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The U.S. Lodging Industry in the New Millennium - A Delphi Study to Predict Changes in the Lodging Industry Structure, Performance and Capital Sources in Years 2000 and 2005

A. J. Singh

THE U.S. LODGING INDUSTRY IN THE NEW MILLENNIUM—A DELPHI STUDY TO PREDICT CHANGES IN THE LODGING INDUSTRY STRUCTURE, PERFORMANCE AND CAPITAL SOURCES IN YEARS 2000 AND 2005

A. J. Singh

ABSTRACT

This article presents the key results of a Delphi study conducted to predict changes in lodging industry structure, performance, and capital sources. The purpose of this study was to make predictions in six areas of concern for lenders, investors, owners, and managers associated with the U.S. lodging industry. These six areas, which also represent "uncertainties," are: (1) capital needs of the lodging industry, (2) availability of capital for the lodging industry, (3) cost and terms of capital, (4) structural changes in the lodging industry, (5) operating and investment performance, and (6) role of financial institutions as suppliers of capital to the lodging industry.

Introduction

As the U.S. lodging industry enters a new millennium, a glance back to the beginning of the previous century reveals that the industry's present structure and characteristics are very different from what they were earlier. In its present form, the industry consists of a wide variety of facilities, ranging from small "mom-and-pop" operations to 5,000-room casino resorts. The average size of a typical hotel has grown from 46 rooms in 1933 to 73 rooms in 1996 (AH&MA). Further, the industry has experienced broad changes in its structure. These changes are characterized by a major increase in the industry's size (room supply), a greater diversity of product, an increased complexity of ownership, a greater variety in organizational form operating arrangements, a broader geographic dispersion of properties, and an increasing trend for independents to be replaced by chains. Such changes are by no means linear. A glance back to various periods during the twentieth century reveals the cyclical nature of the industry. There were periods when hotel room rates, occupancies, and values were rising or peaking; during other periods, the same measures were declining or reaching rock bottom. For example, in 1990 the lodging industry reported a loss of $5.7 billion, with occupancies of 63% and average room rates of $57.96. In 1998, however, the lodging industry enjoyed record profits of $20.9 billion, with occupancies of 64% and average room rates of $78.62 (Smith Travel Research, 1998).

Closely associated with the structural evolution of the lodging industry and its growth rate have been changes in its need for, and in the availability of, debt and equity capital. During certain periods, capital has been readily available, while during other periods the industry has suffered from a dearth of capital. In the 1980s, for example, excess capital availability resulted in a period of overbuilding, whereas the early 1990s were characterized by a financing drought.

Similarly, in different periods, different types of hotel products were favored by funding sources. For example, highway motels were favored in the 1960s, while the present focus is on financing full-service hotels (Hotel Partners Capital Group, 1997). Various financial institutions have played a prominent role in financing the lodging industry during each of these periods. Until the 1960s, commercial banks, life insurance companies, and credit companies provided the majority of lodging industry mortgages. During the 1960s and 1970s, much of the growth in the lodging industry was financed by Real Estate Investment Trusts (REITs). As a result of deregulation in the early 1980s, the savings and loan industry began making commercial loans to hotel companies. As a result of losses incurred in the 1980s, the traditional lenders withdrew from financing the hotel industry. To fill the void, investment banks sold "financially engineered" derivative products (such as commercial mortgage-backed securities) to raise capital for the industry. Although traditional lenders have resumed making loans to the lodging industry, the scope of financing has been revolutionized because of access to public capital markets and the use of securitization to finance the industry. The financial-services industry itself is currently undergoing various changes in its competitive and regulatory environment. These changes will have an impact on its future role as a supplier of capital to the lodging industry. The primary changes in the regulatory environment of financial institutions relate to their ability to sell financial products. Firewall regulations such as the Glass-Steagall Act of 1933 are in the process of being dismantled. If financial institutions are not restricted or segregated from selling different financial products, this will have implications for the competition among them and ultimately on the availability of capital for the lodging industry.

Problem Studied

As we enter the new millennium, the lodging industry faces many uncertainties. These uncertainties are based on the underlying premise that the lodging industry is dependent on financing for its growth and development. Through a study of the literature and discussions with financial and lodging industry experts, the following six types of uncertainties were identified as primary concerns for the industry:

1. Capital needs of the lodging industry in the future
2. Availability of capital in the future
3. Cost and terms of capital availability in the future
4. Structural changes of the lodging industry in the future
5. Operating performance and investment returns of the lodging industry in the future
6. Role of financial institutions as suppliers of capital to the lodging industry in the future

In order to address these issues, 39 industry experts were included in a comprehensive research project using the Delphi technique.[1] The partial quantitative and qualitative results of this study are presented, analyzed and discussed in the present article.

Overview of the Delphi Study and Process

"The Delphi technique is a method used to systematically combine expert knowledge and opinion to arrive at an informed group consensus about the likely occurrence of future events" (Moeller & Shafer, 1994). In the third step of the overall study design, the Delphi technique was used to predict future levels of specific variables relevant to lodging industry financing. According to Helmer and Rescher (1960), the original proponents of the Delphi technique, "the technique derives its importance from the realization that projections of future events, on which decisions must often be based, are formed largely through the insight of informed individuals, rather than through predictions derived from well-established theory" (Moeller & Shafer, 1994).

The Delphi technique was selected as the forecasting technique for many reasons. Most important, however, was that the problem was multi-dimensional in nature and involved expertise such that no individual had sufficient knowledge to effect a solution. Therefore, the problem required a group decision-making method. The traditional face-to-face group decision-making processes would have inserted a study bias. This occurs typically in face-to-face decision-making processes, when participants may be dominated by quantity or by strength of personality, which is typically known as the "bandwagon effect" or the "halo effect."

