

Hurricanes And Values

Though the devastation of Hurricane Katrina, and to a lesser extent Hurricane Rita, has been well reported, these events appear to have had little, if any, lasting effect on U.S. hotel market values. While in many cases the hotels in the storms' paths in southern Louisiana, Mississippi, Alabama and Texas will not reopen until next year (if ever in some cases), the closing of these hotels has actually improved the demand profile of hotel markets in other parts of the country, particularly as it relates to latent group demand that's being absorbed in areas not affected by the hurricanes. In other words, outside the Gulf Coast, the effect of the hurricanes on the values of many U.S. hotels has been, perhaps counter-intuitively, positive.

Had the hurricanes come at a different stage of the U.S. hotel industry cycle, the effects may have been different. Though the hurricanes bruised the overall economy, in particular by causing the first monthly nationwide job losses in two years, the damage was less than many had expected. Overall, nationwide employment dropped by 35,000 net employees in the month following the hurricanes, with most of these declines due to the retail (down 88,000), hospitality (down 80,000) and manufacturing (down 27,000) sectors, declines that were partially offset by increases in the educational services, health services, construction and governmental sectors—all of which generate lodging demand.

Although the net result on employment was negative, it was nowhere near as bad as originally feared by those economists who were projecting net employment losses of

Penn State Index of Hotel Values		
Overall	Value Per Room	Annual % Change
2003	\$67,877	---
2004	\$73,168	7.8%
2005	\$81,005	10.7%
2006	\$87,731	8.3%
2007	\$94,415	7.6%
Luxury		
2003	\$254,720	---
2004	\$271,052	6.4%
2005	\$297,830	9.9%
2006	\$323,069	8.5%
2007	\$350,243	8.4%
Upper Upscale		
2003	\$130,351	---
2004	\$138,151	6.0%
2005	\$152,128	10.1%
2006	\$165,150	8.6%
2007	\$178,758	8.2%
Upscale		
2003	\$ 82,857	---
2004	\$ 92,185	11.3%
2005	\$100,992	9.6%
2006	\$109,307	8.2%
2007	\$117,015	7.1%
Midscale With Food & Beverage		
2003	\$50,892	---
2004	\$53,659	5.4%
2005	\$60,127	12.1%
2006	\$64,988	8.1%
2007	\$69,657	7.2%
Midscale Without Food & Beverage		
2003	\$50,160	---
2004	\$54,292	8.2%
2005	\$62,294	14.7%
2006	\$69,829	12.1%
2007	\$76,125	9.0%
Economy		
2003	\$16,062	---
2004	\$18,377	14.4%
2005	\$22,540	22.7%
2006	\$25,437	12.9%
2007	\$27,982	10.0%

Source: The Pennsylvania State University

Outside the Gulf Coast, the effect of the hurricanes on the values of many U.S. hotels has been, perhaps counter-intuitively, positive.

up to 150,000 jobs. The vast majority of the actual declines were due to Hurricane Katrina, the costliest disaster in U.S. history, not Rita. The bottom line is that these hurricanes came in the midst of a robust U.S. economy and did not thrust the economy, or hotel values, into recession.

One lasting effect of the hurricanes appears to be a higher plateau for gasoline prices, as both hurricanes hobbled vital oil and gas refineries and facilities along the Gulf Coast. While long-term oil prices are expected to decline, they're not expected to decline rapidly. These relatively high prices are expected to negatively affect some U.S.

lodging demand, particularly certain discretionary travel; but again, the effect of oil prices on U.S. hotels has been buffered because we're in the midst of a relatively strong economy. Real gross domestic product is forecast to increase between three and four percent in 2005 and to continue to rise at similar levels in 2006 and 2007.

Hotel values are highly correlated to hotel financial performance. Since U.S. hotel occupancies were relatively high prior to the two hurricanes coming onto U.S. shores, much of any positive financial impact to hotels in non-hurricane areas will come in the form of higher average daily

rates. While some hotels are also experiencing moderate occupancy upswings, the high levels of existing demand—along with the natural capacity constraints during peak demand periods—have resulted in more positive ADR than higher occupan-

cies. This difference is important for hotel values because improvements in ADR are much more powerful enhancers to value than is occupancy. In fact, in the Penn State Index of Hotel Values, ADR has become an increasingly more powerful predictor of hotel

value than occupancy. Over the past few years, the economics of hotel sale transactions have shown that a one-dollar increase in ADR has evolved from having only slightly more effect on hotel value than a one point increase in occupancy a few years ago, to ADR dollars now having more than twice the impact on hotel values than occupancy points.

