

# Featured Article



## Hurricane Katrina's Impact on the Regional Hotel Market

By RERC Principal Greg Kendall, MAI

The emotional, physical, and economic impact of Hurricane Katrina, which struck the Gulf Coast on August 29, 2005, has been huge, especially for those who live and work in these areas. Trying to sift through the aftermath, especially as it relates to real estate investment, may prove difficult as well.

But before we look at the investment potential, we need to look at the situation at impact and where we are at present:

- ▶ Approximately 1,300 deaths in five states (more than 1,000 in Louisiana)
- ▶ Infrastructure damage
- ▶ 200,000 homes lost
- ▶ Temporary or permanent business closings and corresponding increased unemployment
- ▶ Interruption of oil production along the Gulf with corresponding increased energy costs
- ▶ Power outages
- ▶ Shipping ports closed
- ▶ Tourism industry in the area at a standstill, including the sizable gaming industry in Gulfport/Biloxi
- ▶ 70 percent of the area's hotel rooms closed

- ▶ Rising construction costs, with numerous commercial and residential construction projects interrupted

In the still emotion-packed days less than a month after the storm, USA Today conducted a poll among evacuees. The results indicated that 39 percent of those from New Orleans said that they would not return to their homes, while 11 percent of those in other storm-affected areas said that they would not return. In fact, most estimates indicated 50,000 or more homes in New Orleans alone would be demolished. Even if this estimate is ex-

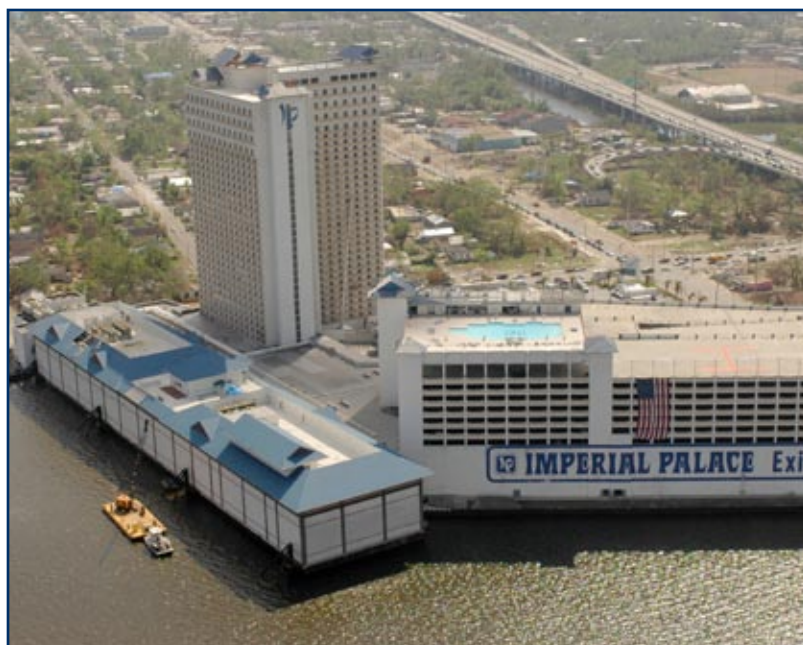


Photo provided courtesy of FEMA



Photo provided courtesy of FEMA

aggregated, the loss obviously will have an impact on the recovery of local housing and labor markets.

Regarding the lodging market, while much of the country's hotel market enjoys a strong recovery in occupancy, room rates, and net operating income (NOI) and as investors drive required returns to historic lows, the Gulf Coast areas of Louisiana, Mississippi, and Alabama are facing the most costly natural disaster to ever hit the U.S.

Among the estimated \$50+ billion in property damage, the number of open hotel rooms in the hardest hit regions was reduced by 70-percent overall—down 95 percent in New Orleans, down 92 percent in Gulfport/Biloxi, and down 18 percent in Mobile. Fortunately, many of these closed rooms have since opened. Smith Travel Research estimates that as of October 11, the percentage of closed rooms in the New Orleans market area has decreased from 95 to 67 percent. However, only about 15 percent of these opened rooms are available to the public, with the other 85 percent available to relief workers and evacuees.

