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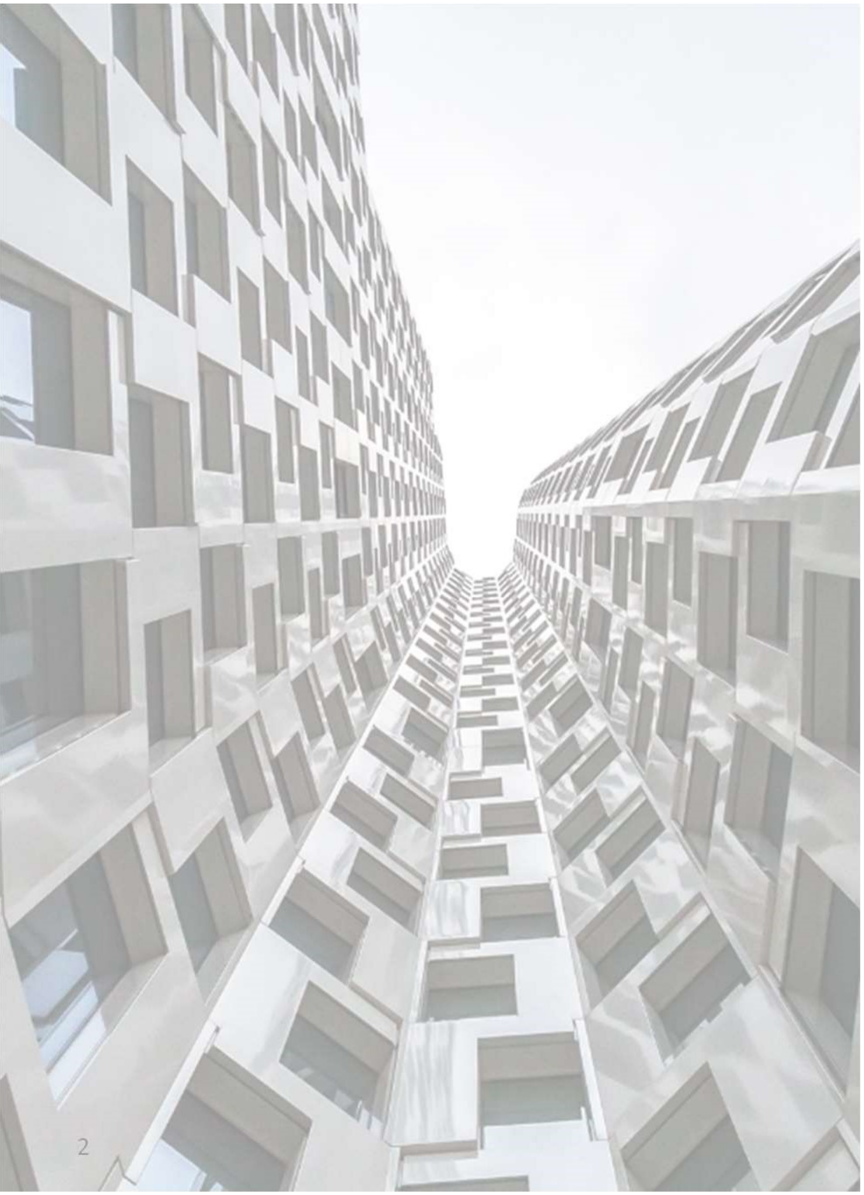
Outlook for the Hotel Industry

