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IN FOCUS:

REASONS FOR HOTELIERS TO ACT NOW

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With increasing demand, low supply, and more access to capital creating a tailwind, the U.S. hotel industry has reached its cruising altitude. Hotel owners and investors should look closely at opportunities to act now on transactions, renovations, and other ways to improve their position in 2014.

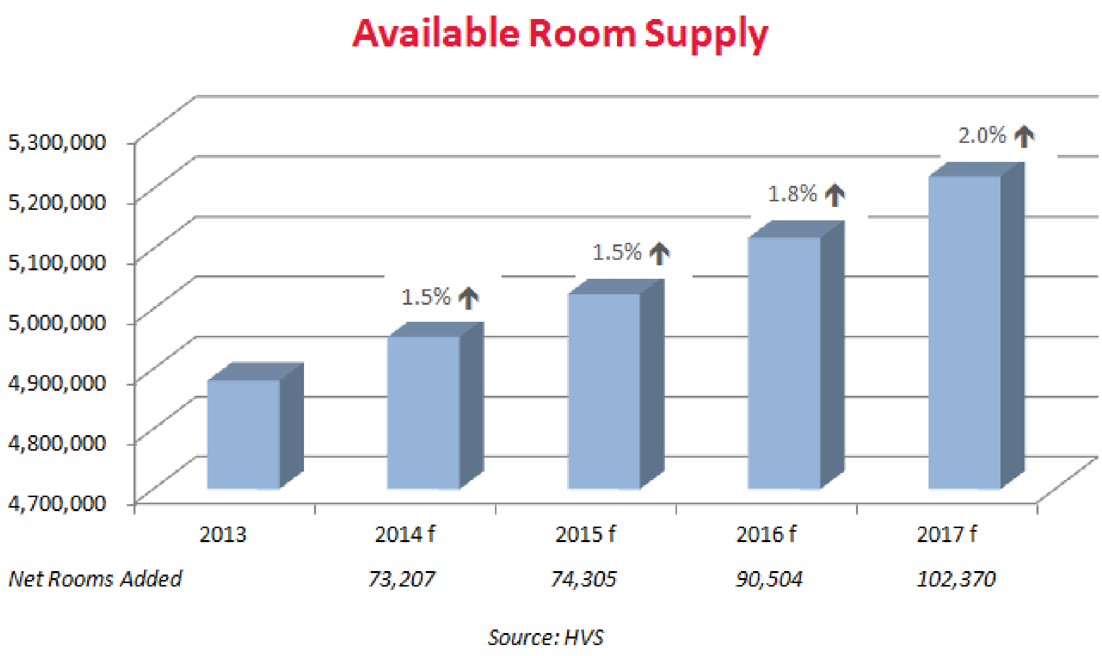
The Year 2014 is Opportune for Hoteliers

At the recent 26th Annual Hunter Hotel Conference in Atlanta, I served alongside other hotel buyers, lenders, appraisers, and advisors on a panel discussion of "Hotel Values in a Rising Market." While we shared insights from our various perspectives on the U.S. hotel industry as of early 2014, it became very apparent that there is a surge of urgency among hoteliers, and with good reason. The conference's theme—"The Time is Now"—couldn't have proven more apt, and other panel discussions, featured speakers, and informal conversations with fellow delegates made the strong impression that now is indeed the time to move ahead with hotel ambitions.

What makes the present so opportune for hoteliers? Here, in brief, are five reasons.

Reason One: Lack of New Supply

During the recession, as business and leisure travel declined and hotel occupancy rates fell, hotels and motels shelved expansion plans and delayed openings, resulting in lower underlying demand for hotel and motel construction. Since the recession, U.S. hotels have realized an overall surge in performance over the past several years, and one of the most potent factors is the lack of new supply. The pressures of the recent recession were formidable; in fact, according to Smith Travel Research, U.S. hotel supply growth averaged less than 1.0% annually from 2010 to 2013. After the North American lodging market bottomed out in late 2009, demand rebounded, and the stalled introduction of new rooms has proven a boon to existing hotels. With lenders once again beginning to finance promising hotel projects, HVS forecasts an annual increase of 1.5% for 2014 and 2015. HNew hotel supply is then forecast to increase by 1.8% in 2016, followed by 2.0% in 2017.



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Reason Two: More Demand

Government, commercial, leisure, and meeting and group travel started to return in force in 2010, as the positive turn in the national economy boosted confidence. Demand for hotel rooms was also drawn by lower average rates, with hoteliers across the nation, representing all hotel types and tiers, cutting rates to put heads in beds. These lower rates allowed hoteliers to weather the economic storm and keep their doors open, and with demand continuing to strengthen through 2013, national occupancy levels neared the pre-recession levels of 2007. In consideration of the overall strengthening economy, HVS expects demand to continue to improve over the next several years, starting with an increase of 3.0% in 2014, resulting in an occupancy lift of just under one point to a level of 63.1%. Over the next few years, demand should continue to slightly outpace new supply, resulting in steady occupancy levels through 2017.

With demand now recovered from the correction in 2009, and the hotel supply pipeline still muted in 2014 and 2015, markets should be able to continue to support healthy average rate gains in the near term.

