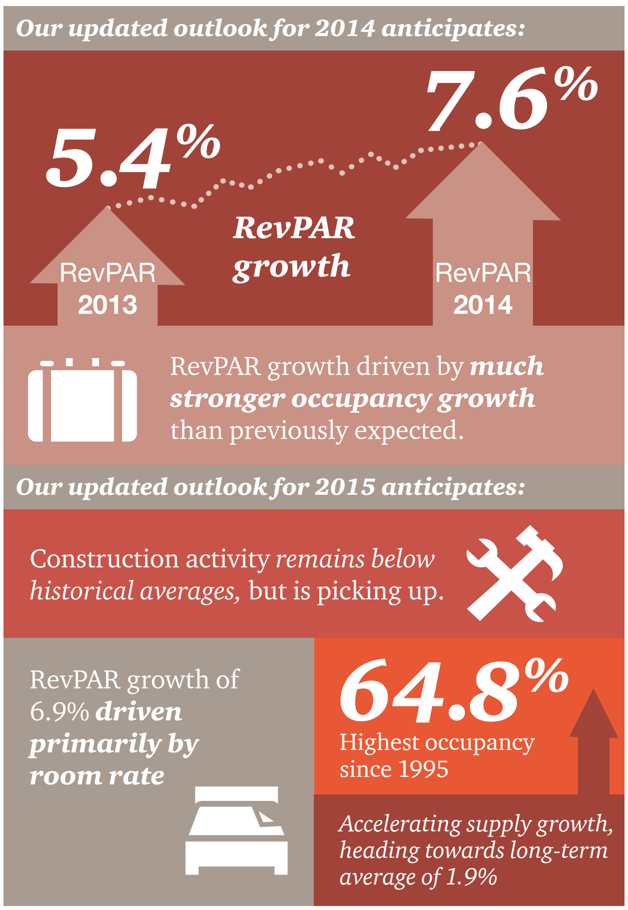
August 2014

Hospitality Directions US

Our updated lodging outlook

Six years after the recession began, room rate driven RevPAR growth gains traction in 2015, as peak occupancy levels support more aggressive revenue management

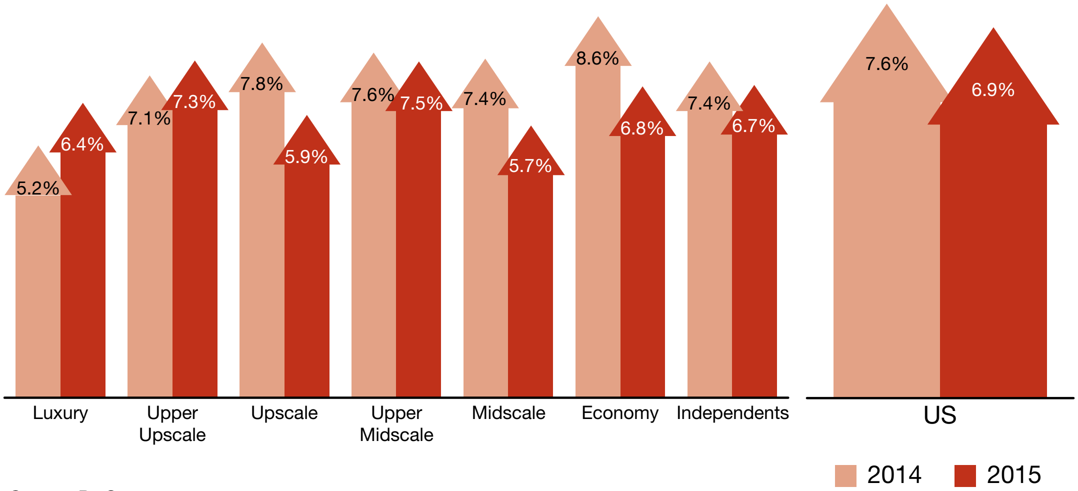


Our updated outlook assumes continued economic growth at above-trend levels in the second half of 2014, and into 2015. We assume GDP growth of 2.0% in 2014 and 3.1% in 2015 (Q4/Q4 basis).