The impact of current events on hotel performance and values

June 2020



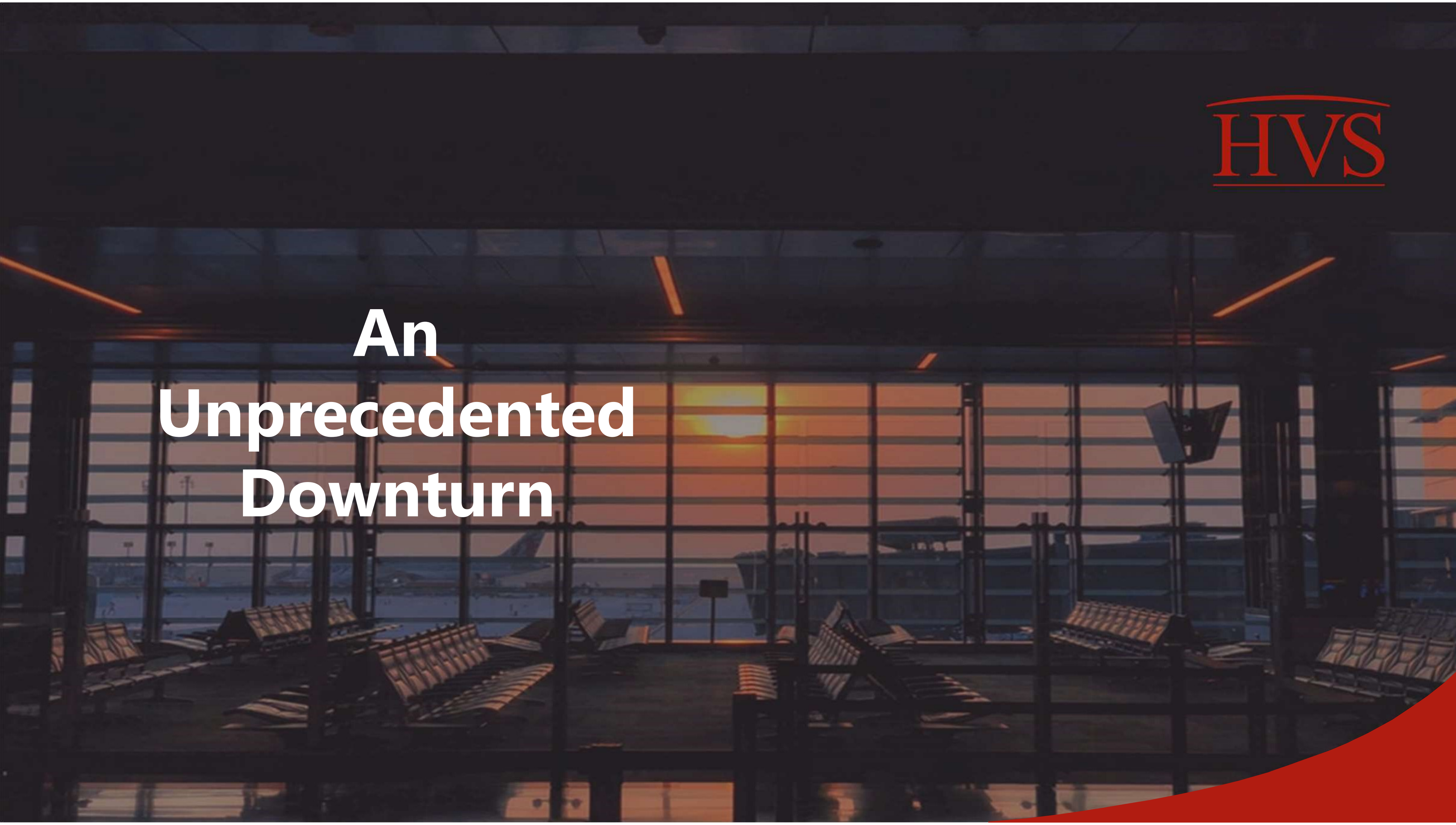
Introduction

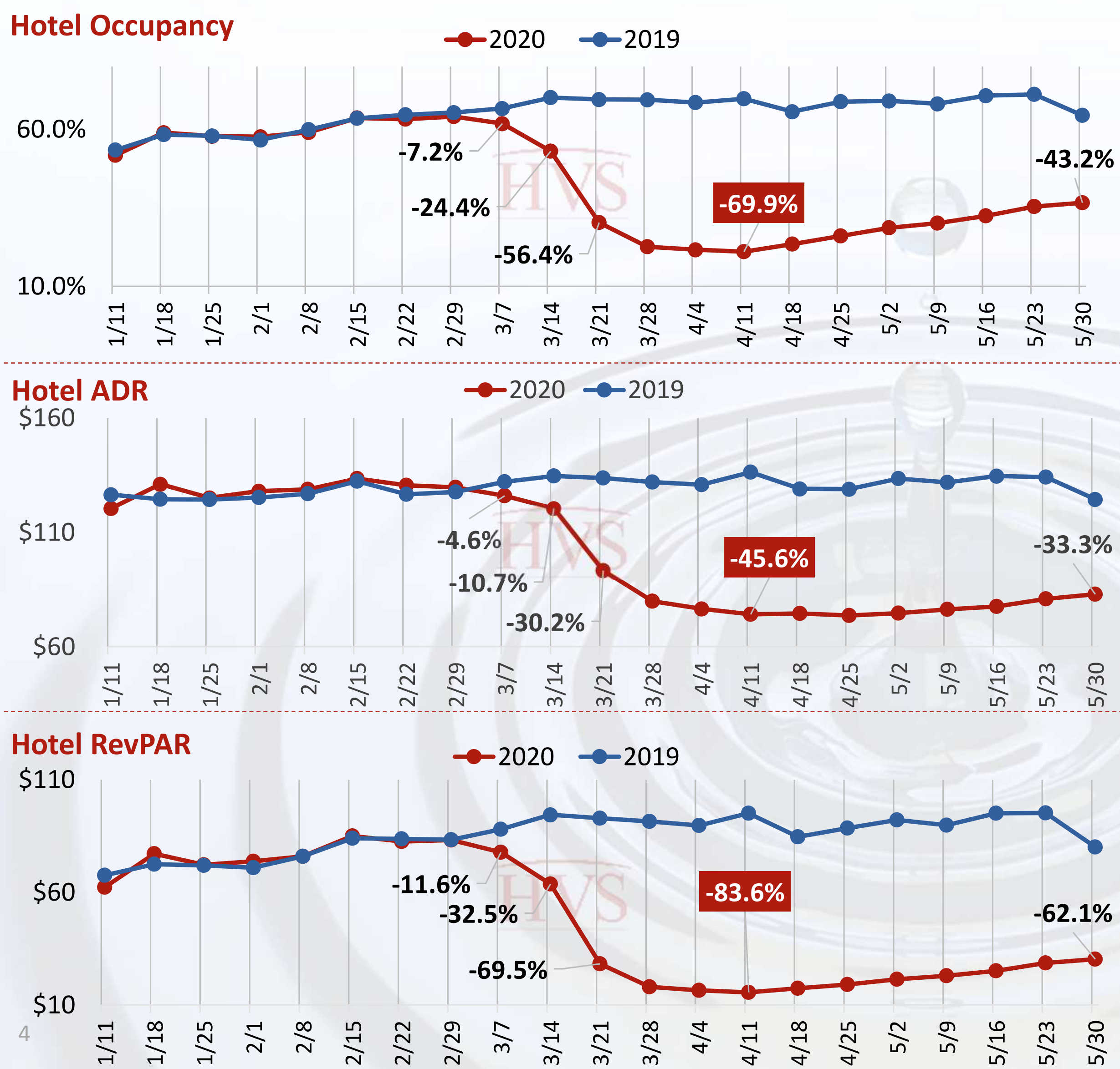
The COVID-19 pandemic and the related restrictions on travel, business activity, and individual movement have had a significant impact on our industry. We don't know how long the pandemic will last, how the lifting of restrictions will progress, and when wide-scale travel will resume. The full, net impact on the economy is also unclear.