Delphi Procedures

A review of the literature revealed a widespread commonality in the basic Delphi procedures. The steps in conducting a Delphi study listed below are combined from various sources in the Delphi literature, which include Moeller and Shafer (1994), Martino (1983), Deveau (1994), Linstone and Turoff (1979), and Tersine and Riggs (1976):

Step 1: Identify the basic issues, problems, and events to be predicted.

Step 2: Select a panel of experts.

Step 3: Explore, discuss, and finalize the basic issues and events to be predicted.

Step 4: Design a draft questionnaire.

Step 5: Pilot-test the draft questionnaire.

[1] The complete study is titled "A 20th Century History and Delphi Study to Predict Changes in the Lodging Industry Structure, Performance, and Capital Sources." This study was conducted by A. J. Singh as part of his doctoral dissertation at Michigan State University.

Step 6: Mail Round 1 of the Delphi questionnaire.

Step 7: Summarize the statistical results of Round 1 and include these results with the Round 2 mailing of the questionnaire.

Step 8: Continue future rounds similar to steps 6 and 7.

Step 9: Analyze the data to show consensus of participants over progressive rounds.

The expert panel for the current research consisted of 39 industry experts from 16 categories as shown in Table 1. The study subjected the panel to successive rounds of questions related to specific issues about the future, such as questions pertaining to the role of financial institutions as suppliers of capital to the lodging industry. At the end of each round, the panelists were provided feedback of the other participants and had an opportunity change their previous predictions. This continued until the panel reached a consensus.

Table 1
Profile of institutions and organizations represented on the Delphi panel

Category	**Participants**
Academic Institution	3
Consulting Company	5
Mortgage Banker	1
Real Estate Broker	2
Acquisition Fund	1
REIT	2
Conduit	2
Investment Bank	5
Money Center Bank	2
Finance Company	3
Life Insurance	2
Investment Advisor	4
Lodging and Financial	2
Management Company	2
Franchisor	1
Lodging Chain	2
Total	39

Research Questions/Study Objectives

The purpose of the Delphi study was to predict future changes in the lodging industry's structure, operating performance, and capital needs in the future; and to predict the

future role of financial institutions as suppliers of capital to the industry. The findings are based on the following four broad research questions posed in the Delphi study.

In the years 2000 and 2005, what will be:

1. *The structure of the lodging industry?*
2. *The operating performance of the lodging industry?*
3. *The lodging industry's need for capital?*
4. *The role of financial institutions as suppliers of capital to the lodging industry?*

For each of the four broad research questions, sets of specific sub-questions were asked to focus panelist attention on the key variables relevant to answering the broader research questions. The responses were summarized using two statistics: the median (MD) and the inter-quartile range (IQR). The median is the midpoint of the distribution of the panel's responses; the inter-quartile range is the middle 50% of their responses and is indicative of the degree of consensus among the Delphi panelists. The responses noted in the tables are the responses of the final Delphi round, and may be interpreted as the expert panel's final decision for a particular question or issue.

In addition to the study's closed-ended questions, three questions were open-ended. The experts on the panel freely expressed their views when answering these questions, and their responses were organized, summarized, and—in some cases—directly transcribed, so as not to lose any meaning in the translation.

Analysis and Discussion of Results

Each of the four research questions are sequentially presented, analyzed and discussed in this section.

Research Question 1: In the Years 2000 and 2005, What Will Be the Structure of the Lodging Industry?

In order to determine the structure of the lodging industry in the future, the Delphi panelists were asked 10 open-ended questions that sought the experts' views on issues that are expected to help shape the structure of the lodging industry in 2000 and 2005. The issues posed to the experts are listed in Table 2 and subsequently discussed.

Table 2
Issues related to structure of lodging industry

1.	Industry consolidation.
2.	Strategic alliances.
3.	Ownership profile of the lodging industry (private to public).
4.	The type of hotels being developed.
5.	The age of room inventory.
6.	Segmentation of the industry (branding issues).
7.	International expansion.
8.	The creation and growth of new types of lodging products (time-share, assisted-living, extended-stay).
9.	The status of independents (rate of conversion to franchise properties).
10.	Industry competition.

Summary of Predictions on Specific Issues Affecting the Lodging Industry's Structure in the Years 2000 and 2005

Industry Consolidation. Most experts predicted that the current trend toward consolidation in the lodging industry will continue, especially until the year 2000. This consolidation will take various forms, including the pairing of REITs with operating companies, the merger of U.S. and international hotel companies, and brand consolidation.

The view for the year 2005 is more split. About 70% of the respondents predicted that the trend toward consolidation will slow down by 2005; in fact, by that time the industry might even see some divestitures. However, the other 30% predicted that consolidation will continue in 2005. One of the participants also predicted that in 2005 new start-ups and a changing user profile will generate new lodging companies.

Strategic Alliances. The majority of the participants predicted that strategic alliances will continue up to the year 2000. However, there were differing views on the nature of these alliances. While some participants stated that the alliances would be between small companies, others stressed alliances between recognizable brands and tax-advantaged structures (such as REITs), and some stressed the international nature of the alliances. There was a minority view that strategic alliances will not work and will slowly fade away.

The view after 2000 ranged from those who felt the growth in strategic alliances would stabilize, to those who felt that they would start to break up. One of the participants also predicted that, during 2005, more alliances are likely between hospitality management, real estate ownership, and possible combination with distribution vehicles (franchisors).

