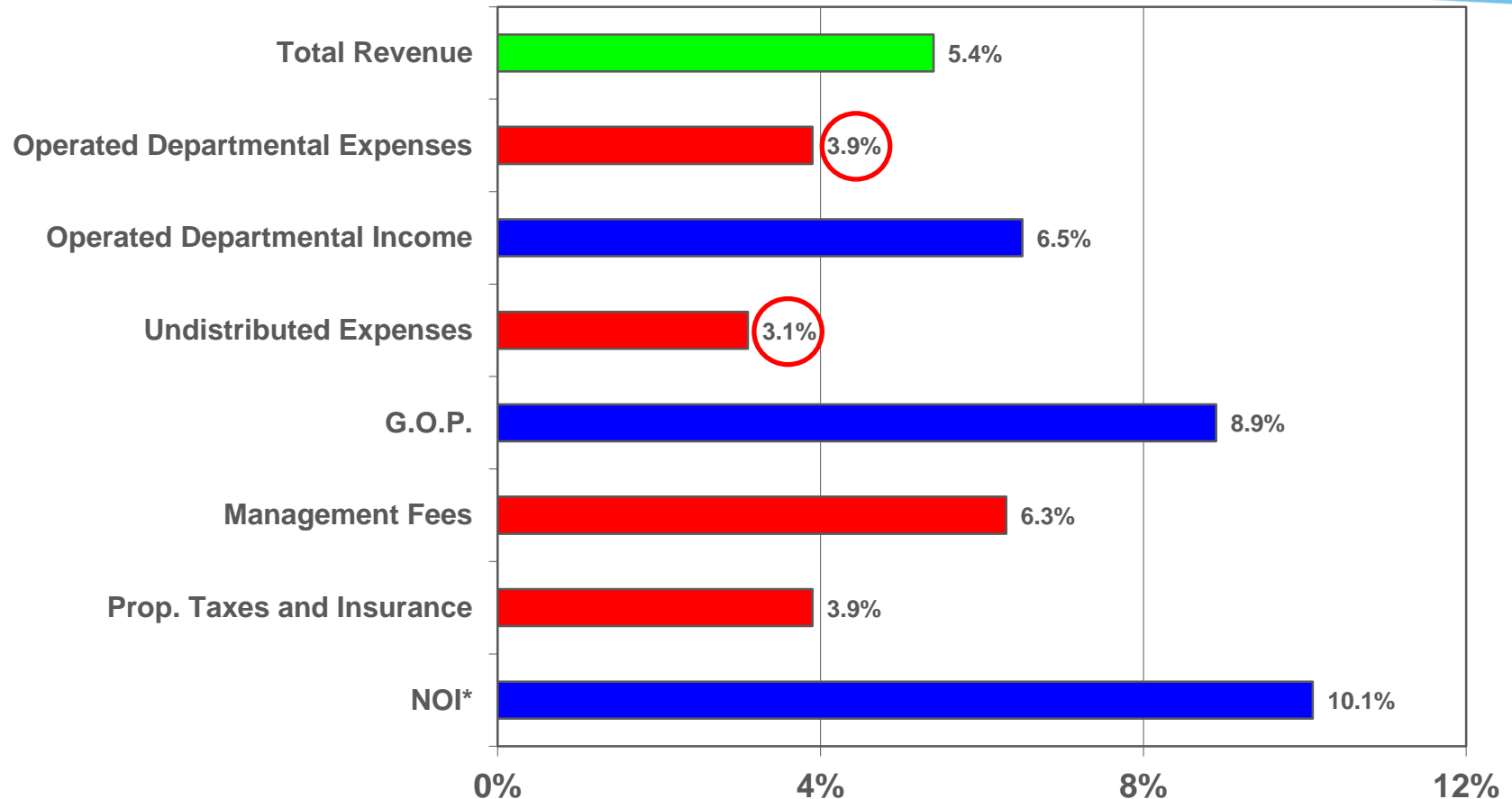
Notes: \* Before deductions for capital reserves, rent, interest, income taxes, depreciation, and amortization.