We do know that the hospitality industry is extraordinarily resilient. Past "shock" events and downturns have caused business to plummet; however, the industry performance has always recovered. Even though the pace and degree of the COVID-19 downturn is unprecedented, market participants believe that the hospitality industry will recover and, as in the past, this cycle will create the opportunity for strong returns through well-timed and well-executed investment strategies.

Owners, operators, lenders, and investors are all facing greater challenges than ever anticipated. HVS is here to help. We have a strong team of senior leaders who have been through numerous prior cycles. With the knowledge and expertise gleaned from past downturns, HVS is available to support you, your hotels, and your investors as we navigate these challenging times.

An Unprecedented Downturn





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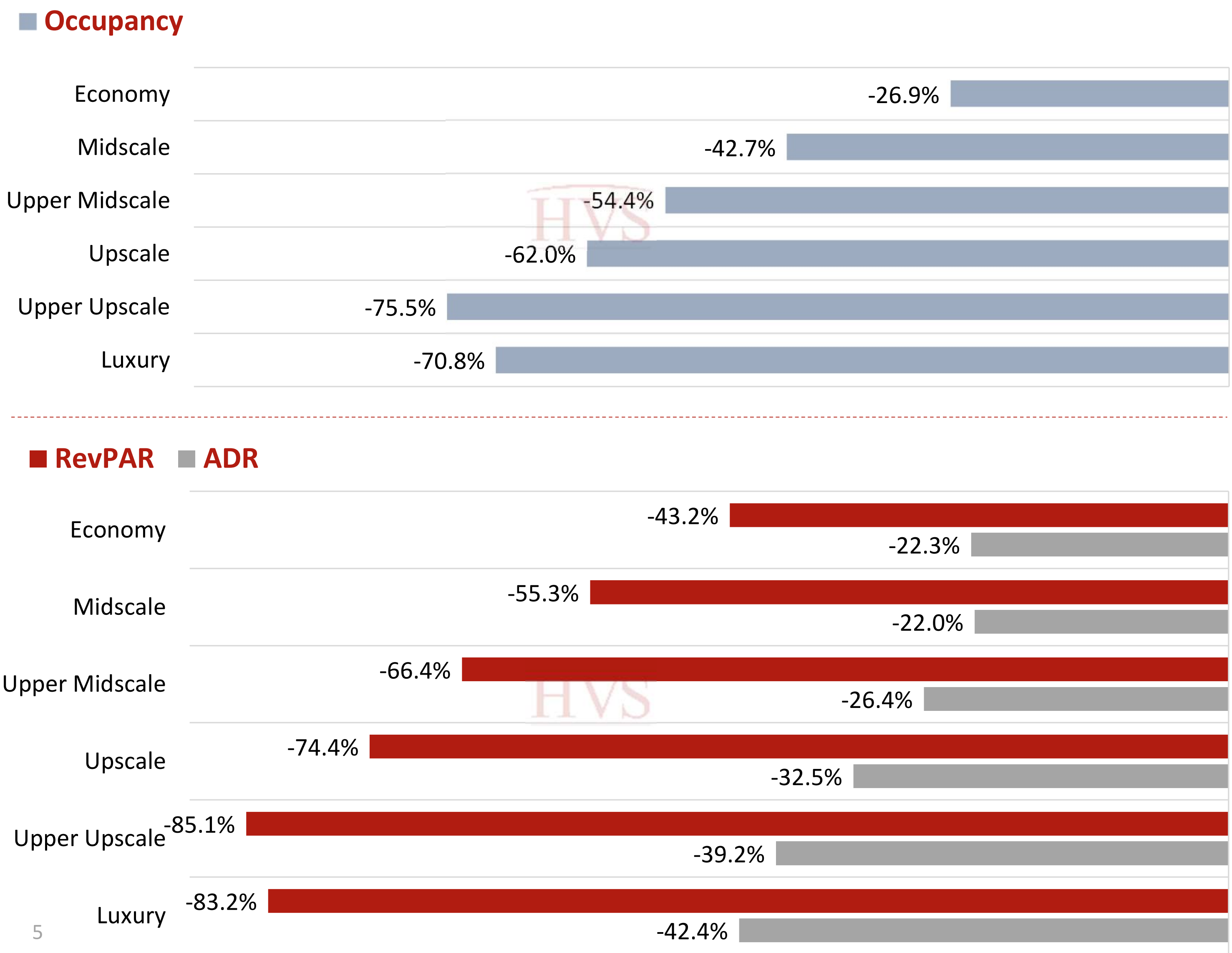
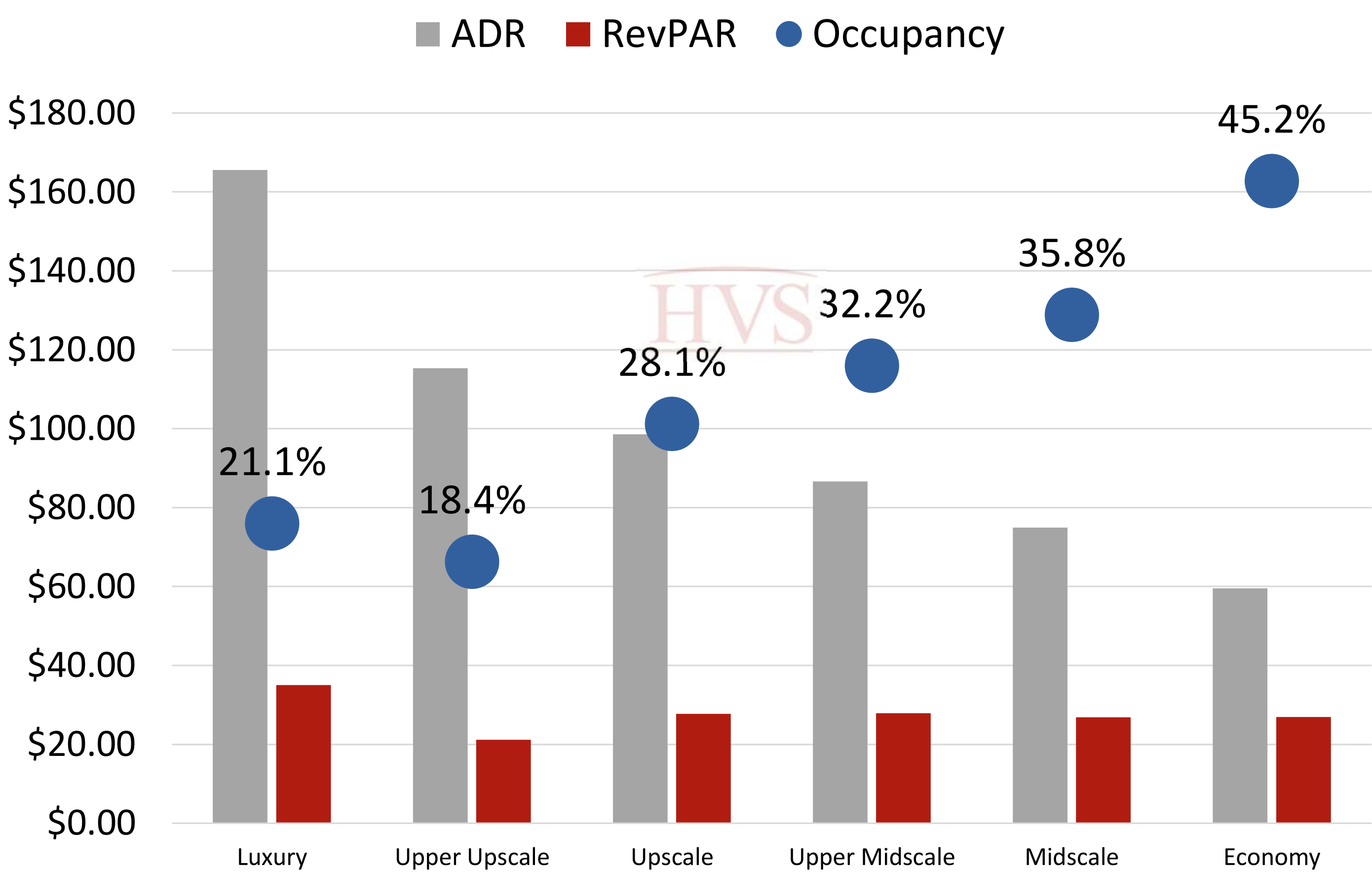
Recent data for the U.S. illustrate that the industry has bottomed out and is starting to recover

Data Source: STR



Impact differs significantly among the hotel classes

Data Source: STR
*Running 28 Days Ending May 30, 2020



Data Source: STR
*Running 28 Days Ending May 30, 2020

All classes are reporting RevPAR levels in the low $25 range except upper upscale, reflecting the significant impact of the pandemic on group business and urban locations

