



2015 INDUSTRY OUTLOOK

Lodging industry participants should have a high degree of confidence that the business environment in 2015 will offer the potential for strong gains in both revenues and profits

By Robert Mandelbaum

It is the fall of 2014 and hotel operators are putting the final touches on their budgets for 2015. While somewhat arduous, the budgeting process provides management an opportunity to complete a thorough review of their property's historical performance, set goals for the upcoming year, and determine the strategies and tactics required to achieve those goals.

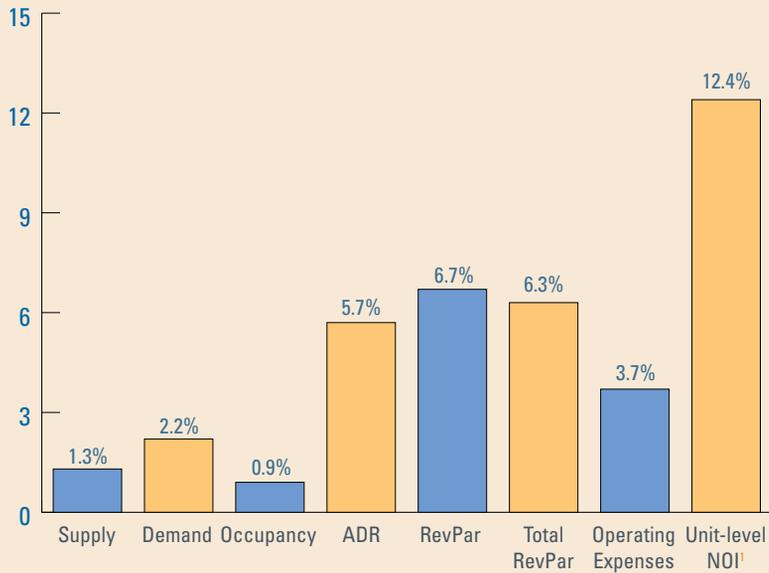
The process typically starts with a review of internal operating statements, followed by an analysis of historical market penetration and forecast reports from external sources. These reports present the historical market conditions in which the hotel has operated, and paint the picture of the market in which the hotel will compete in the future.

After reviewing these reports, the next step for the budget team is to ascertain what the hotel can do to improve its performance in the following year. Can the hotel grow market share by stealing customers or inducing new demand on their own? Should the property raise room rates, or adjust its use of certain distribution channels? On the expense side can management increase productivity, or purchase cheaper goods and services?

To assist general managers, controllers and directors of sales finalize their budgets and marketing plans, PKF Hospitality Research (PKF-HR), a CBRE company, presents the results of our latest annual analysis of hotel budget accuracy, followed by our firm's forecast for the performance of the U.S. lodging industry in 2015.

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U.S. Lodging Industry Budget Guidance for 2015 Change from 2014