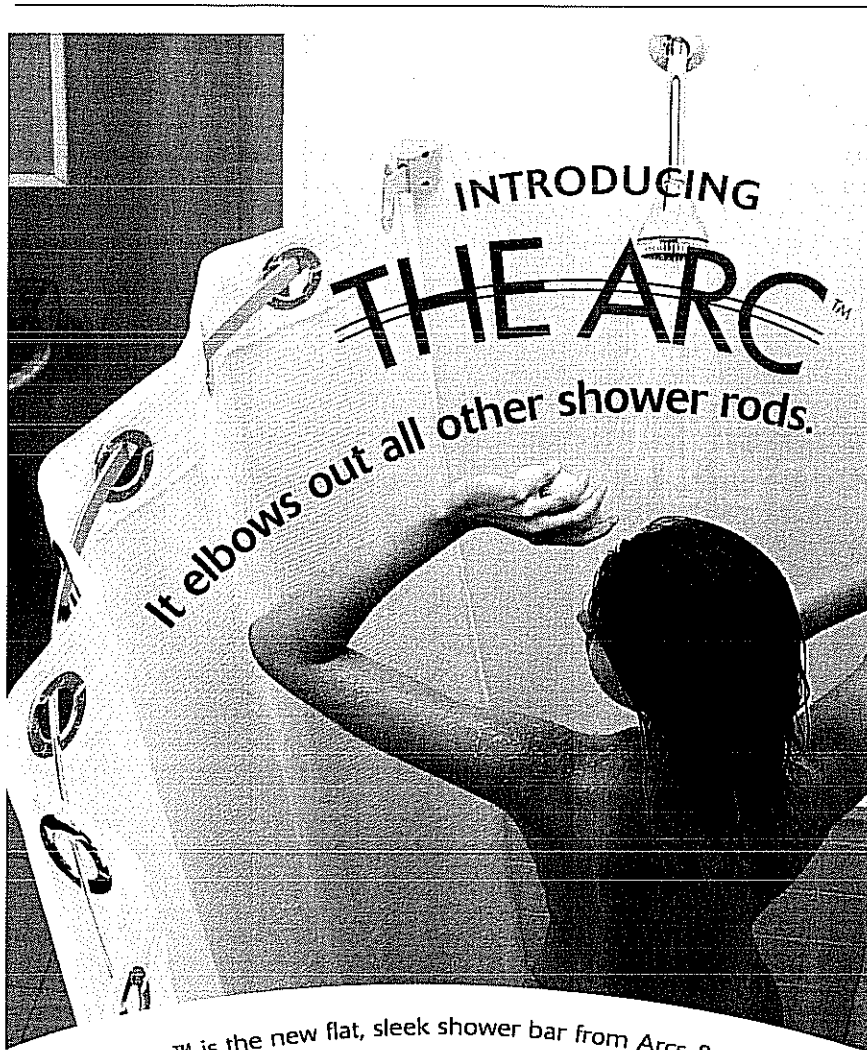
As a result, the Penn State Index projects year-end 2005 hotel values at an average of about \$81,000 per room, up more than 10 percent from last year. It is important to point out that the Penn State Index estimates the average value of all U.S. hotels based on an econometric model, whether or

Perhaps counter-intuitively, the effect on values has been positive.

not they are actually for sale or sold. While the economics of recent hotel sale transactions are taken into account, the existing and anticipated financial performance of all U.S. hotels is considered as well.

This model projects that luxury hotels are expected to experience the greatest increases in value per room this year, up \$26,778 to \$297,830 per room, while economy hotels are expected to show the highest percentage increases, up 22.7 percent to \$22,540 per room in 2005. In 2006, overall U.S. hotel values are forecast to increase by a healthy 8.3 percent; in 2007, a 7.6 percent increase is expected. **LH**

John W. O'Neill, MAI, CHE, Ph.D., is a professor in the School of Hospitality Management at The Pennsylvania State University and a licensed real estate appraiser. He previously held unit-level, regional-level, and corporate-level management positions with Hyatt and Marriott. He can be reached at jwo3@psu.edu or 814-863-8984.



The Arc™ is the new flat, sleek shower bar from Arcs & Angles that gives your guests 30% more elbow room. And because the Arc™ flexes in and out, the bathroom door can't dent, ding or loosen it. Plus, the Arc™ works beautifully with the Hookless® Shower Curtain from Arcs and Angles that hangs in just seconds.

Another smart product from the bright folks at Arcs & Angles.

Arcs & Angles, Inc. www.arcsandangles.com 212-625-6616

The Arc™, US & Int'l Patents Pending, Hookless® US Patent No. 5,186,232. Other US & Int'l Patents Pending. ©2005

CIRCLE 59 ON READER SERVICE CARD