U.S. Lodging Market Trends Through Prior Cycles

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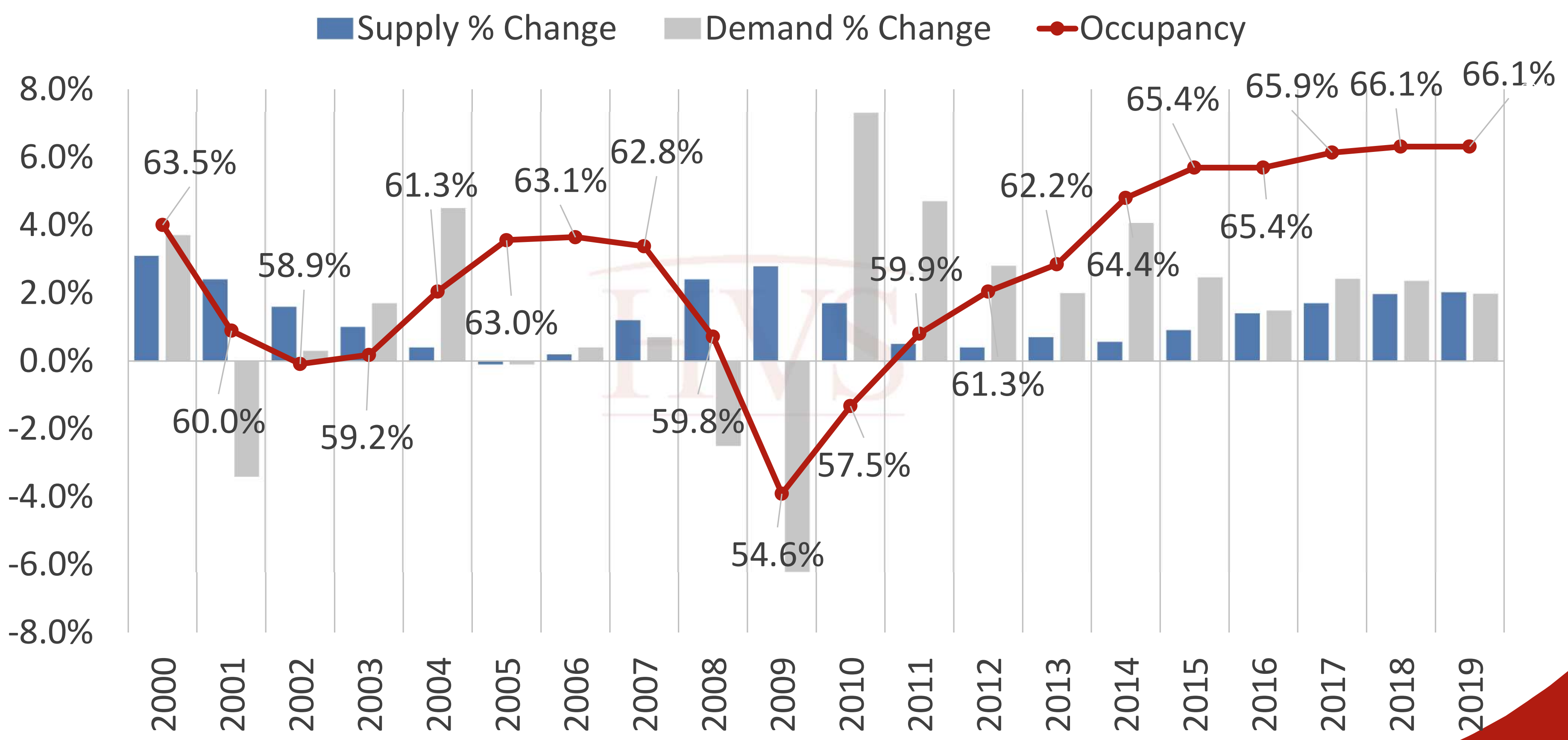