\*\* *Trends® in the Hotel Industry* sample.

Source: PKF Hospitality Research, LLC, *Trends® in the Hotel Industry* reports.

# 2013 U.S. Hotel Operating Performance

## Change – 2012 to 2013

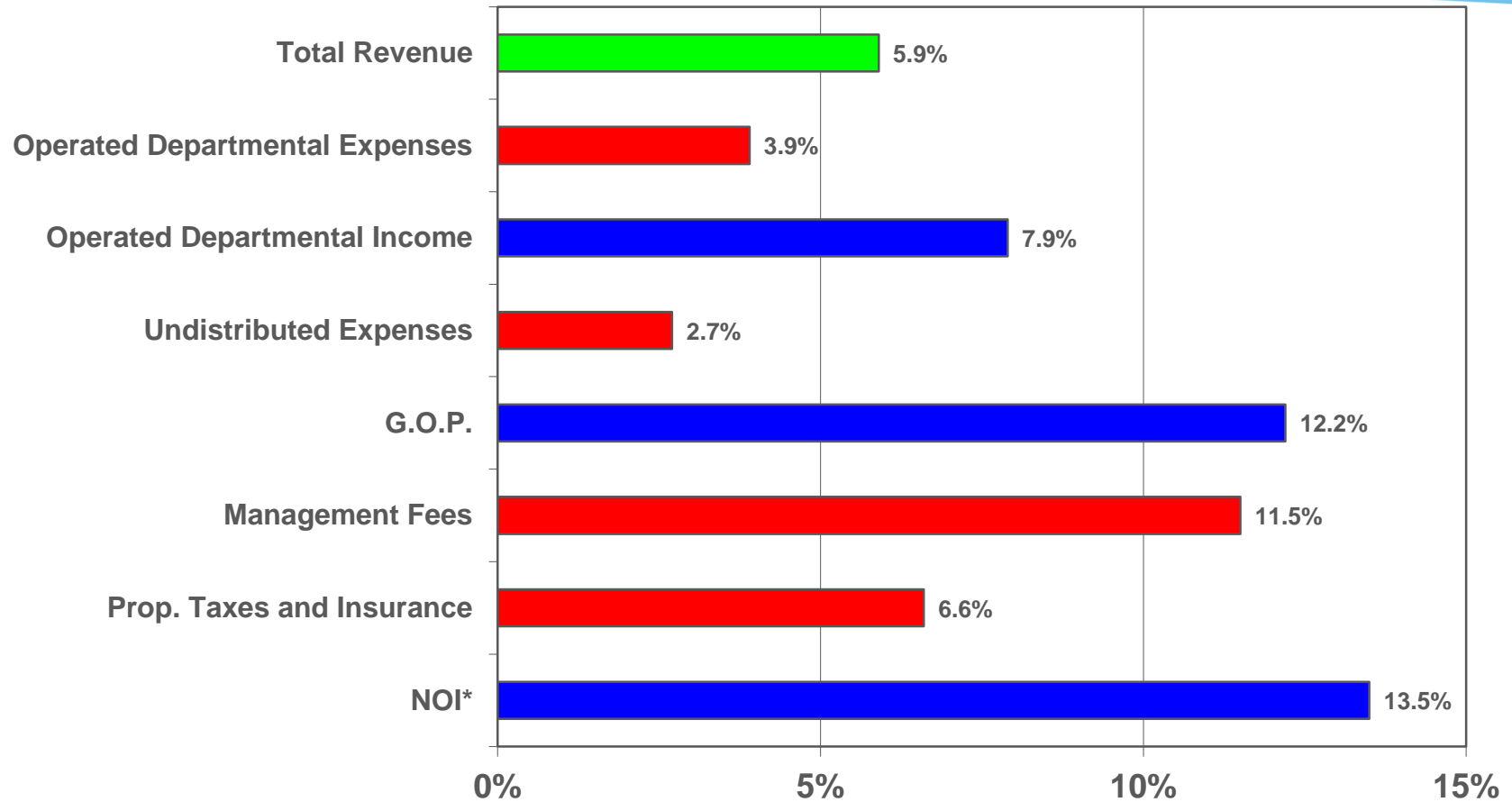


Notes: \* Before deductions for capital reserves, rent, interest, income taxes, depreciation, and amortization.

