

BLACK ORCHID MANAGEMENT, LTD.

UNDERSTANDING SUPPLY, DEMAND & ABSORPTION

By Lucinda L. Turley, Certified Property Manager

The vacation rental housing market demand is a reflection of specific demographics, economic trends and characteristics which specifically relate to a draw area and/or a market area. Each vacation region of the world, has a specific draw area, in which they pull travelers, visitors and buyers from to any given market area.

If your vacation market area is Belize (then for example), your draw area will be the United States, Canada, Central America, Mexico and South America (for the most part).

One measure of the strength for your market area, is a comparison of the supply and demand for vacation rentals in your specific area, and an evaluation of the market's ability to absorb this demand as regards units and additional new construction.

UNDERSTANDING DEMAND

Estimating demand for vacation rentals focuses on households – one or more people, related or not, who jointly or independently come together to occupy a vacation rental, and to share the expense with regards to recreational activities. Household growth is a particularly reliable gauge of a population's vacation needs, because households by definition are occupied as dwelling units. It is important to note, that a dwelling unit can be defined as: 1) a family, which consists of person related by blood or marriage, or 2) a unit, which consist of persons related by common bonds or common goals.

Over time, the demographic characteristics, economic climates of specific draw areas and households change. With each generation, the life experiences and expectation of this generation produce these changes. We have recently seen, an explosive growth in the numbers of young professionals, childless couples, baby boomers, recent immigrants, empty nesters, and elderly individuals who have radically impacted the vacation rental market. Age and gender are demographic variables, along with population size. Babies are born, and mature adults die. Children grow up, move out, and create new families (by marriage or by common bonds) of their own, which means....new households. This movement of new households is what generates the need for consumer products, specifically.....“vacation rentals”.

“AGE” AS IT RELATES TO THE VACATION RENTAL MARKET

Preferences for accommodation requirements varies with a person's age. Young adults tend to choose vacation rentals on a budget, while middle-aged adults tend to choose vacation rental for comfort. Younger people are more prone to looking for an array of exciting activities, social networking, cheaper accommodations and will move more frequently from place to place, while middle aged adults, tend to select activities within certain limitations, social networking, and will remain typically in one place for their entire vacation stay. Demographic projections about these

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population shifts, household formations, and other changes, are important factors to understand when reviewing supply, demand and absorption for the vacation rental market.

“INCOME” AS IT RELATES TO THE VACATION RENTAL MARKET

Increasing household income is another variable that influences the vacation rental market. Demographers define income in different ways for different purposes. Most statistical reports display gross income, which is the total wages paid for work done. However, the amount remaining after deductions for all taxes and benefits – disposable, or net, income – is what the household actually has available to spend. A household's net income is the basis of its ability to purchase goods and services, which includes a household's need for recreational activities (and this directly relates to) vacation rentals.

VACANCY RATE

To calculating a demand, also means calculating a count of the supply. The total number of vacant rental units available (in the market area or region), expressed as a percentage of the total supply - is the area's vacancy rate. This figure includes unoccupied rentals, in existing stock, plus vacancies in new construction (unoccupied inventory of newly built rentals), but does not count unoccupied rental units awaiting demolition, rehabilitation, or conversion.

The supply of unoccupied vacation rentals is only a part of the housing volume in an area. The total number of single-family houses (villas), condominiums, townhouses, and other occupied units – need to be counted in order to determine the total supply of housing and the overall vacancy rate in a particular area.

When we look at vacancies for a particular property, they are characterized as physical or economic. Physical vacancies are unoccupied and are not producing income. Economic vacancies include units which may be occupied, but are not producing income for various reasons (i.e. model units, offices, on-site managers, etc.). The distinction between physical and economic vacancies, highlights the fact that relying solely upon physical vacancy data, usually under-estimates a true understanding of the vacancy status for any one given property and any one given market area.

ABSORPTION RATE

The number of occupied vacation rentals compared to the total number of vacation rentals available for sale within a certain geographic area over a given period of time is called the absorption rate. It relates to both construction of new units and demolition or removal of existing ones from the market.

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When demand exceeds supply, vacancies decrease, and absorption is considered to be favorable; when supply exceeds demand, absorption is unfavorable, and housing construction tends to slow because lenders curtail financing for additional rental units. A negative absorption rate can also reflect other changes in the marketplace, such as a major industry shutdown – when there is a lack of jobs or when people are choosing alternative vacation destinations.