Source: STR

U.S. Lodging Market Trends through Prior Cycles

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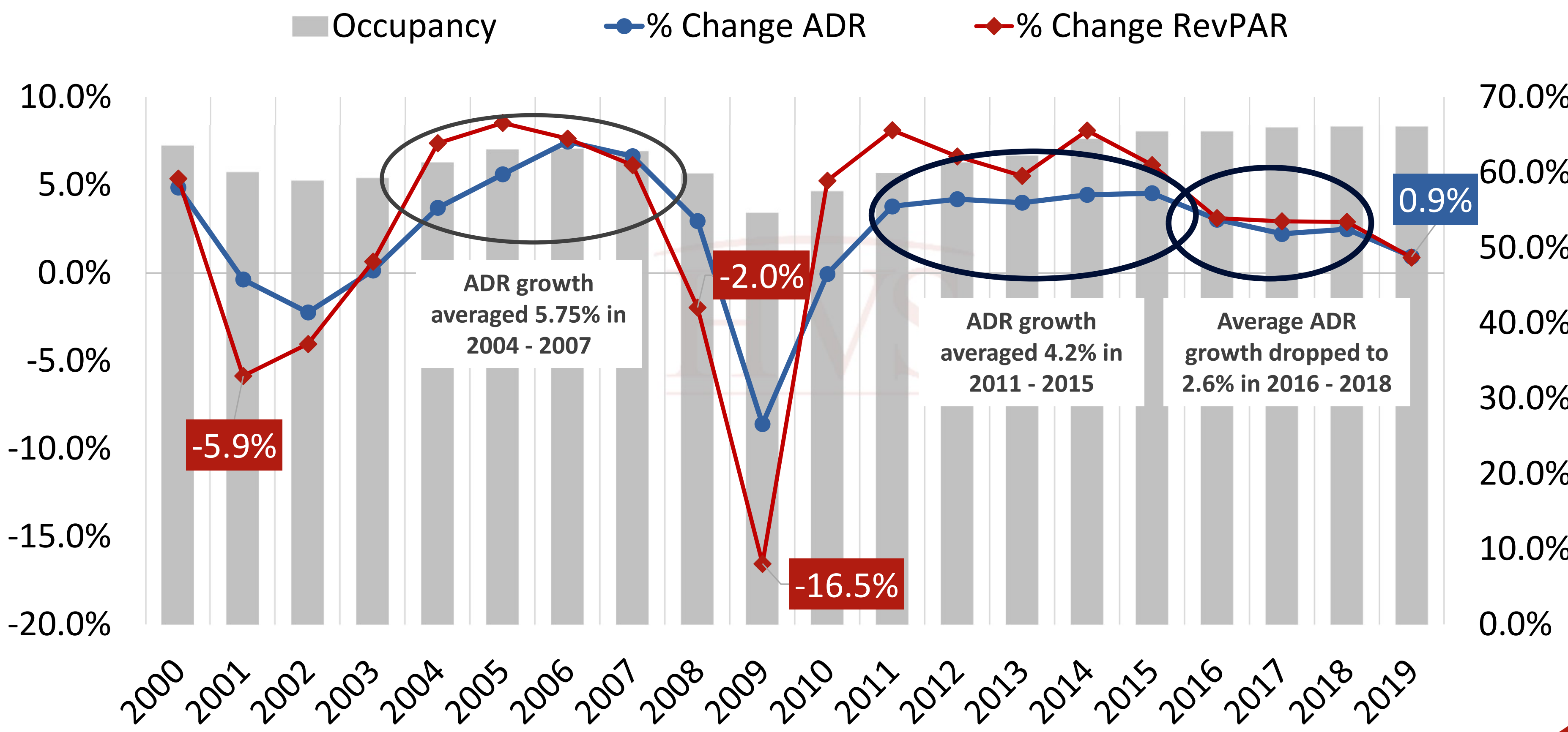


Source: STR

Outlook for the U.S. Lodging Industry

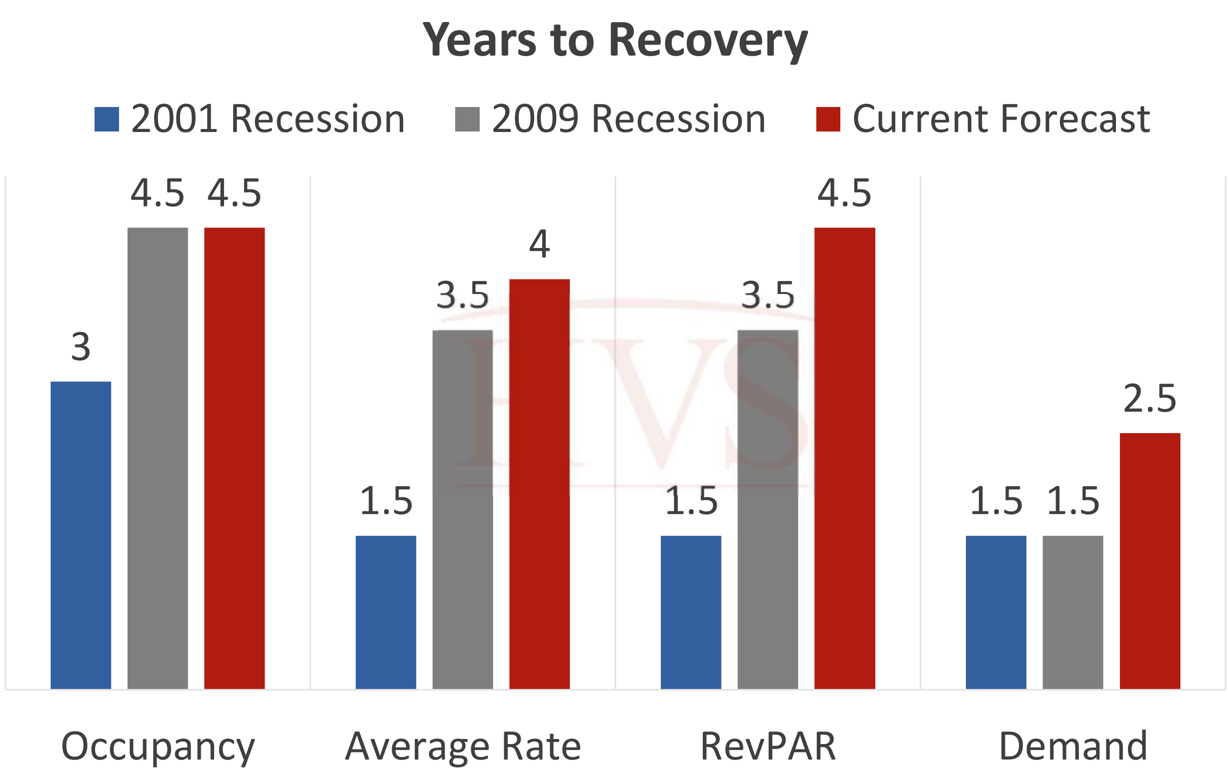
The following forecasts for the U.S. lodging industry reflect the current outlook of market participants, assuming recovery from COVID-19 accelerates in the second half of 2020.