Source: PKF Hospitality Research, LLC, 2014 *Trends® in the Hotel Industry* report.

# 2013 U.S. Luxury Hotel Operating Performance

Change – 2012 to 2013



Notes: \* Before deductions for capital reserves, rent, interest, income taxes, depreciation, and amortization.

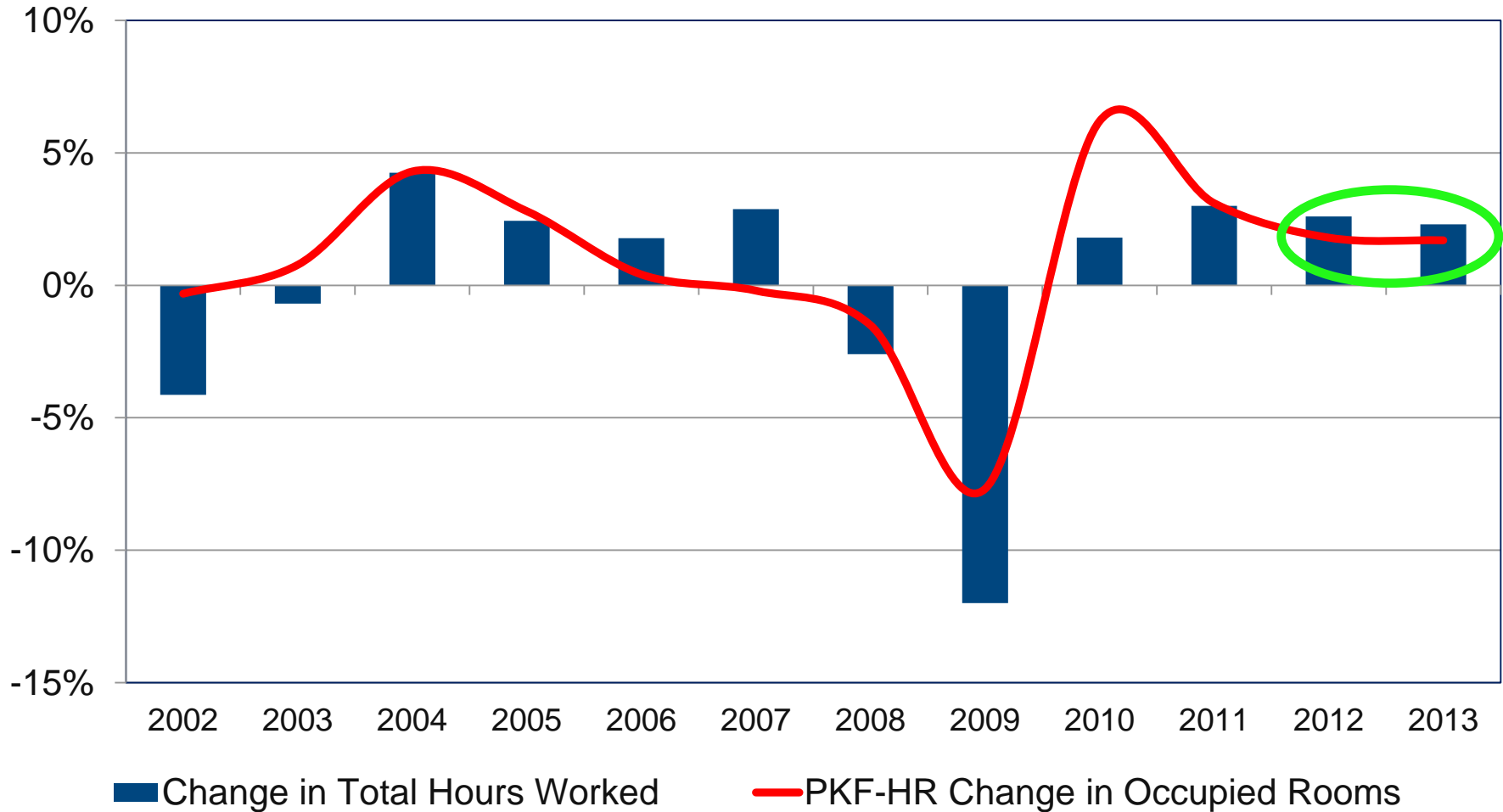
Source: PKF Hospitality Research, LLC, 2014 *Trends® in the Hotel Industry* report.