The impact of this supply reduction has been felt not only in lost room revenue, but in the meals, rental cars, gas, and souvenirs that would have been purchased, the business that would have been conducted, and the paychecks that would have been taken home. An estimated 33,000 hotel employees are without jobs in New Orleans alone—the effect on families, with many not only homeless but without this income, is devastating.

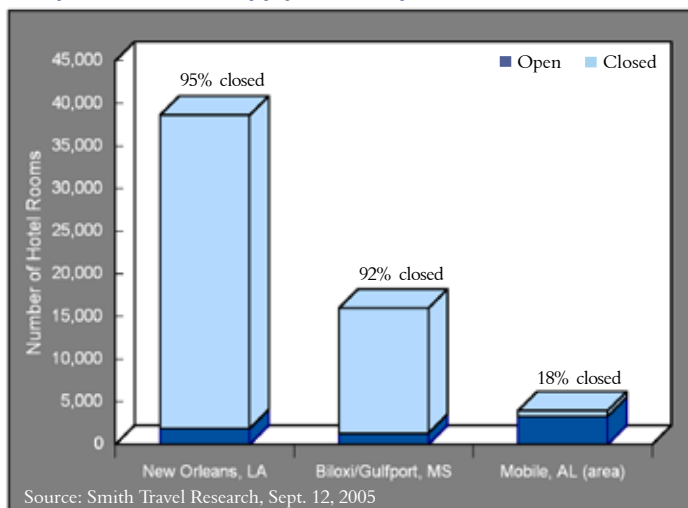
In New Orleans, a major convention destination, this impact is especially profound. With a \$5 billion tourism industry, New Orleans is one of the top 20 hotel markets in terms of annual

room revenues (over \$1 billion). While convention business will not return to New Orleans until mid-2006, it likely will be at reduced levels, as many will be wary of booking a major event during hurricane season (June through November).

The Hyatt Regency New Orleans—the poster-child of the New Orleans hotel damage—suffered damage to more than half of its 1,184 guest rooms. The Hyatt Regency plans to re-open by the end of 2006, but less notable properties without the relatively deep pockets of some of the larger, more well-known hotels, will take considerably longer to come back, and may not re-open at all.

In Gulfport/Biloxi, where tourism is a \$2 billion industry, the state legislature just passed into law a bill that will allow onshore

### Impact on Room Supply, as of Sept. 12, 2005



construction of casinos previously floating on public tidelands. Although opposed by many groups, this will no doubt contribute to a quicker recovery for these businesses, most of which have sizable hotel components, such as the new Hard Rock Casino and Hotel, whose planned opening was only a week away when Katrina struck. The state of Mississippi has lost about \$500,000 a day in tax revenue following Katrina, and an estimated 14,000 casino employees are out of work.

The least impacted of the three states, Alabama, still saw massive destruction along its entire coastline with more extensive damage near the Mississippi border. Its shipping (twelfth largest port in the U.S.) and seafood industries, among others, were hard hit.

## After the Storm

The recovery began with various public and private agencies reaching out to the people devastated by their loss. A few of these organizations are highlighted below:

- ▶ FEMA is reportedly still spending an estimated \$4 million per day on hotel rooms housing some 200,000 people in 70,000 hotel rooms, as efforts continue to find and locate temporary housing for evacuees who are moved out of shelters. Some evacuees and relief workers are housed in cruise ships docked nearby.

- ▶ As of early October, the American Red Cross has provided more than 3.3 million overnight stays in nearly 1,100 shelters across 27 states and the District of Columbia.
- ▶ Habitat for Humanity has several key initiatives underway to help in rebuilding and replacing homes lost in the wake of Hurricanes Katrina and Rita. "Operation Home Delivery" and "Rolling in the River" are two such initiatives where Habitat builds and delivers pre-built and containerized home panels to Gulf Coast communities.
- ▶ America's Second Harvest provides and helps to distribute food through the Country's food bank programs, and as of Oct. 25, 2005, had provided 47.9 million pounds of food and groceries to those affected by these hurricanes.
- ▶ Churches and many other organizations have contributed in incalculable ways, as well. For example, the North American Mission Board (part of the Southern Baptist Convention) reports that over 9,300,000 meals have been prepared for victims of Hurricanes Katrina and Rita, and has helped to provide for many other necessities, including clothing and cleaning/health supplies.