	Historical		Forecast				
	2018	2019	2020	2021	2022	2023	2024
Occupancy	66.1%	66.1%	39.2%	55.2%	63.5%	64.5%	65.0%
Percent Change		*0.0%*	*-40.8%*	*40.9%*	*15.1%*	*1.5%*	*0.8%*
Average Rate	$129.97	$131.17	$102.43	$110.14	$120.74	$126.78	$131.85
Percent Change		*0.9%*	*-21.9%*	*7.5%*	*9.6%*	*5.0%*	*4.0%*
RevPAR	$85.96	$86.76	$40.11	$60.77	$76.70	$81.77	$85.70
Percent Change		*0.9%*	*-53.8%*	*51.5%*	*26.2%*	*6.6%*	*4.8%*

This represents the current expectation for the timing and pattern of recovery, with occupancy anticipated to recover first, followed by ADR. All forecasts are in current dollars.

Source: STR, HVS

Current Forecasts in a Historical Context



Source: HVS

The years to recovery reflect the time from the trough year to the peak (i.e., a return to prior levels).

HVS's occupancy forecast anticipates demand will begin to recover as travel restrictions are lifted, the COVID-19 virus is contained, and consumers resume business and leisure travel.

HVS anticipates that ADR will take longer to recover than in prior cycles given the magnitude of the rate declines. This reflects our expectation that rate will be a key marketing tool used to stimulate demand recovery. The availability of the shadow supply (Airbnb, Sonder, etc.), which was not a factor in prior cycles, will also influence ADR recovery.

How Will Individual Hotels and Markets Be Affected?

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More Vulnerable

- Full-service hotels, dependent on large group/ convention business
- Gateway markets that depend on international travel
- "Fly to" markets that depend on air travel
- Airport markets
- Independent properties
- Markets influenced by the energy sector

Secondary and tertiary markets and drive-to resort destinations should continue to perform better and are expected to return to 2019 levels faster than other markets.

Gateway and major metro markets have been more affected given the dependence on business and group travel. The recovery of these locations is anticipated to be prolonged.

Less Vulnerable

- Hotels that primarily rely on leisure segments
- "Drive-to" markets, which can be expected to recover faster than those dependent on air travel
- Properties affiliated with strong brands
- Extended-stay hotels
- Suburban, small metro town properties
- Economy and midscale properties

Outlook for Supply Growth

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As of January 2020, supply was forecast to increase by roughly 2.0% in 2020 and 2021. Given the recent events, supply growth is now expected to be lower, and at a slower pace, than previously anticipated.

- Under-construction projects are experiencing delays with materials/FF&E, which has pushed back planned opening dates.
- Market conditions have led to delayed openings; some projects have been placed on hold.
- Some hotels that have suspended operations may not reopen, while others may convert to alternate uses, resulting in net lower supply.
- Changes in market conditions may render new or pending projects infeasible, and financing will be challenging. Thus, some projects may be postponed or canceled.
- Some developers perceive this as an opportune time to pursue new projects given current lower construction costs and expected post-crisis opening dates.

EBITDA Impact and Recovery

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Hotel Operating Leverage

Full-Service Hotels	2007	2009	2014	2018
Revenue % Change		-22%	42%	14%
EBITDA % Change		-44%	101%	11%
EBITDA Ratio	25.3%	18.1%	25.4%	24.7%
Multiple of EBITDA Change to Revenue Change:		**2.0X**	**2.4X**	**0.8X**

Limited-Service Hotels	2007	2009	2014	2018
Revenue % Change		-17%	42%	29%
EBITDA % Change		-33%	65%	22%
EBITDA Ratio	40.0%	32.5%	37.9%	35.7%
Multiple of EBITDA Change to Revenue Change:		**1.9X**	**1.6X**	**0.7X**