# Change in Average Hourly Compensation vs. Unemployment



Source: PKF Hospitality Research, LLC, Bureau of Labor Statistics

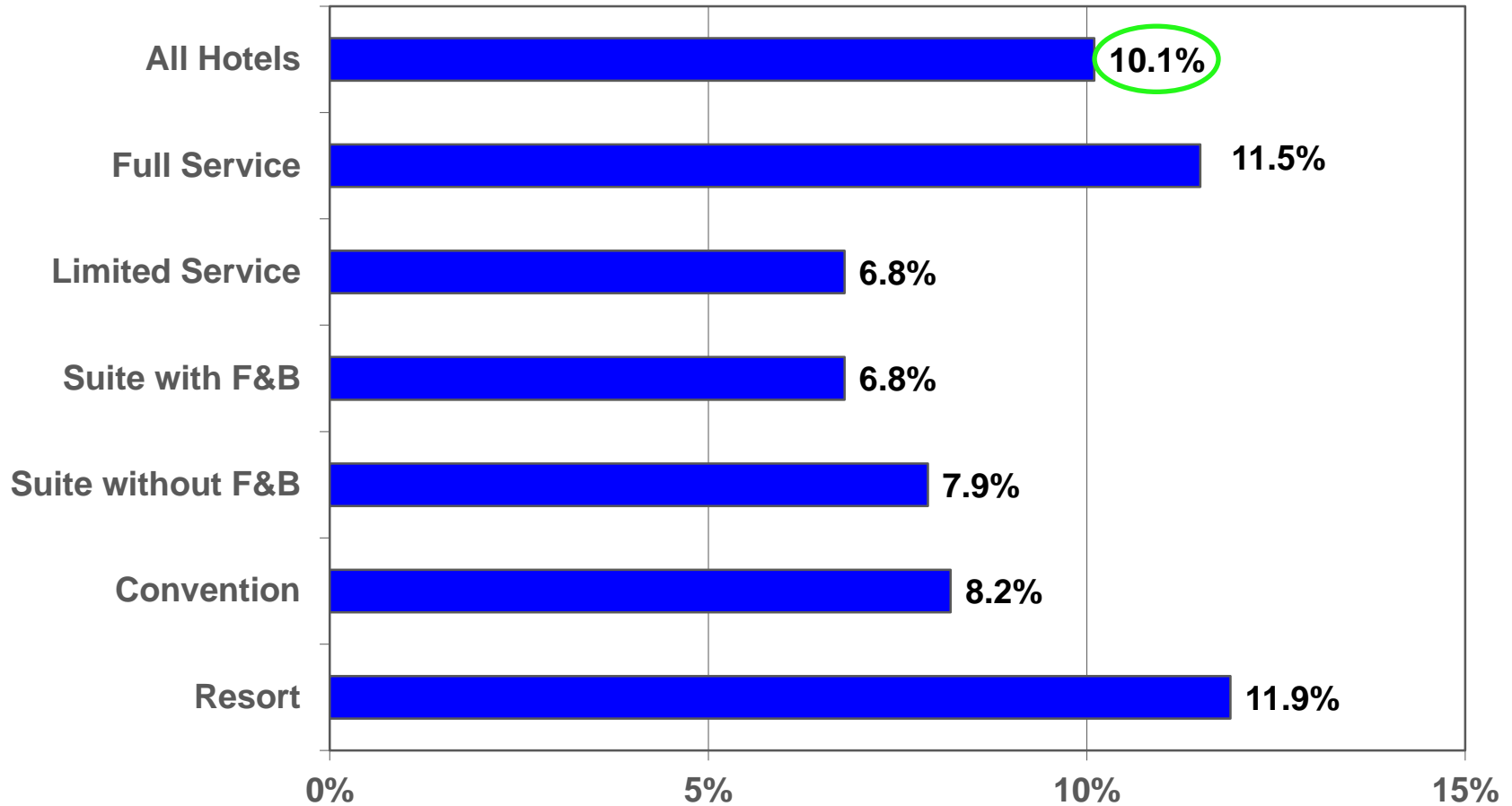
# Change In Hours Worked vs. Change In Rooms Occupied