Ownership Profile (Private to Public). The majority view among the panelists was that the trend toward public ownership would continue into the future; capital costs and access

to capital markets were stated as the primary reasons. Both C-Corps and REITs were expected to increase their share of hotel ownership in the future. However, one of the participants stated that some companies that lose in the public arena might return to private capital markets in the future.

Type of Hotels Being Developed. The general consensus among the panelists was that budget and economy hotels would be a much lower percentage of the overall hotels developed in the year 2000. Full-service, first-class, luxury, and extended-stay products will be the primary choices for new development. Two participants stated that companies would start looking at small communities where "small pockets of demand" exist and develop "sleep-only" 50- to 70-room properties there. Overall, development is expected to slow down by 2005.

Aging of Room Inventory. The panel generally was in agreement that the room inventory is aging. However, it was split on whether the inventory would be replaced by newer properties in the future.

Those who said that in the future the average age of hotels would decline felt that inferior and older product would either be pushed out of the market or would require major renovation. One of the participants stated that budget and economy hotels will age quickly and have a short economic life, which will reduce the average age of the inventory. Another factor that might contribute to the reduction in the average age of hotels was the future addition of new types of products.

Segmentation of the Lodging Industry (Branding Issues). The overall consensus of the participants was that segmentation and branding would continue to grow and be a significant factor in the structure of the lodging industry until the year 2000. This growth will be fueled by the conversion of independent properties to branded properties and the development of new products, such as extended-stay properties. Furthermore, one of the participants stated that new distribution technology (such as the Internet) would aid in the increase of brands. However, participants stated that the rate of growth of new brands in the years ahead will be slower than the current rate. This will be the result of (1) some new brands not reaching critical mass,[2] which will lead to rebranding by established brands, and (2) the slowdown in the overall rate of new hotel development.

By 2005, most participants agreed that the segmentation of the lodging industry will stabilize and even, to an extent, start to decrease. This decrease will be a result of weaker brands and brands that do not focus on management exiting the market.

International Expansion. There was universal consensus among the experts that the growth of the U.S. lodging industry into international markets will continue to increase in both prediction periods. There were four reasons stated for this increase. First, the U.S. lodging market has reached a mature phase, and therefore domestic growth has

[2] "Critical mass," with regard to franchising, refers to the minimum number of franchisees required for the franchise company to at least cover its overhead costs.

stabilized. Second, U.S. lodging companies will continue to follow American businesses as they expand overseas. Third, the economies of many emerging nations are growing at a fast clip, with means these nations have more "middle-class" people with disposable income and leisure time. Finally, good opportunities to purchase hotel real estate overseas as a result of depressed prices and the strong dollar will also spur the rate of international growth.

The Creation and Growth of New Lodging Products. The two relatively new lodging products most study participants mentioned were time-share properties and assisted-living facilities. The growth of the former is primarily due to three factors: first, the purchase of recreational properties in popular resort destinations is out of the reach of most Americans. Second, with the maturing of the baby boom generation, many Americans have reached a stage in their lives that affords them leisure time, disposable income, and a desire to visit destinations that suit their specific leisure tastes and preferences (skiing, diving, hiking, etc.). And finally, time-share companies have grown, becoming more organized and respectable. Many well-known hotel companies have started time-shares as well.

Status of Independents. The consensus of the panel was that independents would continue to decline in the future (for both prediction periods). This decline will be the result of increasing competition, lenders who will be reluctant to lend money for hotels unless they are part of a recognized brand, and the growing power and strength of hotel-chain reservation systems. This prediction does not apply to certain specialty hotels in resort and urban locations. However, a dissenting view on this prediction by one of the participants was that the rate of conversion from independents to brands will slow down in the future. This was primarily attributed to the growth of Internet-based reservations.

Industry Competition. Despite the increase in lodging industry consolidation, most of the experts predicted that the level of competition in the industry will increase during the next few years, leading up to the year 2000. This was primarily attributed to the leveling of demand. Many of the participants predicted that the nature of the coming competitive environment is going to be severe. It was variously described as "deep turning," "cannibalistic," "parasitic," "cutthroat," and "fierce." Where will this competition be focused? One of the participants stated that it will be focused mainly in the lower end of the market, which is expected to be overbuilt by the year 2000. In this environment, only the tough will survive. "Strong management," "best-trained companies," "technically astute," and "strong brand recognition" were some of the survival factors the participants considered to be important. This competitive environment is not expected to ease by the year 2005; in fact, some of the participants stated that it would get even tougher.

Research Question 2: In the Years 2000 and 2005, What Will Be the Operating Performance of the Lodging Industry?

The Delphi panel was asked to predict the operating performance of the lodging industry for the two prediction periods (2000 and 2005). The four most common operating performance indicators—occupancy percentage, average daily rate, revenue per available room (revpar), and pre-tax income—were used as the operating performance

measures. The experts made their predictions for each of the five lodging industry tiers: budget, economy, mid-price, upscale, and luxury.

Prediction of the Operating Performance of Hotels (by Tier) in the Years 2000 and 2005

Table 3 presents the results of the panel's predictions about the future operating performance of the U.S. hotel industry. The experts predicted that, in 2005, the occupancies for the upscale and luxury segments would be much higher (67% and 74%, respectively) than for the budget and economy segments, both of which were predicted to have 60% occupancy in 2005. Occupancies for midscale hotels were predicted at 65%, which falls between the economy and upscale segments.

Interestingly, however, the growth predicted in the average daily rate from year 2000 to year 2005 was highest for both the budget segment and the luxury segment. The predicted rate increase was 17% for budget hotels and 15% for luxury hotels. Other hotel segment room-rate increases ranged from 7.5% to 11%.