As the economy rebounded from a weather-related slowdown in the first quarter, travel activity picked up significantly in the second quarter, driving occupancy gains that were much stronger than expected, and average daily rate levels that were only slightly less than anticipated. During the first half of the year, both transient and group demand exhibited strong growth, with the year-over-year pace of recovery in group demand exceeding expectations. While transient travel – both commercial and leisure – continues to show steady gains, hoteliers are reporting strong production in the group segment, which still has room to recover to peak levels. This increased momentum of demand growth in the second quarter and into the summer also resulted in public lodging companies increasing their guidance on RevPAR growth for the year. Equity analysts covering the lodging sector also highlight strong group demand trends, complementing the robust growth in transient demand. This, coupled with continued growth in group demand and steady above-trend economic momentum supports our expectation of a solid 7.6% RevPAR increase in 2014. In 2015, supply growth is expected to accelerate, resulting in decelerating occupancy growth. Still, industry-wide occupancy levels are expected to reach 64.8%, the highest since 1995, giving hotel operators more confidence to push for higher room rates.

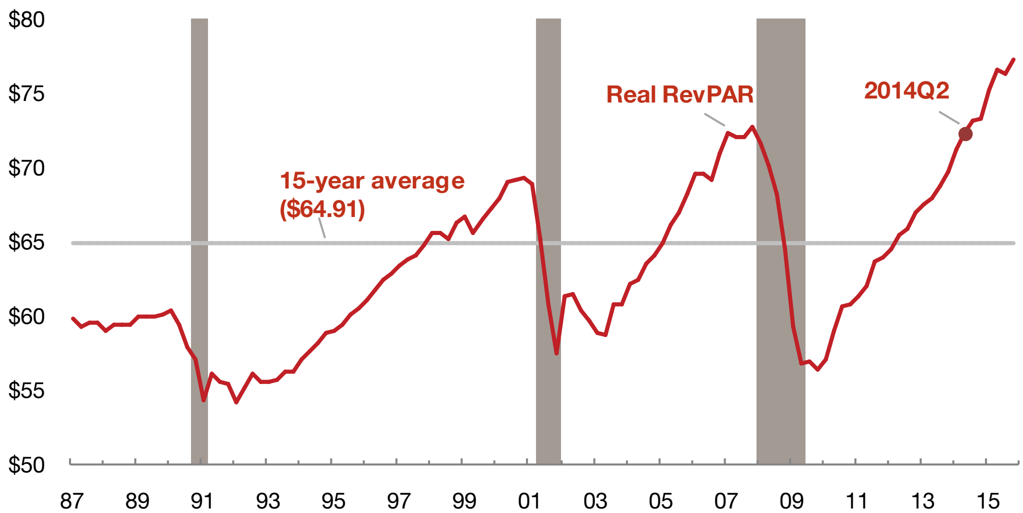
Our updated lodging outlook incorporates operating performance from the first half of 2014 – stronger than expected gains in occupancy levels, driven by the group segment – and a macroeconomic environment that is expected to continue to grow at an above-trend pace. The supply pipeline continues to expand, with hotels under construction increasing by over 50% in the second quarter, compared to the same period last year. As a result, our outlook anticipates supply growth to accelerate to 1.6% in 2015, with supply growth in the higher-priced chain scale segments outpacing growth in the lower-priced segments. Occupancy levels in the lower-priced chain scale segments are expected to approach or exceed prior peak levels, as price-driven compression from higher-priced hotels drives demand to lower priced hotels.

Figure 1: RevPAR growth, US and chain scales



Source: PwC

Figure 2: RevPAR, real (2013 dollars)



Source: Smith Travel Research; Bureau of Economic Analysis; Macroeconomic Advisors, LLC (forecast released August 2014); PwC

Hospitality Directions Outlook

For detailed outlook tables covering the US and each of the chain scales, please access the Hospitality Directions Outlook available online.

