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## Hotel performance is on a roll, but for how long?

October 21, 2014 - Front Section

If you had the foresight and courage, there were many hotel bargains to pick up two to three years ago. In 2012, I made the case for the glass being half full for hotel investments, an indication of a prime time to pursue acquisitions and development as the U.S. economic recovery gained momentum. In 2013, I conveyed continued optimism which was locally buoyed by the Red Sox improbable run to a World Series title. Today, my forecast is still very positive and thankfully bears no resemblance to the Sox implosion from first to last place this season. We have entered into a later, mature phase of the hotel cycle where there is a lot more competition and it is much harder to identify the right investment choices. Unlike some of the other top 15 hotel markets, Boston has limited new supply and strong demand positioning it well for strong performance through 2017.

Some economists believe we are in the midst of an elongated bull run in the stock market and the economy. If this sentiment is accurate then it bodes well for the lodging sector. Driving factors include:

- \* Housing momentum - With insufficient inventory available and the household debt ratio at a 35+ year low, the housing market is poised for continued growth which will have a positive effect on hotel demand through increased construction and consumer spending.
- \* Capital to spend - Many banks and Fortune Five Hundred companies are flush with cash and in position to loan on houses and cars or invest in research and development to fuel growth. The latter of these trends is a critical driver of hotel corporate demand which often leads to higher occupancy and rates during peak demand periods.
- \* Consumer confidence is still relatively low versus historical trends implying that an elongated Bull market will result in more discretionary spending on hotels, vacations and travel in general. This has certainly been seen in the high occupancies reported in Boston and New England over this past summer.
- \* Currency - the dollar is still under-valued versus other currencies making Boston and other gateway cities a bargain for European and Asian travelers.

The hotel industry has had a good five-year run since the depths of the "Great Recession." U.S. Revenue Per Available Room (RevPAR which is occupancy multiplied by Average Daily Rate), the lodging industry's measurement for performance, grew 5.4% in 2013 and is forecasted to grow 6.5% in 2014 while hotel supply has also been kept in check with only modest growth of .7% in 2013 and 1% forecasted for 2014. The construction pipeline in 2015 and 2016 also appears to be moderate compared to prior cycles which bodes well for hotel demand growth continuing to outpace supply growth. Construction lenders are still being quite conservative in terms of how they are underwriting loans for new development and these projects typically require substantial cash investments and personnel guarantees. Many hotel experts believe the US is in for a record expansion that could

exceed the longest upcycle of positive RevPAR growth on record - nine years between 1992 and 2000. This would result in US annual occupancy potentially exceeding 65%, a notable milestone that has not been achieved for many years. Given the positive market trends outlined above and the absence of near term over-building, I tend to agree that we are poised for continued growth nationally for at least the next two to three years. However, some markets may not experience this trend as a result of supply exceeding demand growth (New York) and base demand contracting (Washington DC).

New England and Boston, in particular, have been top performers in the economy recovery. The greater Boston economy has always relied on strong leisure demand in peak season and this trend continued this summer with occupancy up 3.8% to 76.1% year-to-date August (vs 66% for the US), average daily rate up 7.5% to \$171.74 resulting in a RevPAR increase of 11.6% versus August YTD 2013. The market has benefitted from positive trends in the biotechnology, healthcare and financial services sectors, strong convention demand and very good weather in July and August driving leisure business after a particularly long, brutal winter in the Northeast, Mid-Atlantic and Midwest. Boston also continues to grow as an international destination with a more diverse base of leisure travelers that are willing to spend their disposable income. According to PKF, the market is on pace to record RevPAR growth of 9.9% in 2014 and 8.3% in 2015.

Why is Boston in better shape to outlast other markets in this Bull run? The later stage of the hotel cycle has been marked in the past by irrational construction and an onslaught of new supply coinciding with demand contraction. With the Great Recession a "perfect storm" that few markets endured without significant impact, most of the new hotel projects in Boston that opened just prior or during this period went back to lenders and some with lengthy bankruptcies. This fairly recent history has resulted in a governor on the type of projects that make up the supply pipeline in Boston with most being smaller and better conceived in term of scope, branding and an absence of luxury condominium component which drove the financing of several failed projects in the last cycle. Even if there is a pull back in hotel demand growth, the Boston supply pipeline appears very much in check and several years away from past supply "boom" cycles of the late 1980's and mid 2000's.

Hotel cycles can turn quickly and a hotel's lease is only for one night, thus hotel performance is often seen as a leading indicator of the state of the economy. The outlook continues to be robust, especially in Boston, however the most savvy hotel investors and developers understand the volatility of the market and recognize that the unprecedented run we are in will not last forever.

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