Source: PKF Hospitality Research, LLC, Bureau of Labor Statistics

# 2013 Net Operating Income\*

## Change from 2012



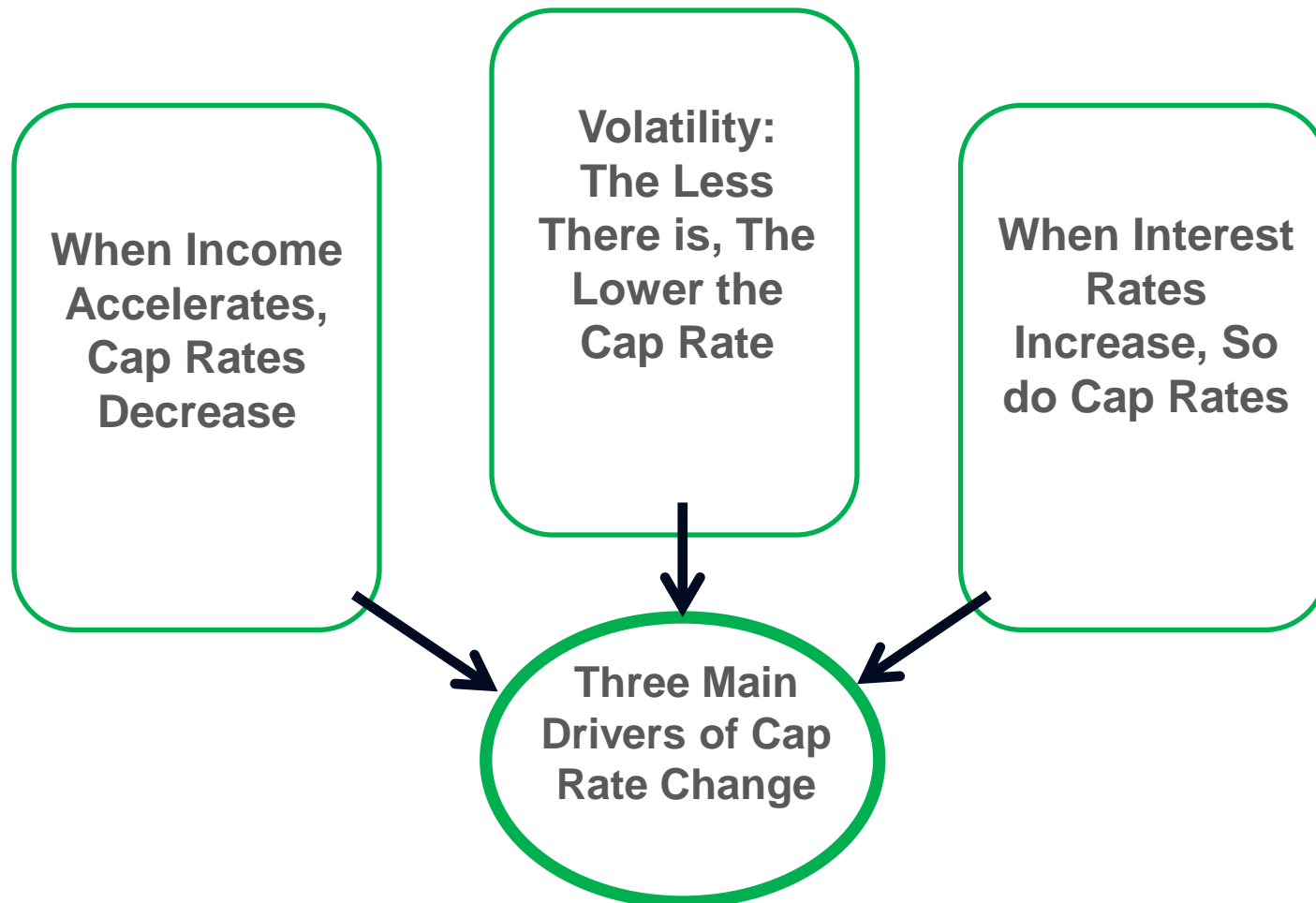
Notes: \* Before deductions for capital reserves, rent, interest, income taxes, depreciation, and amortization.

