THE OUTLOOK

Marcus & Millichap

HOSPITALITY

MIDYEAR 2021

Hotels Making Great Strides Toward Recovery; Numerous Hurdles Remain on the Horizon

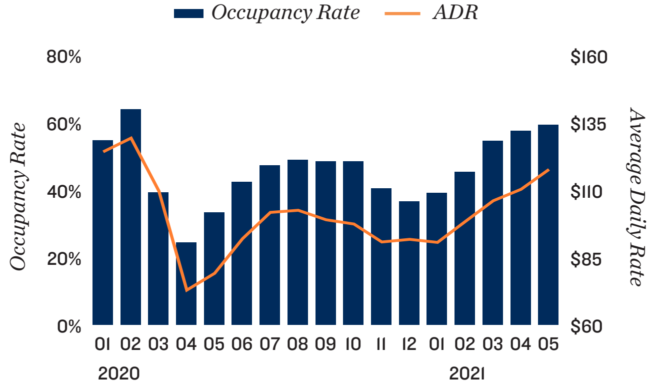
Hospitality demand improving. After being disproportionately impaired by the COVID-19 pandemic last year, hotels are welcoming back guests in greater numbers as postponed vacations are being taken. Air travel, in particular, has recovered significantly from the spring of 2020 when daily passenger volumes were only about 5 percent of normal levels. That metric has since increased fifteenfold as the rapid dissemination of vaccines has helped reduce infections, although about 25 percent fewer people are flying on any given day compared with 2019. This turnaround has nevertheless been able to lift hotel occupancy from a trough of 24.5 percent in April 2020 to back over 60 percent in June of this year. Demand for rooms from summer getaways is also aiding average daily rates, and the combination of higher occupancy and ADR has pushed the average U.S. RevPAR to within 20 percent of where it was two years prior.

Labor shortage manifesting as operations ramp up. As the demand for hotel rooms continues to ascend, many hoteliers are encountering difficulties with hiring staff. The total number of accommodation workers contracted by 48 percent between February and May of last year, by far the steepest peak-to-trough drop of any employment sector. While 563,000 accommodation jobs were created over the subsequent 13 months, payrolls remain 25 percent below pre-pandemic levels. Narrowing that gap further is less a question of labor needs, but rather a shortage of qualified candidates. Some former hospitality workers have moved away or changed professions, while others are still unable to work due to health concerns or childcare responsibilities. Most hotels are also competing for new hires at the same time, with more open positions now than at any other time on record dating back to 2000. The end to expanded federal unemployment benefits may accelerate onboarding in the coming months.

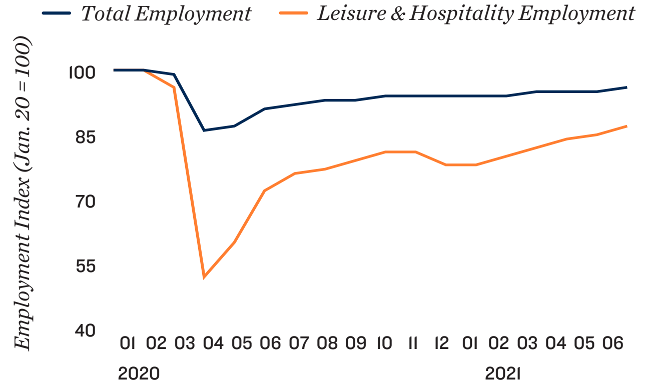
Domestic tourism driving hotel performance rehabilitation. Room demand from leisure travelers is anticipated to climb throughout the summer season as vaccinated households make up for lost time. A return to offices and in-person schooling in the fall may temper some of that activity later in the year, but overall hotel performance for 2021 will well exceed the previous year. Lodging business will be driven primarily by domestic leisure trips, with total spending expected to improve by about 20 percent this year after dropping by roughly 25 percent in 2020. By 2023 outlays by U.S. residents on vacations should reach or exceed 2019's benchmark. The return of full international travel will take longer, however, as the uneven distribution of vaccines globally will likely keep some transit precautions in place. Total international leisure travel spending may not surpass the pre-pandemic level until 2024. As such, hospitality markets with a strong reliance on global tourism may take longer to fully recover, such as New York City, Miami, San Francisco and Los Angeles.

Resumption of large corporate events yet to come. While individuals and families have been fairly quick to return to the road or the air for vacations, business trips remain less common. This behavior is reflected in lower weekday occupancy relative to the weekends, a pre-pandemic dynamic that has become more pronounced since the health crisis began. While smaller enterprise bookings are already underway, total domestic business travel spending more broadly is not expected to surpass 2019's level until 2022 or later. Although some larger corporate events are scheduled for the fall, it will take more than a year for the normal meeting and convention cycle to resume, especially given digital options and constrained overseas transit. Global conference metros, including Washington, D.C., may be impacted by this lag in international business travel.