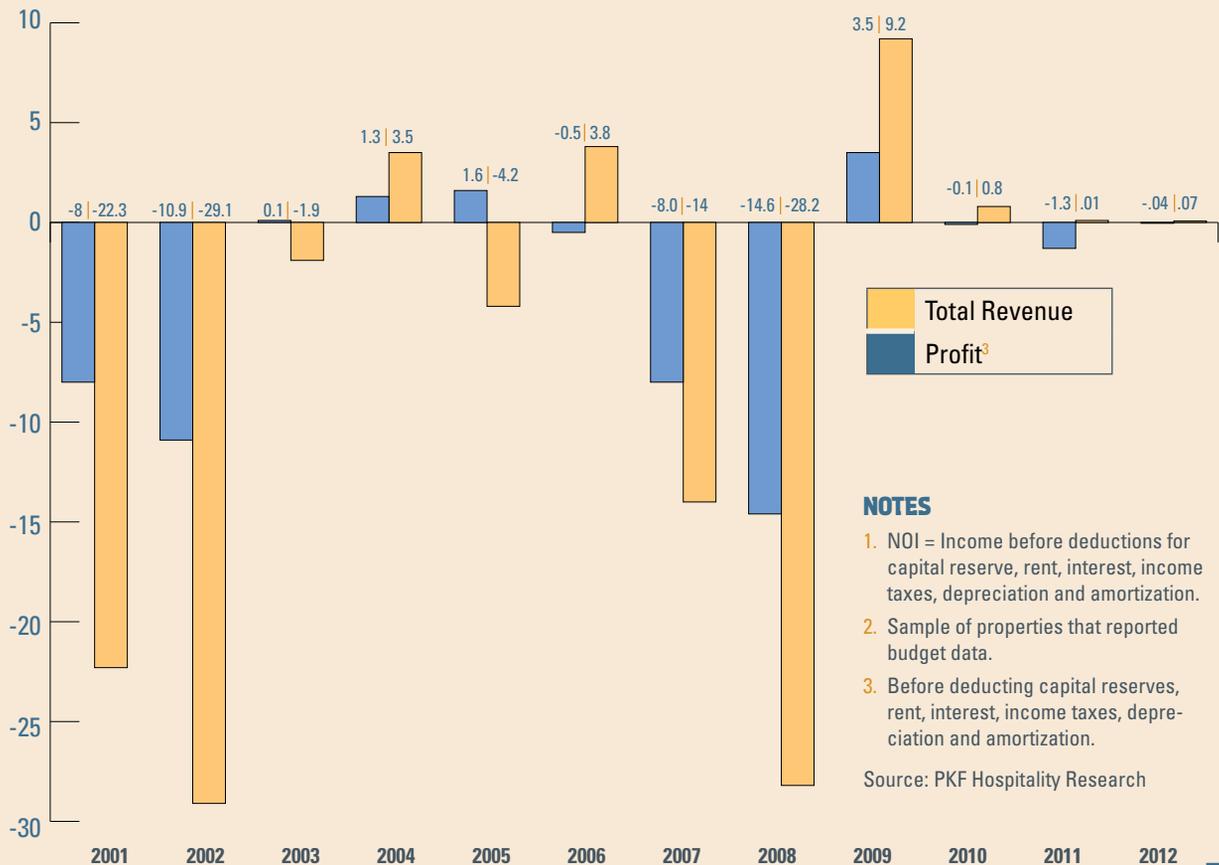
Budget Accuracy

To assess how accurate U.S. hoteliers were in preparing their budgets for 2013, PKF-HR identified 545 operating statements in our *Trends® in the Hotel Industry* database that contained both actual and budgeted data for 2013. Using these statements, we compared the revenues and expenses projected for 2013 with what was actually earned and spent during the year.

Over the years, one trend has become very predictable. During times of industry prosperity, hotel budgets are extremely accurate. In 2013, U.S. hoteliers overestimated their total property revenues by just 0.04 percent. By accommodating fewer rooms than anticipated, the amount spent to operate hotels was 0.07 percent less than anticipated, thus allowing for profits 0.07 percent in excess of the budgeted

Historical Budget Accuracy (Percent Difference)

Actual Compared to Budgeted Dollars²



NOTES

1. NOI = Income before deductions for capital reserve, rent, interest, income taxes, depreciation and amortization.
2. Sample of properties that reported budget data.
3. Before deducting capital reserves, rent, interest, income taxes, depreciation and amortization.

Source: PKF Hospitality Research

amount. For the purpose of this analysis, profits are defined as net operating income (NOI) before deductions for capital reserve, rent, interest, income taxes, depreciation and amortization.

A Little Short In Rooms

Unlike recent years, hotel managers overestimated the number of rooms they would rent in 2013. In their budgets, operators anticipated a 1.5 percent increase in occupied rooms. At the end of the year, these same hotels achieved just a 1.4 percent gain in occupancy rooms.

Accommodating fewer rooms led to slightly less pricing power. The hotels in our sample anticipated a 4.3 percent rise in average daily rates (ADR) in 2013, but only achieved a 4.2 percent increase.