Source: PKF Hospitality Research, LLC, 2014 *Trends® in the Hotel Industry* sample.

## Where Are Cap Rates Going?



# Where are Cap Rates Going?



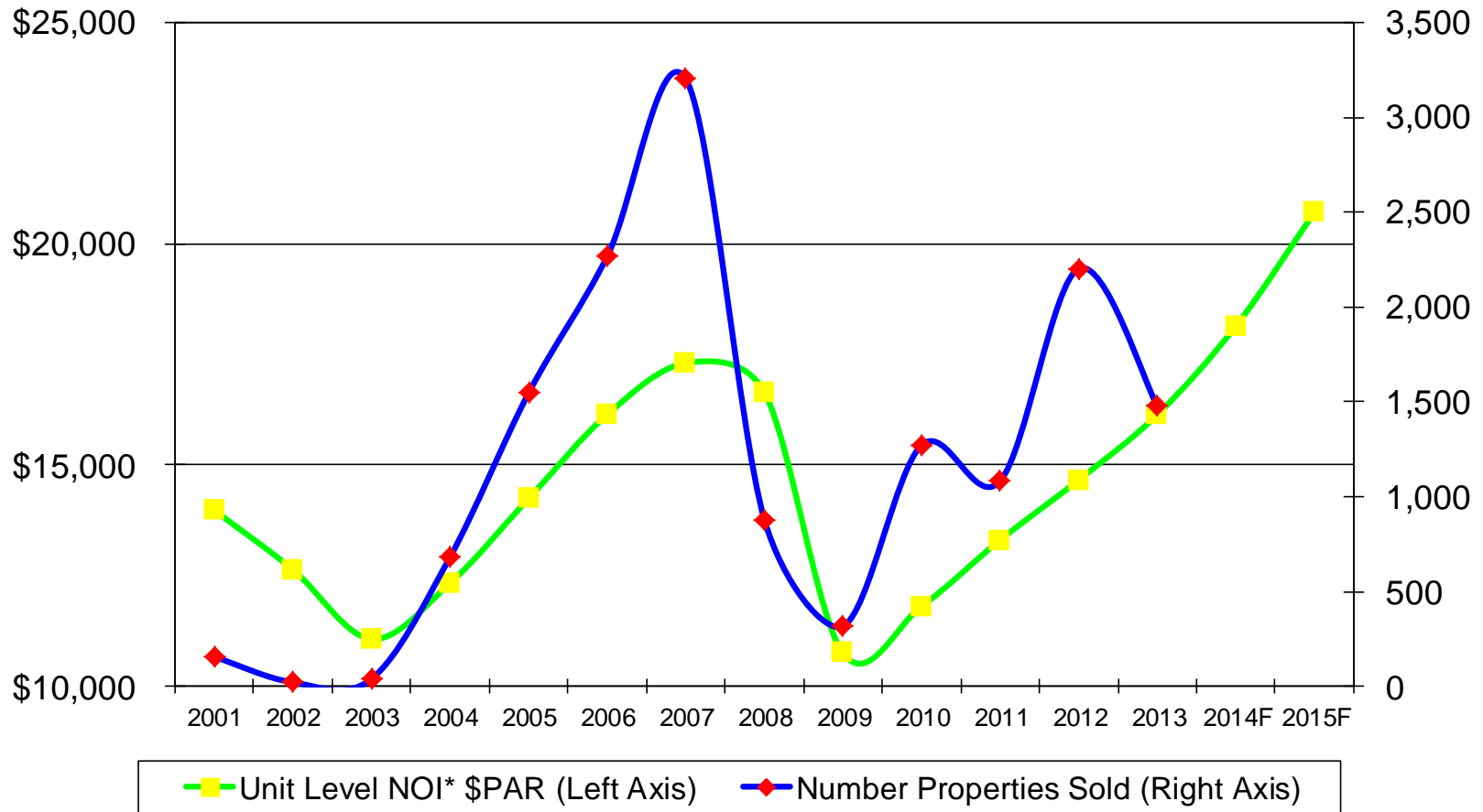
# Forecasts of Return Components

## Hotel Risk Premium Contracts

	Cap Rate	Baa	Hotel Risk Premium	% Δ Supply	% Δ Net Operating Income
2011	8.2%	5.6%	2.6%	0.5%	12.7%
2012	8.1%	4.9%	3.2%	0.4%	10.2%
2013	8.0%	5.0%	3.0%	0.7%	10.1%
2014F	8.3%	6.0%	2.3%	1.0%	12.4%
2015F	8.8%	6.9%	1.9%	1.3%	14.2%
2016F	8.8%	7.6%	1.2%	1.7%	6.3%

Source: PKF Hospitality Research, LLC, STR, Inc., RERC, RCA, Moody's Analytics

# Unit Level Hotel Profits\* and Hotel Transaction Volume



Note: \* Before deduction for capital reserve, rent, interest, income taxes, depreciation, and amortization.