Occupancy & ADR Trends

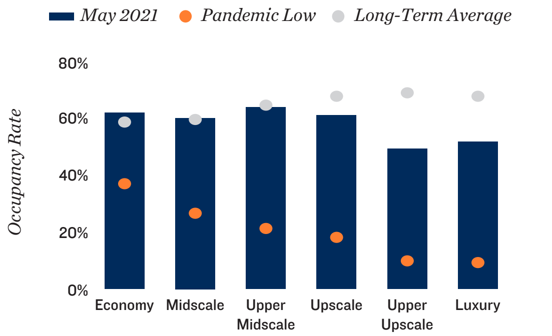


Hospitality Hiring Lags Rest of Economy

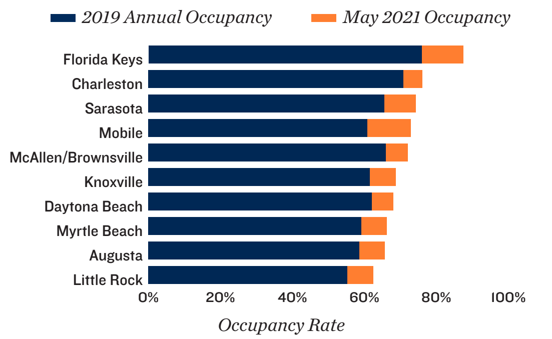


Sources: BLS; CoStar Group, Inc.

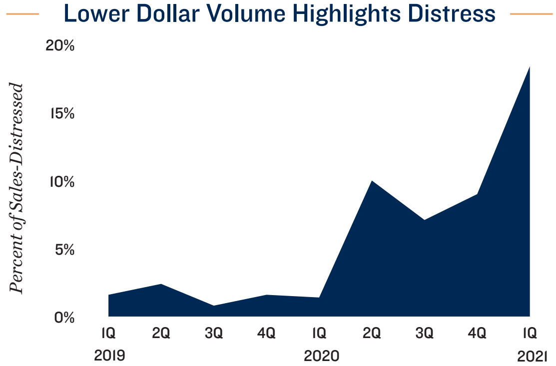
Economy Hotels Outperform Average



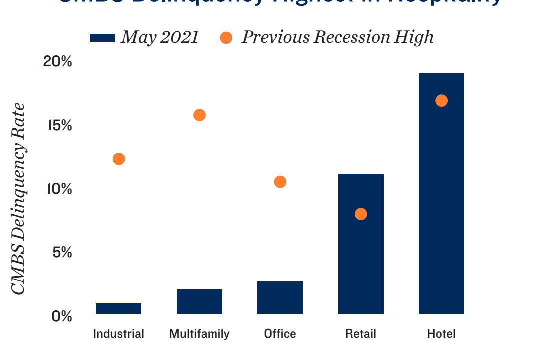
Select Markets Exceeding 2019 Occupancy



Lower Dollar Volume Highlights Distress



CMBS Delinquency Highest in Hospitality



Sources: CoStar Group, Inc.; Moody's Analytics; Real Capital Analytics

Hotel Performance Varies Markedly by Region

Hotels in scenic areas draw guests; budget-friendly options outperform. As various forms of travel recover at differing speeds, hotels in some markets are performing better than others. At the top end of the spectrum, multiple geographies across the U.S. are reporting occupancy rates and ADRs that are well above the same periods in 2019. Cabin fever and lower health risks are encouraging greater visitation to many coastal areas as well as metros near popular outdoor attractions such as state or national parks. This includes several markets in the Sunbelt and Mountain states where health-related restrictions have been less prevalent, offering visitors more entertainment options. These scenic settings also tend to favor travelers on a budget and are better positioned to capture demand from people who live in the region who are not dependent on air travel. These dynamics are contributing to more resilient property performance among lower service-level hotels nationally as well. Occupancy at economy and midscale hotels fell by smaller margins in 2020 relative to other chain scales, and these properties are now reporting rates close to or above their long-term averages.

Markets oriented toward business travel set for stronger second half of 2021. Occupancies in New York City, Boston, San Francisco and Washington, D.C., continue to lag the 2019 annual average by more than 35 percent. The dearth of global tourism and major corporate events have cut visitor spending in these locales, while capacity restrictions at restaurants and other entertainment venues also tempered interest from regional leisure travelers. Looking ahead, with most major metro economies reopen, leisure and business travel to these destinations should markedly improve. While international visitation may be slower to recover, the higher service-level options in these settings may draw some domestic travelers who would have otherwise taken a trip abroad. While bookings at many luxury hotels remain well below pre-pandemic levels, the average ADR for the chain scale in May was actually above the same month in 2019. While limited labor may be capping how many rooms can be occupied without compromising the full-service experience, guests' willingness to pay for such care has not diminished.