The net result was a rooms revenue (RevPAR) shortfall of 0.24 percent. Concurrently, total hotel revenue was off budget by only 0.04 percent. This implies that the combined growth in revenue from food and beverage, other operated departments, and rentals and other income exceeded the budget. The growth in revenue sources other than the rooms department was welcome news.

Better on the Bottom

Facing a revenue deficit relative to budgeted expectations, hotel managers were forced to take corrective actions in order to achieve their profit objectives. During 2013, expenses at the properties in the study sample increased by 3.9 percent. This is 0.1 percentage points less than the budgeted expense growth rate of 4.0 percent.

Fortunately for hotel operators, and their owners, the 3.9 percent growth in expense was sufficient to allow these properties to surpass their budgeted profit levels. On average, the hotels in our sample exceeded their 2013 budgeted NOI goals by 0.07 percent.

What to Budget for 2015

According to the September 2014 edition of PKF-HR's *Hotel Horizons*® forecast report, the U.S. lodging

industry will continue to prosper in 2015. During the year, several milestones will be achieved:

- The 65 percent occupancy level forecast for 2015 is an all-time high for the U.S. lodging industry since STR started reporting data in 1987.
- U.S. hotels are in the middle of a six year streak (2011–2016F) of double-digit growth in U.S. hotel profits, the longest such streak since PKF began reporting data in 1937.
- U.S. hotels will achieve “real” recovery in ADR and profits in 2015.
- Several markets, including Seattle, Los Angeles, Houston, Pittsburgh and Miami will achieve their all-time record occupancy levels.

The following paragraphs summarize PKF-HR's forecast for the market and financial performance of U.S. hotels in 2015.

Top Line: Limited access to capital, rising construction costs and low asset prices continues to mute new development activity in the U.S. lodging industry. PKF-HR is forecasting the net inventory of hotel rooms in the U.S. will increase by just 1.3 percent in 2015, the sixth consecutive year of supply growth below the long-run average of 2 percent. Concurrently, the demand for lodging accommodations is forecast to increase by 2.2 percent. The net result is a 0.9 percent rise in occupancy to the 65 percent record setting level.

With U.S. hotels achieving all-time high occupancy levels, PKF-HR believes that hoteliers will be able to increase their ADRs by 5.7 percent in 2015. This is more than double the 2.2 percent pace of inflation forecast for 2015 by Moody's Analytics, PKF-HR's source for economic projections.

The combination of a 0.9 percent rise in occupancy, along with a 5.7 percent increase in ADR results in a 6.7 percent forecast gain in RevPAR for the overall U.S. market. Fortunately, PKF-HR's forecasts of positive performance apply to almost all

aspects of the U.S. lodging industry. In 2015, all six national chain-scales, and the vast majority of major markets, will have surpassed their pre-recession levels of RevPAR.

While RevPAR growth has been strong during the recovery, hoteliers have struggled to entice guests to spend money on other hotel services and amenities. Accordingly, PKF-HR is projecting that the combined growth in revenues from food and beverage, other operated departments, and rentals and other income will increase by just 5.4 percent. The net result is a 6.3 percent forecast increase in total revenue for 2015.

Bottom Line: Several factors point towards a strong flow-through of revenue to profits in 2015:

- The forecast pace of inflation for 2015 is just 2.2 percent.
- 85 percent of RevPAR growth in 2015 will be driven by ADR.
- At the forecast high occupancy levels, hotels have covered their fixed expenses, and the 0.9 percent increase in occupancy limits the growth in variable costs.
- The implementation of green and sustainable practices has helped to temper the rise in utility costs.

On the other hand, we acknowledge hotel operators recent concerns regarding the rising cost of employee benefits, as well as the recent surge in food prices. For 2015, PKF is forecasting total hotel expenses to increase by 3.7 percent. With total revenues projected to grow by 6.3 percent, the typical U.S. hotel should enjoy a healthy 12.4 percent gain in NOI.

Confidence

We know that hotel budgets, as well as PKF-HR's forecasts, are most accurate during the current prosperous phase in the business cycle. Accordingly, all industry participants should have a high degree of confidence that the business environment in 2015 will offer the potential for strong gains in both revenues and profits. ■