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## **Quantifying Hotel Demand Growth Projections** **By Jeffrey H. Walker, MAI, CHME**

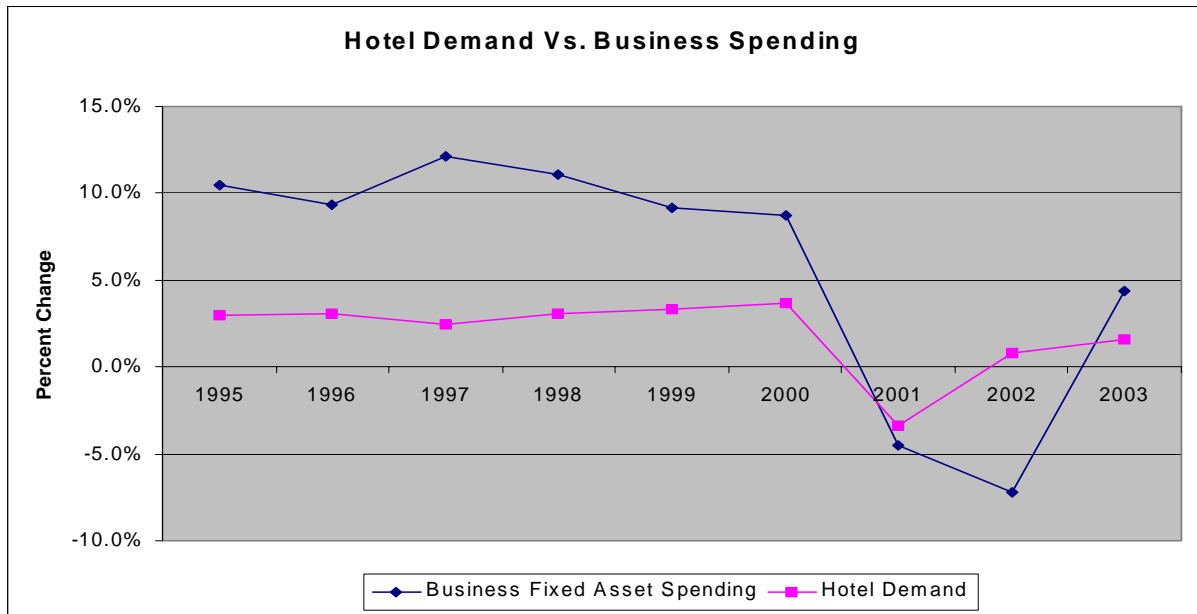
Within the hotel community, there is finally a sense that demand may be turning the corner. But the optimism is still somewhat cautious, as several previous predictions of increasing demand since 9/11 have failed to fully materialize.

To get a clearer picture of future trends, USRC has analyzed historical hotel demand increases in relation to historical levels of business fixed asset investment, as tracked by the U.S. Bureau of Economic Analysis. In general, during periods of economic recession, corporations cut costs in order to protect bottom-line profits in a weakening sales environment. Historically, corporate travel, including travel to conventions and corporate meetings, is one of the first expenses cut in a slowing economy. During an expanding economy, corporations invest in future profits by increasing sales, marketing, and training, which includes increased business travel. Similarly, corporations have similar spending habits on long-term fixed investments in such items as computers, software, infrastructure, and buildings. Thus, the demand for corporate travel, as well as group and convention demand for hotels often mirrors the statistical data on corporate fixed investment.

The following chart presents the historical change in business fixed investment. As presented, during a period of rapid increases in full-service hotel demand (the late 1990's) corporate fixed investment saw very strong growth. Similarly, during one of the worst downturns in the hotel industry for groups and conventions, corporate investment shrunk.

<b>Business Fixed Asset Investment Change</b>								
<b>Percent Change from Previous Period</b>								
<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>
10.5%	9.3%	12.1%	11.1%	9.2%	8.7%	-4.5%	-7.2%	4.40%
Source: U.S. Bureau of Economic Analysis								

The following chart graphically demonstrates the relationship between historical demand changes, according to Smith Travel Research, and the above business fixed asset investment changes.



In general, hotel demand has closely tracked trends in business fixed asset investment, with hotel demand experiencing more moderate fluctuations. In 2002, hotel demand recovered somewhat quicker than fixed asset investment, but the trend returned to normal in 2003.

The historical business investment picture becomes clearer when looking at the historical data on a quarterly basis. As demonstrated in the chart below, despite only modest growth in 2003 on a calendar year basis, business investment dramatically increased throughout 2003, after negative trends in 2002.

<b>Business Fixed Investment Change</b>							
<b>Percent Change from Previous Quarter</b>							
2002 Q1	2002 Q2	2002 Q3	2002 Q4	2003 Q1	2003 Q2	2003 Q3	2003 Q3
-7.0%	-3.0%	-1.1%	-0.1%	-0.6%	7.0%	12.8%	10.9%

Source: U.S. Bureau of Economic Analysis

The advantage of establishing this relationship is the availability of projections for changes in business fixed asset investment. The following table presents projected changes to business asset spending for the next two years by quarter, according to the Mortgage Bankers Association.

<b>Business Fixed Investment Change</b>							
<b>Projected Change</b>							
<b>2004 Q1</b>	<b>2004 Q2</b>	<b>2004 Q3</b>	<b>2004 Q4</b>	<b>2005 Q1</b>	<b>2005 Q2</b>	<b>2005 Q3</b>	<b>2005 Q4</b>
14.6%	12.6%	12.8%	12.4%	10.3%	8.3%	6.7%	6.4%
Source: Mortgage Bankers Association							

As indicated, the association projects double-digit growth in business fixed asset investment for the next five quarters, rivaling or exceeding the growth experienced during the hotel expansion years of 1995-1998. If the relationship holds true, hotel demand should be “pulled up” by the dramatic rise in business investment, and hotel demand increases in the late 1990’s range of 3.0 – 5.0% should be achievable for the next 12 – 18 months. Coupled with the projected slower increase in supply, these demand increases provide a strong indicator of an environment of increased occupancy and, with increased compression in many markets, increasing ADR. As hotels continue to focus on expense control, this improving top-line environment should lead to strong flow-through to the bottom line, with a result of healthy improvement in hotel profitability.

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