Distress in Pandemic Less Than Predicted

Hotel distress falls short of expectations. As hoteliers' incomes were drastically disrupted by the health crisis, concerns of potential distress on hospitality assets increased. The greatest concentration of new distress — bankruptcies, loan defaults, court administrations and liquidations — entered the investment market in the second quarter of 2020 when uncertainty was highest. Since then new inflow has lessened, while existing dilemmas have begun to be resolved. Most remaining issues are tied to outstanding CMBS loans that were transferred to a special servicer. As such, the share of sales involving a hotel under distress increased from under 3 percent before the pandemic to over 18 percent in the first quarter of this year. That ratio is inflated, however, by the fact that total hotel acquisition dollar volume remains historically subdued. On the basis of dollar volume, more distressed hotel trades occurred in the second quarter of 2018 than within any 90-day period of the past 18 months. Overall, the degree of distressed sales did not reach the severity anticipated at the onset of the health crisis. There are nevertheless pockets of concern, especially in the country's premier gateway metros, including New York City, San Francisco, Boston and Washington, D.C. High operating costs amid limited demand create steep financial hurdles, especially for assets with pre-existing issues.

Open Hotels Well on Way Toward Resuming Full Operations

2021 Forecast

U.S. CONSTRUCTION

106,000 hotel rooms completed

- Completions for this year will modestly exceed the 103,000 rooms delivered in 2020 but fall short of the 120,000 keys finalized the year prior. There are approximately 196,000 rooms under construction as of mid-2021, with completion dates extending beyond 2024.

U.S. OCCUPANCY

1,200 basis point increase Y-O-Y

- After an unprecedented year during which occupancy fell to an annual average of 44.2 percent, down 2,180 basis points year over year, the measure will improve to 56.2 percent for 2021. Between 1987 and 2019, U.S. hotels had an average occupancy rate of 62.5 percent.

U.S. ADR

7.5% increase Y-O-Y

- The average daily rate for 2021 will climb to $110.83 after contracting 21.2 percent to $103.10 in 2020. On a trailing-12-month basis, ADR had reached a record high of $131.15 in February 2020 before the health crisis cut the monthly metric by as much as 45 percent last year.

U.S. REVPAR

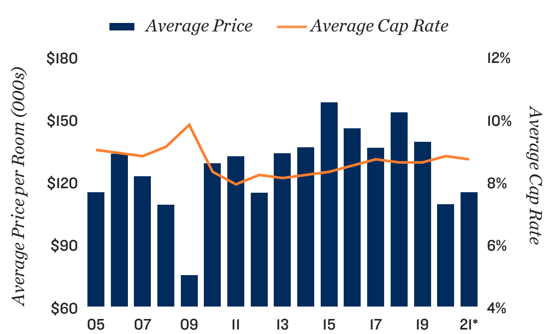
34.5% increase Y-O-Y

- The combination of rising occupancy and ADR will translate into an annual average RevPAR of $61.29. Before the onset of the pandemic the trailing-12-month measure had achieved a peak of $86.71. Returning to that benchmark will not occur until after 2021.

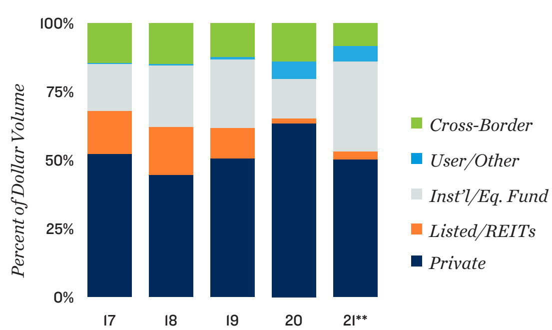
2021 INVESTMENT OUTLOOK

- **Transaction velocity reveals signs of normalcy.** Hotel trading activity plunged to just 20 percent of year-ago levels in the second quarter of 2020 as the health crisis unfurled. Sales velocity has improved in each subsequent quarter, returning to a pre-pandemic level of transactions in March of this year. Investment demand is strongest for limited-service hotels, which comprised over three-fourths of acquisitions in the first quarter of 2021.
- **Sale prices begin recovery.** The comparatively higher volume of limited-service trades during the peak of the health crisis last year contributed to a decline in the overall average sale price per room to $114,700 for the trailing-12-month period ended in March. While on an upward trajectory from 2020's mean of $109,000 per room, the measure is still below the 2019 pre-pandemic benchmark of $138,800. The average cap rate has meanwhile hovered in the mid-8 to high-8 percent zone, falling to a high-7 percent mean for full-service assets.
- **Sunbelt states draw attention.** Amid the turbulence created by the pandemic last year, hotels in the warm climates of California, Florida, Georgia and Texas led transactions. Relative to what has changed hands so far in 2021, hotels in Colorado, Florida, Oregon and Massachusetts have represented an increased share of trades. The popularity of low-density scenic towns and beaches among recent travelers is likely drawing the attention of buyers seeking properties in strong recovery positions. For investors who amassed capital in preparation for a wave of distress, competition for the lower-than-expected number of assets in acute financial trouble will limit the downward pressure on pricing.