Revenue per available room (revpar), a statistic that takes into account both the average room rate and occupancy percentage, is predicted to increase by about 7% for the budget, economy, and midscale segments, and between 13% and 14% for the upscale and luxury segments.

Pre-tax income predictions, the final indicator of lodging industry operating performance, vary widely between the lodging segments. The common factor, however, was that for neither prediction period were any of the segments expected to show negative pre-tax income. The budget and economy segments were expected to have the lowest profitability, predicted at between 5% and 6% for 2000 and 2005. The luxury segment is predicted to have the highest profitability, at 24% in 2000 and 23% in 2005. The profitability of midscale hotels was predicted to range from 14% in 2000 to 15% in 2005. Finally, upscale hotels were predicted to have a pre-tax income of 17% for both prediction periods.

Table 3
Operating performance of the hotel industry, years 2000 and 2005

Budget	**MD 2000**	**IQR 2000**	**MD 2005**	**IQR 2005**
Occupancy (%)	60.0	60.0–60.0	60.0	60.0–60.0
Average Daily Rate ($)	42.0	42.0–45.0	49.0	45.0–50.0
Revpar ($)	26.0	25.0–26.0	28.0	17.0–29.0
Pre-Tax Income (%)	5.0	3.75–8.0	6.0	5.0–10.0

Economy	**MD 2000**	**IQR 2000**	**MD 2005**	**IQR 2005**
Occupancy (%)	60.0	59.0–60.0	60.0	60.0–60.0
Average Daily Rate ($)	53.0	40.0–54.0	57.0	54.0–58.0
Revpar ($)	31.5	30.0–32.0	34.0	33.0–35.0
Pre-Tax Income (%)	6.0	5.0–8.0	5.0	5.0–10.0

Midscale	**MD 2000**	**IQR 2000**	**MD 2005**	**IQR 2005**
Occupancy (%)	65.0	64.0–65.0	65.0	64.0–65.0
Average Daily Rate ($)	67.0	66.0–68.0	72.0	70.0–75.0
Revpar ($)	45.0	44.0–45.0	48.0	46.0–49.0
Pre-Tax Income (%)	14.0	13.0–15.0	15.0	15.0–15.6

Upscale	**MD 2000**	**IQR 2000**	**MD 2005**	**IQR 2005**
Occupancy (%)	68.0	67.0–68.0	67.0	67.0–68.0
Average Daily Rate ($)	90.0	90.0–93.0	100.0	95.0–108.0
Revpar ($)	61.0	60.0–62.0	69. 0	68.0–69.0
Pre-Tax Income (%)	17.0	17.0–17.0	17.0	15.0–17.0

Luxury	**MD 2000**	**IQR 2000**	**MD 2005**	**IQR 2005**
Occupancy (%)	74.0	73.0–75.0	74.0	72.0–75.0
Average Daily Rate ($)	135.0	130.0–135.0	155.0	140.0–160.0
Revpar ($)	100.0	98.0–101.0	114.0	110.0–120.0
Pre-Tax Income (%)	24.0	20.0–24.0	23.0	22.0–24.0

Discussion of the Operating Performance of the Lodging Industry in the Years 2000 and 2005

The ability of an industry to attract capital is determined to a large extent by its operating performance, which impacts its overall profitability. Overall, demand for lodging industry products is definitely slowing down; occupancies have declined in the past two years (Bond, 1998). However, predicted future changes in operating results are not uniform across the various hotel segments. Based on the experts' predictions, it appears that the upper end of the market will experience higher demand, room rate, and overall profitability, and therefore should attract more capital than the budget and economy segments. Two contributing factors to this view may be seen among the experts' previous predictions on the structure of the lodging industry (research question 1), in which they said that the lower end of the lodging industry is becoming overbuilt and that the lower-end products have a shorter economic life, thus leading to faster physical obsolescence.

When comparing the growth in revpar, a statistic that includes both the occupancy and room rate component, we find that for the year 2000 it is virtually unchanged from the current revpar (1997). This would indicate that the industry has peaked in terms of demand for its product and that growth is limited in the United States. The net result of this could be more merger and consolidation activity, an increase in competition, more international growth, and the creation of new types of lodging products in order to increase sources of revenue. For 2005, the growth in revpar is mainly in the luxury and upscale segments of the industry. The lower end was predicted to have very minimal growth.

Historically, the lower end of the market, which includes limited-service hotels, has achieved a higher percentage of pre-tax income as compared to the upper end of the lodging market, which includes full-service hotels. For example, in 1996 the pre-tax income for limited-service hotels was 27%; for full-service hotels, it was 15.7% (Smith Travel Research, 1997). However, for the prediction periods covered in this study, it is interesting to note that the upper end of the market is expected to achieve higher profitability than the lower end.

Overall, it is also important to note that the panel predicted no growth in pre-tax income for any of the segments. This may be due to a combination of three factors: (1) the growth in revenue is merely keeping pace with increases in operating expenses such as labor and marketing, (2) hotels may be undertaking additional capital expenditures during this period for renovation and refurbishment to keep their properties competitive, and (3) panelists do not perceive opportunities to increase productivity and/or to cut operating costs.

Research Question 3: In the Years 2000 and 2005, What Will Be the Lodging Industry's Need for Capital?

Research question 3 asked the panel of experts to predict the nature of demand for capital by the lodging industry. The sub-questions in this category covered the level of demand for capital, based on the type of financing activity, segment or tier of the lodging industry, location of the hotel, and type of owner.