Economic growth restarts, reaching above-trend gains in the second half of 2014

After temporary factors, including weather, restrained growth during the first quarter, US economic output increased sharply in the second quarter, with GDP increasing approximately 4.0%, three-tenths of a point higher than previously expected. This recent strength of the economy is expected to continue during the remainder of the year and into 2015, boosting economic growth to above-trend levels. Macroeconomic Advisers now anticipates GDP to grow at approximately 3.1% during the second half of 2014. In 2015, economic growth is expected to continue at an above-trend pace of 3.1%, driven by solid employment gains, absence of fiscal drag, improving financial conditions, and firming household balance sheets. While downside risks continue to be minimal, with the pace of the housing market's recovery remaining a concern, recent geo-political events, including ongoing conflicts in the Middle East and Ukraine, pose some peripheral uncertainty.

Table 1: US outlook (released August 25, 2014)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Demand growth	2.8%	0.4%	0.7%	-2.5%	-6.2%	7.2%	4.6%	2.8%	2.2%	4.0%	2.7%
Supply growth	-0.1%	0.2%	1.2%	2.4%	2.8%	1.7%	0.5%	0.4%	0.7%	1.0%	1.6%
Room starts, % change	2.6%	66.1%	5.3%	-9.5%	-63.8%	-39.1%	56.5%	26.7%	26.3%	33.9%	34.5%
Occupancy	63.0%	63.2%	62.8%	59.8%	54.6%	57.5%	59.9%	61.3%	62.2%	64.1%	64.8%
% change	2.9%	0.2%	-0.5%	-4.8%	-8.8%	5.4%	4.2%	2.3%	1.5%	3.1%	1.1%
Average daily rate	$91.03	$97.83	$104.31	$107.39	$98.16	$98.21	$101.93	$106.19	$110.34	$115.18	$121.75
% change	5.6%	7.5%	6.6%	2.9%	-8.6%	0.1%	3.8%	4.2%	3.9%	4.4%	5.7%
RevPAR	$57.37	$61.78	$65.55	$64.24	$53.55	$56.46	$61.04	$65.08	$68.61	$73.81	$78.91
% change	8.6%	7.7%	6.1%	-2.0%	-16.6%	5.4%	8.1%	6.6%	5.4%	7.6%	6.9%
GDP, % change Q4/Q4	3.0%	2.4%	1.9%	-2.8%	-0.2%	2.7%	1.7%	1.6%	3.1%	2.0%	3.1%
Inflation, % change	2.9%	2.7%	2.5%	3.1%	-0.1%	1.7%	2.4%	1.8%	1.1%	1.6%	1.7%

Source: Smith Travel Research; Bureau of Economic Analysis; Macroeconomic Advisors, LLC (forecast released August 2014); MHC Construction Analysis System; PwC

Table 2: Chain scale outlook, percentage change from prior year

	2014					2015				
Chain scale	Demand	Supply	Occupancy	ADR	RevPAR	Demand	Supply	Occupancy	ADR	RevPAR
Luxury	2.5	2.0	0.5	4.7	5.2	2.5	2.1	0.4	6.0	6.4
Upper upscale	3.2	0.7	2.4	4.5	7.1	2.2	1.0	1.1	6.1	7.3
Upscale	5.9	3.1	2.8	4.9	7.8	4.5	4.0	0.4	5.5	5.9
Upper midscale	4.9	1.3	3.5	4.0	7.6	3.8	2.3	1.4	6.0	7.5
Midscale	4.2	0.7	3.5	3.8	7.4	2.4	1.1	1.2	4.5	5.7
Economy	3.8	0.0	3.8	4.6	8.6	2.2	1.0	1.2	5.5	6.8
Independent hotels	3.2	0.5	2.7	4.6	7.4	1.8	0.7	1.1	5.5	6.7
US total	**4.0**	**1.0**	**3.1**	**4.4**	**7.6**	**2.7**	**1.6**	**1.1**	**5.7**	**6.9**

Source: PwC, based on Smith Travel Research data

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Definitions and information requests

Abbreviated terms include average daily rate ("ADR"), revenue per available rooms ("RevPAR"), and real gross domestic product ("GDP"). Growth rates are percentage change in annual averages, except GDP growth, which is expressed on a fourth-quarter-over-fourth-quarter basis. The personal consumption expenditure price index is used to measure inflation, including the conversion of RevPAR to constant dollars, which is reported as real RevPAR.

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