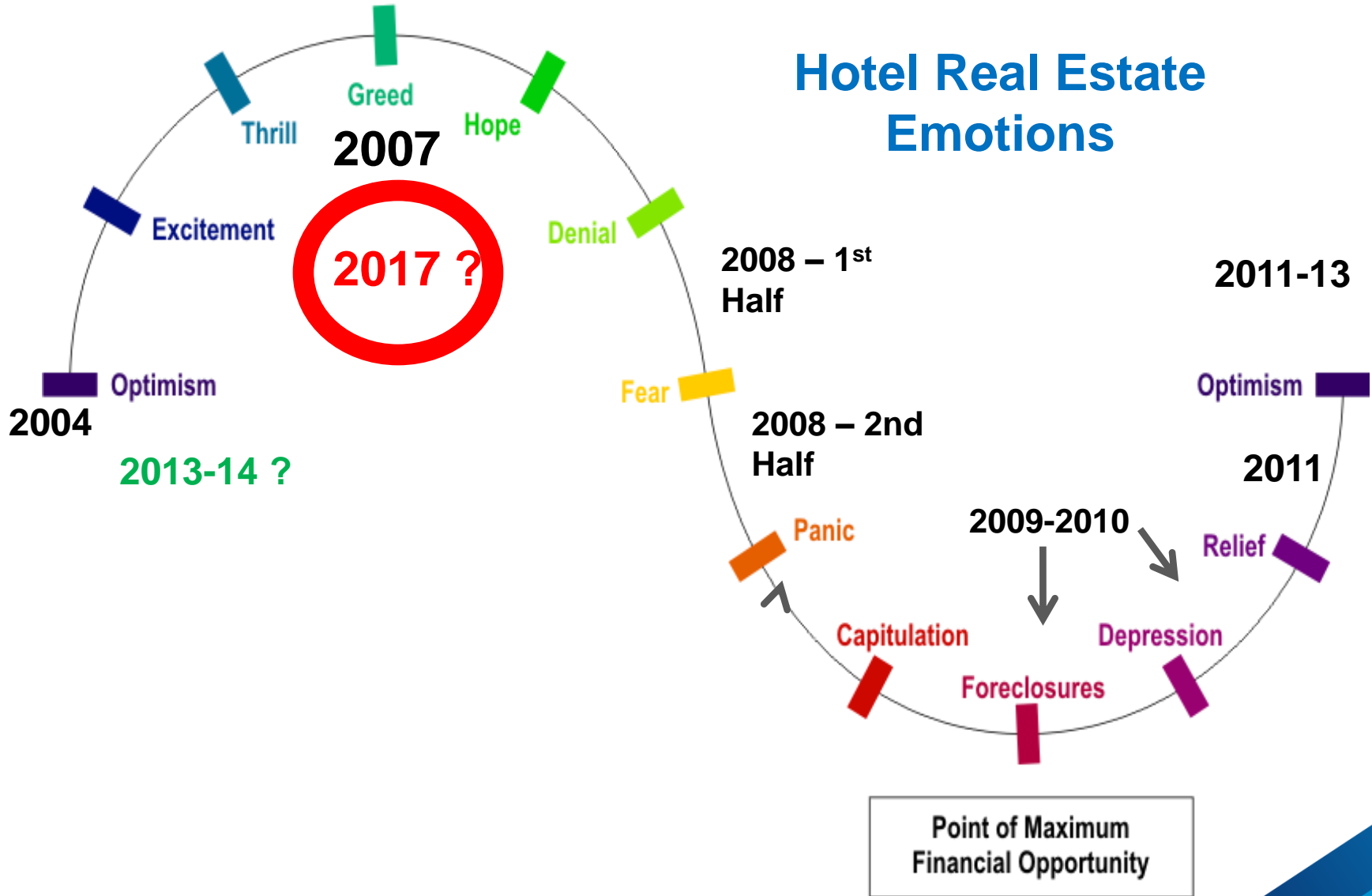
Sources: Real Capital Analytics March 2014, PKF Hospitality Research, LLC, March 2014 Hotel Horizons® Report

# National Forecast – 2014/2015

	Long Term Average	2009	2010	2011	2012	2013	Very Limited New Supply	
							2014F	2015F
Supply	1.9%	2.8%	1.7%	0.5%	0.5%	0.7%	1.0%	1.3%
Demand	2.1%	-6.2%	7.2%	4.7%	3.0%	2.2%	3.0%	3.0%
Occupancy	61.9%	54.5%	57.5%	59.9%	61.4%	62.2%	63.4%	64.5%
ADR	2.9%	-8.7%	0.0%	3.8%	4.2%	3.9%	4.3%	5.4%
RevPAR	2.9%	-16.7%	5.4%	8.2%	6.8%	5.4%	6.3%	7.1%


Passing Through Long  
Run Average Level

Point of Maximum  
Financial Risk



# Summary Thoughts:

- 1. The Economic Outlook for 2014 Has Remained Relatively Consistent Over the Past Three Years; Uncertainty is Disapating.**
- 2. Industry Fundamentals Remain Solid.**
- 3. Supply Growth will Remain in Check for at Least Another Two Years as Real ADR's Recover.**
- 4. Attractive Hotel Profit Growth Continues and will Serve to Mitigate the Impact of Rising Interest Rates.**
- 5. Owners and Investors will be Rewarded as a Result.**



**How Much  
Longer to the  
Peak?**

**Think 2016/17**

**Thanks for Your Time**