Sales Trends



Buyer Composition



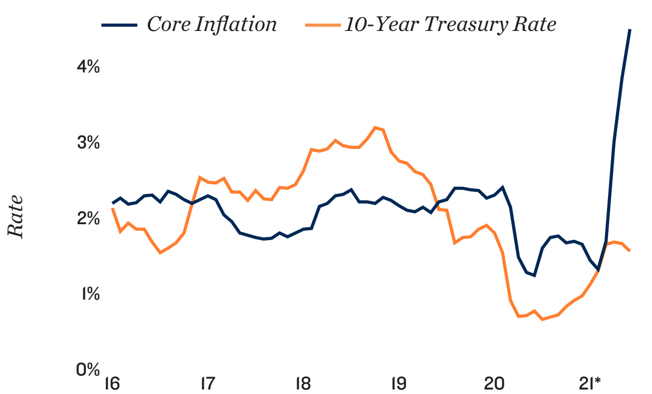
** Through 1Q ** Trailing 12 months through 1Q*
Includes sales $2.5 million and greater
Source: Real Capital Analytics

Capital Availability Remains Constrained for Hospitality; Inflation Concerns Become Apparent

Fed positions for temporary higher inflation period. Applying lessons learned from the global financial crisis, Congress and the Federal Reserve acted swiftly to preserve market liquidity and support borrowers amid the pandemic last year. As U.S. infections recede and the economy reopens, attention is shifting to the potential longer-term ramifications of these actions. The rapid increase in money supply from multiple stimulus provisions paired with low interest rates and disrupted supply chains has led to higher inflation, with core CPI climbing 4.5 percent annually in June. While above earlier expectations, the Federal Open Market Committee (FOMC) still considers this a transitory concern and intends to allow inflation to stay above the traditional 2 percent growth target for longer than it has in the past. The Fed also expects to keep the overnight lending rate low for the near future, citing still-high unemployment as one reason to hold off. More committee members are now open to the prospect of raising rates in 2023, however. Current quantitative easing practices will also remain in effect for the time being. The FOMC will wait for more substantial economic progress before tapering asset purchases, although some pandemic period programs have already expired.

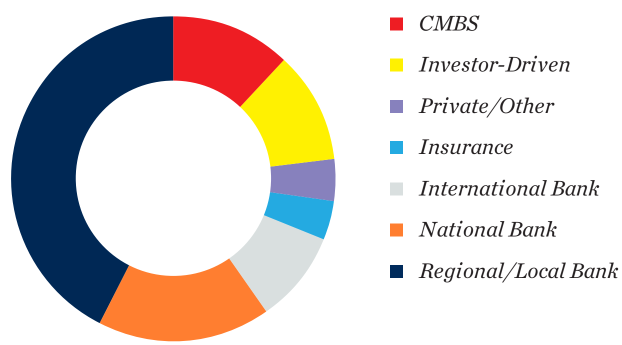
Financing still difficult to obtain for many hotels, but improving fundamentals brighten outlook. Following significant disruptions last year, the majority of lenders are now actively lending in relation to a range of commercial real estate. General sentiment is improving, aided by greater population mobility that will help properties in commercial and travel hubs that were disproportionately affected by lockdowns. Lenders are nevertheless favoring borrowers with whom they have an established and positive relationship. A borrower's credit worthiness and track record bear considerable weight when accessing capital, as does recent property performance, including income. This is especially true of hospitality assets, as the lodging industry has been significantly impaired by the health crisis. More opportunities are available for assets that demonstrated durability during the pandemic or since reopening. While hotel occupancies and revenue have been rapidly improving as vaccination rates climb and more people travel, lenders are nevertheless examining deals on a case-by-case basis, placing heavy emphasis on the most recent changes in fundamentals. CMBS lenders are a primary capital source for the property type at the moment, although local and regional banks as well as some debt funds may also provide financing for the right asset. As the hospitality industry recovers the availability of capital for lodging assets is anticipated to expand, aided federal government efforts to maintain liquidity at a general level.

Inflation and Interest Rate Trends



** Through June*
Sources: BLS; Federal Reserve; Real Capital Analytics

2020 Hospitality Lender Composition



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