Reason Three: Rate Growth

The rebound in occupancy began in late 2010, not coincidentally driven by the lure of lower average rates. Sensing the swell in demand, hoteliers were swift to switch gears, and by 2011, average rates in most U.S. markets showed increases. According to Smith Travel Research, average rate rose 3.8% and 4.2% in 2011 and 2012, respectively, followed by a 3.9% increase in 2013. By year-end 2013, nationwide average rate surpassed the prior 2008 peak. In many primary markets across the U.S., strong occupancy levels and a lack of new supply are allowing hotel operators to make aggressive average rate gains in 2014. Due to the limited amount of new supply and the strong demand over the past several years, HVS believes that hoteliers will continue to focus on rate growth, which should outpace the rate of inflation over the next several years. Average rates have been forecast to increase by 5.0% in 2014, resulting in a RevPAR growth rate of 6.6%. In 2015 and 2016, we expect rate to continue to increase; however, the rate of growth should decline slightly to 4.5% and 3.5%, respectively. In 2017, HVS forecasts rate of growth to be 3.0%.

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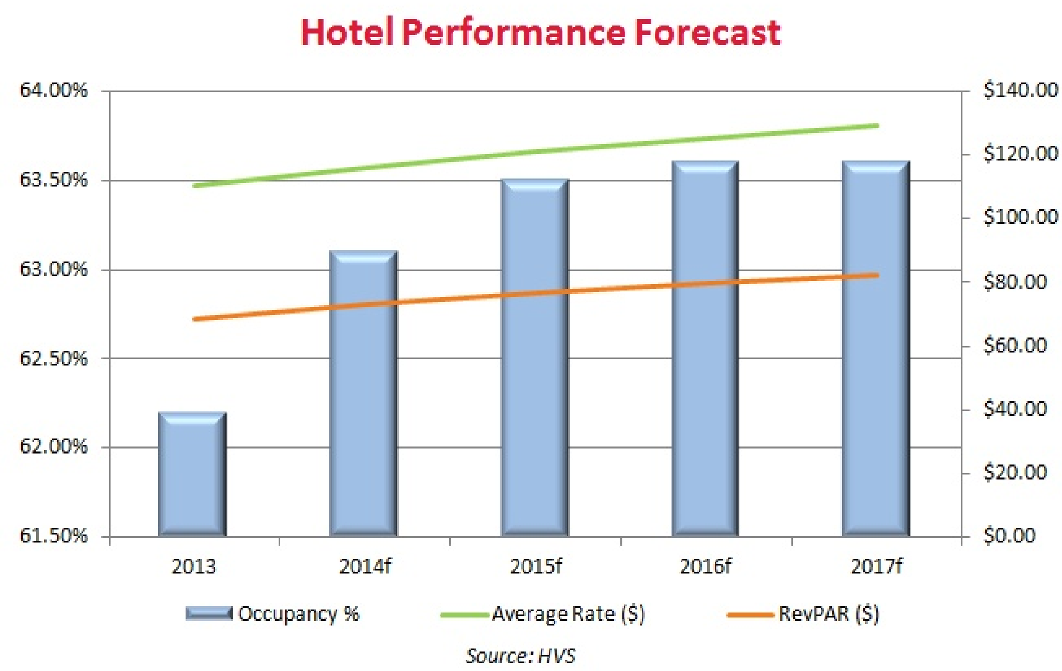

Reason Four: Favorable Financing

Hotel financiers have been especially attuned to the pulse of the industry and the national economy since the recession, and that pulse has grown far stronger in the past two years. Lenders have shored up their reserves of capital and gained a great deal of confidence in how to maneuver their funds into successful hotel projects. As a result, access to capital for hotel builds or improvements is nowhere near as scarce as in the years immediately following the recession.

The Fed reports that U.S. banks hold some 10 trillion dollars in deposits, far exceeding the value of all loans by a record $2.5 trillion as of March of 2014. Banks are amassing even more cash; as such, lending to U.S. companies in the first quarter of 2014 is poised to increase by the most since 2007.

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Reason Five: Action has its risks, but inaction can be more costly.

The U.S. economy's growing strength shows no sign of stopping or turning back in the near term. Interest rates are low, and financing is available (under the right terms). Demand is up, which has translated into improving occupancy levels and, consequently, higher average rates. Supply growth remains at a relative standstill even as conditions make markets across the nation prime for new hotel projects. Given all this, hoteliers wondering whether to make a move need to ask themselves the following: can I afford not to act?

Investors that hold off face "a potentially costly set of risks," according to David McSpadden, Senior VP of Global Marketing Services for Franklin Templeton Investments. "In the long term, remaining highly risk-averse can cause investors to fall short of their goals," said McSpadden. "The key is not avoiding risks but rather managing them."

Conclusion

Mr. McSpadden's words ring true for hoteliers in 2014. Touch base with an expert in your market to find the data, insights, outlook, and advice for making the best possible decisions for your hotel venture. However, don't hesitate to get guidance and make your move, because if you wait to take advantage of the swift tailwinds of today's hotel market, you might be left lagging behind.

About HVS

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About the Author

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