You will typically hear the word “absorption” used in the commercial markets. Analysts typically consider the square footage in commercial buildings occupied at particular rent levels as a way of forecasting the supply – of office space for the future. The vacation rental housing absorption rate, can be measured much the same way, by examining occupancy levels on the basis of what we described earlier as count data expressed in periodic terms.

For a better understanding of what we have just discussed, let's review some of the recent information published by the BTB (Belize Tourism Board) for the country of Belize. A country which has converted over 40% of its land into national parks, in an effort to preserve tourism and natural resources for this country.

ESTIMATED OVERNIGHT TOURISTS

| DISTRICTS | 2007 | 2008 | 2009 | 2010 |
|-----------------------|----------------|----------------|----------------|----------------|
| Belmopan | 11,151 | 8,190 | 7,817 | 8,016 |
| Belize | 33,590 | 36,297 | 31,849 | 32,660 |
| Corozal | 10,013 | 8,051 | 7,236 | 7,420 |
| Orange Walk | 10,878 | 11,820 | 8,011 | 8,215 |
| Cayo | 46,607 | 47,023 | 41,605 | 42,663 |
| Stann Creek | 13,017 | 13,402 | 10,660 | 10,031 |
| Punta Gorda | 5,462 | 5,258 | 5,685 | 5,830 |
| Ambergris Caye | 46,061 | 55,749 | 52,006 | 53,329 |
| Caye Caulker | 45,378 | 31,644 | 51,295 | 52,601 |
| Other Cayes | 7,237 | 9,400 | 7,429 | 7,618 |
| Placencia | 22,029 | 19,172 | 8,657 | 8,877 |
| | | | | |
| TOTAL | 251,422 | 245,007 | 232,249 | 238,160 |

Source: Belize Tourism Board

In reviewing the numbers above, it should be noted that the country as a whole, experienced a drop in the total number of people traveling to Belize. This for the most part, can be attributed to the financial banking meltdown, several years back in the United States.

If we look at specific market areas, we can see that certain parts of the country, did not follow the national trend, but in fact actually increased year by year. Reflective of this is, Ambergris

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Caye, Caye Caulker, and Punta Gorda, which have shown steady increases (for the past four years), despite a downturn in tourism for the overall country.

To understand this, we need to look at several factors which play into this. When looking at a specific market area, the number of choices that tourists are given, has a great deal to do with the incentive for them to visit these market areas. An increase in traffic, will result in more area amenities (i.e. grocery stores, tour operators, doctors offices, restaurants, gift shops, etc. etc.)

Though some of the main attractions for this country are located in the mainland, many tour operators have made these attractions accessible by either boat or aircraft, from Ambergris Caye & Caye Caulker (islands). For this reason, coupled with a plentiful supply of gift shops and restaurants, Ambergris Caye and Caye Caulker continued to draw the majority of the vacation rental traffic for this country, from the various draw areas.

Additionally, over 50 dive sites are conveniently located off any dock in Ambergris Caye and Caye Caulker, and for this reason, the bulk of tourists possessing diving skills or interests, are drawn to these areas as well.

NUMBER OF HOTELS & VACATION RENTALS

| Market Area | 2007 | 2008 | 2009 | 2010 |
|-----------------------|------------|------------|------------|------------|
| Belize | 59 | 61 | 56 | 54 |
| Corozal | 29 | 34 | 34 | 36 |
| Orange Walk | 20 | 19 | 19 | 19 |
| Cayo | 97 | 95 | 101 | 101 |
| Stann Creek | 56 | 60 | 58 | 56 |
| Punta Gorda | 35 | 36 | 37 | 38 |
| Ambergris Caye | 99 | 108 | 125 | 141 |
| Caye Caulker | 73 | 71 | 75 | 79 |
| Other Cayes | 35 | 37 | 37 | 36 |
| Placencia | 88 | 99 | 109 | 104 |
| TOTAL | 591 | 620 | 651 | 664 |

Source: Belize Tourism Board

As we have already discussed, there were three specific market areas (Ambergris Caye, Caye Caulker & Punta Gorda) in the country of Belize which have shown continuous growth over the last four years, despite an overall decline in visitors. What's interesting about the chart above, is how it relates to the chart we just discussed. Even though Ambergris Caye, Caye Caulker and Punta Gorda, have shown consistent increases, this was not consistent with the number of new vacation rentals coming on the market.