Prediction of the Financing Activity Requiring Capital in the Years 2000 and 2005

Table 4 presents the results of the panel's predictions of the type of financing activity within the lodging industry that would be undertaken to meet demand for capital in the future. The lodging industry is expected to demand less or about the same amount of capital for U.S. construction, conversions, and mergers and acquisitions in 2000 as compared to the current period. However, demand for capital to finance acquisition, construction, and renovation activity overseas will be higher than in the current period. This trend is expected to continue in 2005 as well.

Table 4
Demand for lodging capital based upon type of financing activity

Financing Activity	MD 2000	IQR 2000	MD 2005	IQR 2005
Construction	4.0	3.0–4.0	4.0	3.0–4.0
Conversion	3.0	3.0–3.0	3.5	3.0–4.0
Mergers and acquisitions (corporate)	3.0	3.0–3.0	3.0	3.0–4.0
Acquisition of individual hotels	3.0	3.0–4.0	4.0	3.0–4.0
Acquisition of portfolio of hotels	3.0	3.0–4.0	4.0	3.0–4.0
Expansion overseas: acquisition	2.0	2.0–3.0	2.0	2.0–2.0
Expansion overseas: construction	2.0	2.0–3.0	2.0	2.0–3.0
Renovation/upgrading	2.0	2.0–3.0	2.0	2.0–2.0

Scale: 1 = Much Higher, 2 = Higher, 3 = About the Same, 4 = Lower, 5 = Much Lower

Prediction of Lodging Tiers Demand for Capital in the Years 2000 and 2005

Table 5 presents the results of the panel's prediction on each lodging tier's demand for capital. For the year 2000, the "upper upscale" and upscale tiers will demand higher capital than they do today; capital demand will be about the same as today for the midscale products and will be lower for the economy, budget, and independent products. In 2005, demand for capital will continue to remain lower than today for the tiers ranging from independent to midscale; the level of capital demanded by "upper upscale" and upscale tiers is expected to be about the same as today.

Table 5
Demand for lodging capital based upon lodging tier

Tiers	MD 2000	IQR 2000	IQR 2005	IQR 2005
Upper Upscale	2.0	2.0–2.0	3.0	3.0–4.0
Upscale	2.0	2.0–2.0	3.0	3.0–4.0
Midscale with F&B	3.0	3.0–4.0	4.0	4.0–4.0
Midscale w/o F&B	3.0	3.0–3.0	4.0	4.0–4.0
Economy	4.0	4.0–4.0	4.0	4.0–5.0
Budget	4.0	4.0–4.0	4.0	4.0–5.0
Independent	4.0	3.0–4.0	4.0	3.0–4.0

Scale: 1 = Much Higher, 2 = Higher, 3 = About the Same, 4 = Lower, 5 = Much Lower

Discussion of Lodging Industry's Need for Capital in the Years 2000 and 2005

The panel predicted a lower need for construction capital in both 2000 and 2005, indicating that it doesn't view the lodging industry's growth as coming from major increases in room supply. Its prediction of higher future capital needs for international acquisition and construction is indicative of a maturing of the U.S. lodging industry (which means fewer growth opportunities). This also suggests elements of opportunistic investing, as real estate values are lower in some overseas countries as compared to the United States. The panel's prediction about increasing uses of capital for renovation and upgrades in both 2000 and 2005 is in keeping with its view that the lodging product is aging and many facilities need to be upgraded in order to remain competitive. The panel predicts that financing needs for the acquisition of individual hotels and hotel portfolios in the year 2000 will remain about the same as today; the need will be lower in 2005. The panel's prediction that financing needs for corporate mergers-and-acquisitions activity will be about the same as today in both 2000 and 2005 (1998 mergers-and-acquisitions activity has slowed down as compared to the previous two years) is indicative of an industry that has approached the peak of its consolidation, with fewer lucrative deals left.

The Delphi panel's prediction that the future need for capital will be found more in the upscale segment is consistent with its previous prediction that the upscale segment is the least overdeveloped segment. Furthermore, the operating performance from this segment was predicted to be high in the future; the converse was true of the middle and lower tiers. The lower tiers will demand the least amount of capital, as the panel predicts that this tier will become overbuilt during the prediction period, further depressing operating performance.

With the growth of gaming and time-share vacation concepts, it is not surprising that the Delphi panel predicted a higher need for capital in the resort segment. However, it was interesting to note that the panel identified a higher need for capital in both urban and suburban locations. This prediction appears to be contradictory, as, generally speaking, growth in suburban locations is at the expense of urban locations. This contradiction may be partially explained by the growth of urban time-share concepts, the conversion of urban buildings to hotels, and urban renewal projects being undertaken by cities across the nation.[3]

The ownership structure of the lodging industry has changed and continues to change. While earlier in the century, individual owners dominated the industry, the current trend is toward multiple ownership entities such as REITs, partnerships, and opportunity funds. The panel's prediction that equity REITs and C-Corps will demand more capital in the year 2000 than in the present period may indicate a resurgence of growth plans for C-Corps and REITs (as of October 1998, REITs in particular had considerably slowed down their acquisition activity due to declining prices of their stock). However, this raises the question: will market capitalization for these two public entities be restored in order to access public sources of capital or will they be dependent upon

[3] Results discussed but not presented due to space limitations.

private debt and equity sources? Overall, the panel's prediction of capital needs by the ownership entities during 2000 and 2005 presumes an overall slowdown of financing activity, because the median response concerning the capital needs of most owners was 3.0, indicating that capital needs will be about the same as today.[4]

Research Question 4: In the Years 2000 and 2005, What Will Be the Role of Financial Institutions as Suppliers of Capital to the Lodging Industry?