Prior to the hurricanes, the nation was seeing general economic growth. Job growth had improved each of 27 consecutive months, and payroll employment had increased by 4.2 million jobs since the trough in 2003.



As the area continues to rebuild and the regional economy comes back, investors will be watching the commercial real estate as well. As far as the hotel market goes, watch for:

- ▶ Compression of capitalization rates should dissipate, now offset by the additional risks associated with these markets.
- ▶ Government aid and insurance payments will fuel a construction boom. Among other benefits, this influx of money and workers will fill open hotel rooms with construction crews, while closed hotels will have to compete to find workers to rebuild their hotels.
- ▶ Overall, occupied room nights are projected to increase for the surrounding areas through year-end 2005 and well into 2006, while occupancy rates will increase sharply, reflecting the decreased supply.
- ▶ Other markets across the nation will see growth as displaced businesses, including lucrative convention business, is displaced to these markets.

Overall, while the hurricane has had a devastating effect on supply, and no doubt will result in reduced demand during the hurricane season (June through November), we expect the lodging market to not only recover, but to come back even stronger. Likewise, we view the larger economic outlook as positive in the long term, although there are many challenges and the future is uncertain. As Mardi Gras organizers in ravaged New Orleans plan to proceed with the annual celebration in February, despite significant obstacles, so too commercial real estate market participants expect “the show to go on.”

*Greg Kendall is principal of Real Estate Research Corporation and director of RERC Hospitality in RERC's Gulf Coast office. Aside from minor damage from Hurricane Katrina, his family, home, and office are fine.*

## A Look Back at 9/11

As we look at the devastation caused by this recent “natural” event, it is reasonable to reflect also on the “unnatural” disaster of the terrorist attacks of September 11, 2001. The tremendous impact on travel, exacerbated by already depressed economic conditions, resulted in a deep trough in lodging performance, which has extended to the present day in many markets. Of course, the impact of September 11 was not only on the lodging industry, but on many industries, most directly on the airline industry, which suffered the “double whammy” of reduced demand (travel) and higher costs (increased security chief among them) following the attacks.

We note that there are obvious differences between the unexpected impact of the terrorist attacks on September 11, 2001 and the expected impact of Hurricane Katrina, including the ability to predict that the hurricane was coming and where it might hit. Additionally, while the breadth of a hurricane's physical impact can be much broader, the emotional and psychological impact of a terrorist attack is certainly much larger, as it has implications for the rest of the country. We also note that the impact of the 2001 recession and decreased travel following the September 11 terrorist attacks affected demand only (with the notable exception of several hotels in the immediate vicinity of the Twin Towers in Manhattan), while the destruction resulting from Hurricane Katrina affects both demand and supply (in a large way).

A month after the terrorist attacks of September 11, 2001, a group of hotel general managers was surveyed by RealTime Hotel Reports, LLC and The Center for Hospitality Research at Cornell University. From the more than 1,200 hotel managers that replied, several key indicators can be correlated to the present situation.

- ▶ 58 percent of all hotels refocused their marketing efforts on local business
- ▶ 25 percent of respondents indicated they were putting off renovation plans, while 9 percent said they were using the slowdown as an opportunity to close and renovate rooms
- ▶ Only 12 percent of respondents changed their security procedures
- ▶ Most believed the national economy would begin to recover in second quarter 2002, while the hotel industry would trail slightly and recover in the third quarter 2002
- ▶ 23 percent believed the Government would provide tax breaks and other relief to the hospitality industry
- ▶ Hoteliers did not anticipate a major shift in the business mix (leisure, business, group) over the next 3 months.

In hindsight, we now know that the hotel market took much longer to recover than estimated by these general managers. Prior to Hurricane Katrina, hotel occupancy rates in many markets had just recently returned to pre-2001 levels, with the anticipation of rising ADRs and RevPARs on a large scale across much of the country. Still, the outlook that the market would remain resilient in the face of this arguably more ominous tragedy bodes well for the outlook today.