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In the previous chart, areas of the country which reflected substantial increases in vacation rentals were, Placencia and Ambergris Caye. Yet Placencia, declined in the number of visitors, while Ambergris Caye increased. Why?

When comparing the two market areas (Placencia vs. Ambergris Caye), Ambergris Caye offers by far more choices for travelers to choose from. 1) There are more hotels and vacation rentals to consider, offering a wider range in prices and services. 2) There is a large selection of restaurants, offering a variety of cuisines and/or choices. 3) A number of tour operators offer full service tours, anything from diving, snorkeling, sailing, fishing, jungle trips, mayan ruins and much more. 4) There is a large selection of local services, ranging from grocery stores, salons, banks, doctors, and gift shops. In part, Ambergris Caye offers tourists more choices, and for this reason, Ambergris Caye will consistently draw more visitors than any other region of the country.

MARKET DRAW AREAS FOR BELIZE

| DESTINATIONS DRAWN FROM | 2007 | 2008 | 2009 | 2010 |
|-------------------------|----------------|----------------|----------------|----------------|
| Americans | 152,569 | 148,624 | 139,561 | 145,081 |
| Canadians | 16,665 | 17,695 | 17,211 | 17,891 |
| Other Europeans | 6,972 | 6,995 | 7,124 | 6,237 |
| United Kingdom | 10,180 | 10,100 | 8,534 | 8,885 |
| Germany | 4,054 | 4,161 | 3,376 | 3,250 |
| Italy | 2,702 | 2,371 | 1,679 | 1,787 |
| Netherlands (Holland) | 3,496 | 3,915 | 2,607 | 2,387 |
| France | 2,126 | 3,258 | 3,269 | 2,792 |
| Spain | 1,806 | 1,627 | 1,472 | 1,466 |
| Sweden | 1,088 | 1,130 | 800 | 807 |
| Switzerland | 750 | 713 | 742 | 936 |
| Jamaicans | 643 | 584 | 669 | 661 |
| Other Caribbean | 1,952 | 1,723 | 1,719 | 1,840 |
| Honduras | 2,928 | 3,105 | 3,506 | 3,678 |
| Central America | 4,811 | 5,428 | 5,745 | 5,769 |
| Mexicans | 5,752 | 4,774 | 4,783 | 4,694 |
| Guatemalans | 14,130 | 11,674 | 12,957 | 12,407 |
| South America | 2,239 | 2,019 | 2,089 | 2,155 |
| Asia | 3,280 | 2,774 | 2,459 | 2,986 |
| Middle East | 435 | 588 | 400 | 778 |
| Africa | 491 | 512 | 668 | 574 |
| Oceania | 2,202 | 2,460 | 2,514 | 2,771 |
| All Other Nations | 0 | 0 | 0 | 0 |
| Belizeans Living Abroad | 9,160 | 8,779 | 8,365 | 8,237 |
| TOTAL | 251,422 | 245,007 | 232,249 | 238,160 |

Source: Belize Tourism Board

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In reviewing the previous chart, you can see where the majority of the visitors to Belize are coming from – as it relates to specific draw areas. With the majority of travelers coming from, the United States, Canada, Guatemala, and the United Kingdom.

In the field of economics, the law of supply and demand explains the pricing of products (or vacation rentals as we are discussing) in terms of their availability. As applied to the vacation rental market, this law can be stated as follows: high demand reduces the supply of vacation rentals and thus permits prices and rental rates to rise; conversely, as oversupply of units tends to drive prices and rental rates down.

The principles of supply and demand and absorption are important in the vacation rental industry because.....they help to illustrate whether a particular market is soft and, whether it is soft for particular reason. Soft markets are characterized by high vacancy levels, and relatively constant (or diminishing) sales prices and rental rates. Expressing these two concepts in a single statement, one would say absorption rates represent demand over a specified time period, as contrasted and evaluated in terms of competitive supply.

I would like to take this opportunity to thank the Belize Tourism Board, for their diligent efforts in tracking this countries progress, as it relates to the "vacation rental" industry. The information compiled by the BTB, is shared freely with resort owners, developers, and managers, to use as a gauge in understanding market trends for this country.

CONCLUSION

In conclusion, I hope this brief discussion has help you to see and understand the process of supply and demand, as it relates to our specific market areas.

I hope to continue our discussions, and it is my desire that this information is useful in helping you become a better manager and/or vacation resort owner.