The final research question asked the panel of experts to predict the role of financial institutions as suppliers of capital to the lodging industry. A series of sub-questions covered issues such as the relative role of financial institutions in providing equity and debt to the lodging industry, lending criteria, cost of loans, loan size, segments and types of lodging products expected to be financed, types of financing provided, and the stage of financing in which the various financial institutions will be involved. Due to space limitations, only a part of the results will be presented and discussed in the present article.

Prediction of the Relative Share of Equity Capital Investment in Lodging Industry Real Estate by Financial Institutions in the Years 2000 and 2005

Table 6 presents the panel's predictions of the relative share of equity capital directly invested by financial institutions in lodging industry real estate. The experts predicted that in 2000 and 2005, pension funds and life insurance companies will be the two top equity investors in lodging real estate. The median percentages reported were 40% and 20%, respectively, for both prediction periods. Investment companies (mutual funds), investment banks, and conduits rounded out the top five equity investors.

Table 6
Relative share of equity capital in lodging industry real estate by financial institutions

Institution	**MD 2000**	**IQR 2000**	**MD 2005**	**IQR 2005**
Pension Fund	40.0%	37.0–40.0%	40.0%	35.0–40.0%
Life Insurance Company	20.0	20.0–20.0	20.0	15.0–20.0
Investment Company (mutual fund)	10.0	8.0–15.0	15.0	12.0–15.0
Investment Bank	10.0	10.0–11.0	10.0	10.0–15.0
Conduit	8.0	5.0–10.0	10.0	4.0–15.0
Finance Company	4.0	3.5–5.0	3.0	3.0–6.5
Commercial Bank	2.0	2.0–6.0	2.0	2.0–5.0
Thrift Institution	1.0	1.0–1.0	1.0	1.0–1.0

Prediction of the Relative Share of Direct Loans Provided by Financial Institutions for Lodging Construction or Acquisition in the Years 2000 and 2005

[4] Results discussed but not presented due to space limitations.

Table 7 presents the panel's predictions on direct loans provided by financial institutions for construction and acquisition. Financial institutions provide debt capital directly to the lodging industry by providing mortgage loans for construction or acquisition. Commercial banks and life insurance companies will be the primary financial institutions providing such loans in the years 2000 and 2005. Commercial banks were predicted to have 40% of the total market in 2000 and 2005; life insurance companies, 20% in 2000 and 16% in 2005. Conduits and investment banks were predicted to have a 10% share in 2000 and 2005. Thrifts, finance companies, and pension funds are expected to have 5% of the market in both years.

Table 7
Relative share of direct mortgage loans provided by financial institutions for lodging construction or acquisition

Institution	**MD 2000**	**IQR 2000**	**MD 2005**	**IQR 2005**
Commercial Bank	40.0%	35.0–40.0%	40.0%	30.0–40.0%
Life Insurance Company	20.0	15.0–20.0	16.0	15.0–20.0
Conduit	10.0	10.0–15.0	10.0	10.0–15.0
Investment Bank	10.0	10.0–13.0	10.0	8.0–15.0
Thrift Institution	5.0	5.0–5.0	5.0	4.0–5.0
Finance Company	5.0	5.0–6.0	5.0	5.0–6.0
Pension Fund	5.0	5.0–5.0	5.0	5.0–5.0
Investment Company (mutual fund)	1.5	1.0–2.0	2.0	2.0–2.0

Discussion of the Relative Role of Financial Institutions in Providing Debt and Equity Capital to the Lodging Industry in the Years 2000 and 2005

The capital provided to the lodging industry can be categorized as "equity" or "debt." Tables 6 and 7 illustrate the relative role of financial institutions in the provision of capital to the lodging industry in the future. It is clear from these tables that pension funds and life insurance companies are expected to be the major sources of direct-equity capital for lodging real estate in the future. On the other hand, mutual funds, pension funds, and life insurance companies are predicted to be the largest purchasers of lodging company stock. A surprising prediction was the increased role of mutual funds in direct-equity lodging real estate investment. While mutual funds have been purchasers of lodging industry stock in the past, their involvement in direct-equity investment has been limited. The future merging of financial institutions predicted by the participants may provide a partial explanation for this change.

The panel was quite consistent in their prediction of relative role of equity investment by financial institutions from year 2000 to 2005.

On the debt side, commercial banks were expected to remain the dominant source of mortgage capital for both prediction periods, followed by life insurance companies. Life

insurance companies were expected to reduce their share of mortgage debt in 2005 (apparently, this loss was offset by an increase in their role as equity providers in 2005). The role of conduits and investment banks is predicted to remain constant at 10% in both 2000 and 2005. It is important to note that, despite the overall reduction in the market share of commercial banks (as a percent of total financial institutions' assets), the panel does not predict a decline in their role as providers of mortgage capital to the lodging industry.

The panel was very positive about the role of life insurance companies, mutual fund companies, commercial banks, and pension funds as purchasers of debt securities in the future. These four institutions are expected to control approximately 70% of the debt securities in both of the prediction periods. While, in the past, commercial banks participated in the debt market mainly through the provision of mortgage capital, they are expected to play an increasing role as purchasers of debt securities.

Lodging Segments and Products Financed by Financial Institutions in the Future

Discussion of the Lodging Segments and Products Financed by Financial Institutions in the Years 2000 and 2005.[5]

The Delphi panel expects that pension funds, life insurance companies, investment banks, and money-center banks will primarily finance luxury and upscale hotels in the two prediction periods. This is consistent with its earlier prediction that these segments will have high operating performance ratios in the future. Furthermore, changes in the relative additions to the supply of hotel rooms from 1990 to 1997 also indicate that, while the room supply of midscale and economy segments grew by 84%, the top two tiers only increased by 31% (Smith Travel Research, 1997).[6] This inequity in room supply (more supply of rooms than demand) has had a negative impact on the operating performance of the lower tiers.

Despite a high percentage of net additions in the room supply of economy hotels in the past five years, the panel predicted that there is a high probability that community banks will continue to finance these products. Their specialized knowledge of economy hotels and the markets where these loans are made is probably the reason for this optimistic projection by the panel.

The traditional sources of capital for midscale, economy, and budget hotels have been finance companies and regional banks. These institutions are predicted to be moderate to low probability sources of financing for these sectors in the prediction periods. The fast rate with which the room supply in these segments has grown in the past five

[5]Results discussed but not presented due to space limitations.

[6]Please note that there was also a decrease in supply of certain segments by 22%, and other segment changes are not shown; as a result, 84% and 31% do not total 100%.

years is likely one reason for the panel's low confidence in their willingness to provide future financing for low tier properties.

The extended-stay segment has shown very high growth in the past three years. In 1995, the segment had 366 properties and 43,000 rooms; this has grown to 893 properties and 100,361 rooms (Smith Travel Research, 1998). This is an overall room growth of 133%. As a result, overbuilding fears may be developing in the lending community. Therefore, the panel's overall prediction of "moderate probability" on the future financing potential for this product is not surprising. Furthermore, an Arthur Andersen study reported by Shroders Research (1998) indicates that the extended-stay segment may be suffering from an erosion of brand loyalty. Even established extended-stay products such as Residence Inn have a low customer loyalty, according to that study.

The panel predicted that life insurance companies and pension funds have a high to moderate probability of financing convention hotels in 2000 and 2005. Convention hotels in general have shown high operating performance ratios. In 1996, their operating statistics were 72.5% occupancy, $130.17 average daily rate, and operating profits of $16,014 per available room (PKF, 1997). However, convention hotels are expensive to construct and require tax and other development incentives from cities in order to make their construction financially feasible.

Casino hotels, by combining lodging and entertainment, have created a product that has become very popular with travelers. The tremendous growth of hotel rooms in Las Vegas in recent years is an example of this popularity. However, the Delphi panel was tentative in its prediction of financing availability for this product. The consensus was toward a moderate to low probability that financing would be available for casinos in 2000 and 2005. Three factors may have contributed to this tentative prediction: (1) there is a general feeling in the lending community that some of the large casino destinations are approaching an overbuilt status; (2) casino hotels are expensive to build; and (3) while casino gambling is currently legal in 22 states, its growth will depend on more states legalizing gambling.

Resorts have a high probability of being financed by the large lenders in the prediction periods. Lender interest in the future performance potential of resorts is fueled by four factors: (1) the trend in fitness, leisure, and recreation is expected to continue into the future; (2) the market mix of the resort product, while heavily dependent on tourists, is well diversified, as 40% of the mix is from conventions, conferences, and business travelers; (3) this product is expensive to construct, so barriers to entry are high; and (4) the increasing growth and interest in the time-share resort market is expected to further fuel interest in resorts.

Types of Hotel Mortgage Loans Provided by Financial Institutions in the Future: Analysis of Results

Prediction on Sources of Construction Loans for the Lodging Industry in the Years 2000 and 2005

Table 8 presents the panel's predictions of sources of construction loans for the lodging industry. The panel predicts that depository institutions such as community banks,

regional banks, money-center banks, and thrifts will be the construction lenders in years 2000 and 2005. However, only community banks in the year 2000 have a "high probability" of being involved with construction financing during the prediction periods. Furthermore, the level of consensus was weak—an IQR of 1.0–3.0 for community and regional banks, 2.0–3.0 for money-center banks, and 3.0–4.0 for thrifts. All other institutions are not expected to be involved in construction lending during 2000 and 2005.

Table 8
Sources of construction loans by financial institutions for the lodging industry

Lender	**MD 2000**	**IQR 2000**	**MD 2005**	**IQR 2005**
Community Bank	1.0	1.0–2.0	2.0	1.0–3.0
Regional Bank	2.0	1.0–2.0	2.0	1.0–3.0
Money-Center Bank	2.0	2.0–2.0	2.0	2.0–3.0
Thrift Institution	2.0	2.0–3.0	3.0	3.0–4.0
Finance Company	3.0	2.0–3.0	3.0	3.0–4.0
Conduit	3.0	2.0–4.0	3.0	2.0–4.0
Life Insurance Company	3.0	3.0–4.0	3.0	3.0–4.0
Investment Bank	3.0	3.0–3.0	3.0	3.0–4.0
Pension Fund	4.0	3.0–4.0	4.0	4.0–4.0

Scale: 1 = High Probability, 2 = Moderate Probability, 3 = Low Probability, 4 = Not Probable

Prediction of Sources of Mini-Perm Loans for the Lodging Industry in the Years 2000 and 2005

Table 9 presents the panel's predictions on sources of mini-perm[7] loans for the lodging industry. Money-center banks have a "high probability" of being involved in mini-perm loans in the year 2000; in 2005, this tapers off to a "moderate probability." All other institutions have a moderate to low probability of being involved in this form of financing.

[7] This is a combination of a construction and permanent loan.

Table 9
Sources of mini-perm loans by financial institutions for the lodging industry

Lender	**MD 2000**	**IQR 2000**	**MD 2005**	**IQR 2005**
Money-Center Bank	1.0	1.0–2.0	2.0	1.0–2.0
Community Bank	2.0	2.0–2.0	2.0	2.0–2.0
Regional Bank	2.0	2.0–2.0	2.0	2.0–2.0
Life Insurance Company	2.0	2.0–3.0	2.0	2.0–3.0
Thrift Institution	2.0	2.0–3.0	3.0	2.0–3.0
Finance Company	2.0	2.0–2.0	2.0	2.0–2.0
Conduit	3.0	2.0–3.0	3.0	2.0–3.0
Pension Fund	3.0	3.0–3.0	3.0	3.0–3.0
Investment Bank	3.0	3.0–3.0	3.0	3.0–3.0

Scale: 1 = High Probability, 2 = Moderate Probability, 3 = Low Probability, 4 = Not Probable

Prediction of Sources of Permanent Loans for the Lodging Industry in the Years 2000 and 2005.

Table 10 presents the panel's predictions of sources of permanent loans for the lodging industry. Pension funds and life insurance companies are expected to be the primary providers of permanent financing in 2000 and 2005. Money-center banks and conduits are expected to have a "moderate probability" of involvement in this form of financing for both prediction periods. Other financial institutions are not expected to be involved in permanent financing.

Table 10
Sources of permanent loans by financial institutions for the lodging industry

Lender	**MD 2000**	**IQR 2000**	**MD 2005**	**IQR 2005**
Pension Fund	1.0	1.0–2.0	1.0	1.0–2.0
Life Insurance Company	1.0	1.0–1.0	1.0	1.0–2.0
Money-Center Bank	2.0	2.0–2.0	2.0	2.0–3.0
Conduit	2.0	2.0–2.0	2.0	2.0–3.0
Community Bank	3.0	2.0–3.0	3.0	3.0–3.0
Regional Bank	3.0	2.0–3.0	3.0	3.0–3.0
Thrift Institution	3.0	2.0–3.0	3.0	3.0–3.0
Finance Company	3.0	2.0–3.0	3.0	3.0–3.0
Investment Bank	3.0	3.0–3.0	3.0	3.0–3.0

Scale: 1 = High Probability, 2 = Moderate Probability, 3 = Low Probability, 4 = Not Probable

Discussion of the Type of Hotel Mortgage Loans Provided by Financial Institutions in the Years 2000 and 2005

Commercial banks have been considered the traditional construction lenders. However, they cut back their construction lending as a result of the real estate crash during the 1987–1992 period. They started to return to this form of lending as the lodging industry recovered in the mid-1990s. Although, relative to other financial institutions, commercial banks will continue to be the primary source for construction loans, the panel's prediction appears to be that they will play a limited role in construction lending in 2000 and 2005. Only community banks are predicted to have a high probability of involvement in construction loans. There may be three reasons for this prediction: (1) the panel sees a general slowdown in lodging construction activity during the prediction periods; (2) alternative sources of financing—such as foreign banks, foreign investors, and REITs—may be expected to replace U.S. commercial banks as sources of construction funds; and (3) commercial banks may become more involved in purchasing debt securities rather than making direct construction loans in the future.

The two traditional sources of permanent financing—pension funds and life insurance companies—are predicted to have a high probability of continued involvement with this type of lending.

Mini-perm loans, which are a combination of a construction loan and a permanent loan, were extensively used in the 1980s. It is interesting to note that even though all financial institutions indicate a moderate probability offering these loans, they are all competing for making these types of loans.

The overall predictions of the panel, in terms of the role of financial institutions in providing the various types of direct mortgage financing, show that there will be a general slowdown in practically all stages of mortgage financing during 2000 and 2005.

Synthesis of the Delphi Study's Results

The results of the Delphi study presented, analyzed, and discussed in this article are predictions that the Delphi panelists made about two interdependent industries, the lodging industry and the financial services industry.

The future growth of companies in the lodging industry is not predicted to be in the form of major increases in room supply, but through consolidation, strategic alliances, international expansion, and the introduction of some new products. As a result, the panelists see the future of the lodging industry as dominated by large hotel companies, diversified both in terms of geographic expansion and product offering. In this type of operating environment, in which the industry has only limited growth potential by increasing room supply, hotel companies that have renovated and have fresh products under strong management will be increasingly important. As a result, while fierce competition is expected to continue up to the year 2005, the panel believes that by that year there will be a shakeout of older properties with weak management and

not-so-clearly-identified brands. In this competitive, low-growth environment, the overall growth in pre-tax income projected by the panel was flat, showing almost no growth between 2000 and 2005.

It appears that this shakeout will take place mostly in the budget, economy, and "midscale with food and beverage" segments. The panel viewed these segments as overbuilt or approaching an overbuilt status. This is reflected in the panel's prediction of slow or no growth in the room supply within these segments. Conversely, the luxury and upscale segments (due to limited barriers to entry) are predicted to be the most popular hotel segments in which to acquire or develop hotels.

In 2000 and 2005, the lodging industry is expected to be dominated by partnerships, C-Corps, individual investors, and equity REITs, which indicates that the industry will still consist of a mixture of private and public ownership entities.

In the near future, the lodging industry will need capital less for construction and more for renovation and international expansion. It is expected that upper-tier hotels and hotels in suburban and resort locations will need more capital than other types of properties. While REITs and C-Corps were predicted to have a higher need for capital in the year 2000 than they do today, there was a lack of consensus among the panelists about the total returns on REIT stocks in the future.

The top providers of equity capital to the lodging industry in the future are expected to be pension funds, life insurance companies, investment companies (mutual funds), and investment banks. Debt capital sources will be primarily commercial banks, life insurance companies, investment companies, pension funds, investment banks, and conduits.

However, not all hotel products are expected to be viewed with favor by lenders and investors in the future. Luxury/upscale hotels, convention hotels, and resorts are expected to be favored by the large lending institutions. The popularity of lending and investing in extended-stay products is expected to wane.

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A. J. Singh, Ph.D., is an Assistant Professor in the School of Hospitality Business at Michigan State University.