Source: STR Host Almanac, HVS

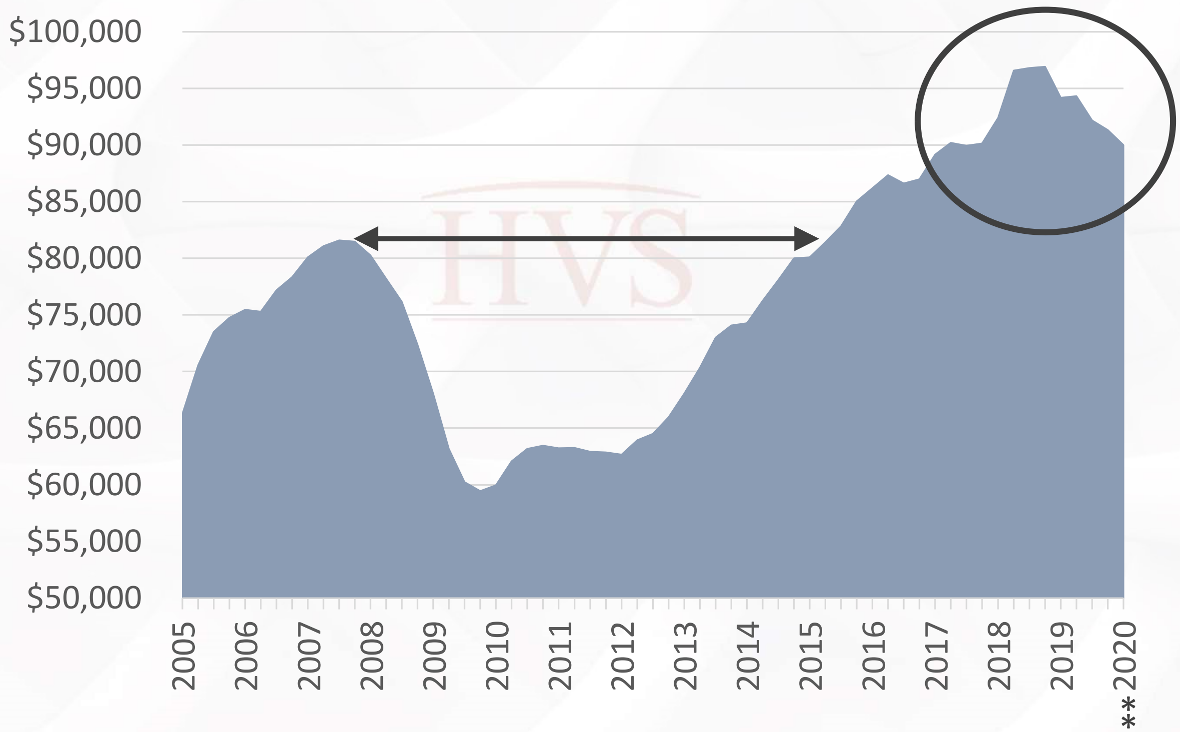
- Hotel EBITDA rises significantly when revenue growth outpaces expense growth, resulting in positive operating leverage.
- Positive operating leverage turns negative when revenue declines or grows at a slower rate than expenses. For this reason, EBITDA can decline significantly during revenue contraction.
- Once RevPAR rebounds, hotel EBITDA can increase significantly as positive operating leverage returns. This explains why hotels are extremely popular investments once EBITDA bottoms out and revenue begins to recover.

Positive Operating Leverage and Enhanced Operating Efficiency Will Support EBITDA Recovery

- Operating costs are being cut to the bone to minimize expense levels, creating the opportunity to rethink policies, procedures, and service standards from top to bottom.
- Limiting "touchpoints," supplemented by increased reliance on technology, supports reductions in staffing and service costs.
- Food and beverage service is being curtailed, reduced, or reengineered.
- New cleanliness and safety protocols may result in additional operating costs.
- Retaining these savings will enhance operating leverage as demand and revenue recovers.
- Owners and operators are now reporting lower breakeven levels: 30% to 35% for limited- and select-service hotels, and 40% to 45% for full-service hotels.

Hotel Values

A Look at U.S. Historic Price-Per-Key Trends*



Source: Real Capital Analytics

Timeline of the Investment Cycle

Market Peak – Prices peaked in Q3 2007 and began to slide prior to the market shock in Q3 2008.

Market Trough – Prices bottomed out in Q4 2009, and once hotel performance bottomed out, investors jumped in. Hedonic average price per key declined by 27% from peak to trough.

Recovery – Prices reached prior peak in Q2 2015, reflecting a five-year recovery from trough (2009) to peak (2015).

* PPK based on the Real Capital Analytics Hedonic Series (RCA HS), which reflects pricing for the average property rather than an average of the prices of properties that have transacted.

** Q1 2020 data

Hotel Values Have Declined

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The current downturn is affecting hotel values.

Although there’s no transaction activity to provide market evidence as of yet, market participants agree that hotel values have declined because of falling EBITDA and elevated uncertainty.

The bid-ask gap between buyers and sellers is significant: sellers are citing value declines of 10% to 15%, while buyers are seeking discounts of 30% to 45% from 2019 levels. Continued financial pressure will compel some sellers to exit their investment; the gap will narrow, and transaction activity will resume.

Numerous opportunistic investors and capital funds are anticipating acquiring hotels at well below 2019 levels and replacement cost; competition between bidders should temper value declines.

How Will Hotel Values Be Affected in the Current Downturn?

HVS has modeled three scenarios, addressing the range of potential impact of hotel values. The model considers a base scenario and three alternate scenarios, which reflect the range of potential impact. This model is intended to reflect the potential range and degree of impact on hotel values. The impact of current conditions on an individual property would depend on the characteristics of the property, its market, and its location.

2019 Base

Reflects the 2019 value, without any impact from current conditions.

Least Impact

Anticipates moderate declines in RevPAR and EBITDA. The degree of the decline is assumed to diminish over time as the market recovers.

Typical Impact

Assumes more significant impact in the first year (breakeven EBITDA). The degree of the decline is assumed to diminish over time as the market recovers.

Greatest Impact

Assumes greater negative EBITDA in the first year, followed by diminishing negative impact as the market recovers. This case assumes a longer recovery period.

In all scenarios, the capital market is assumed to result in higher discount and terminal capitalization rates in 2020, diminishing as the market recovers.

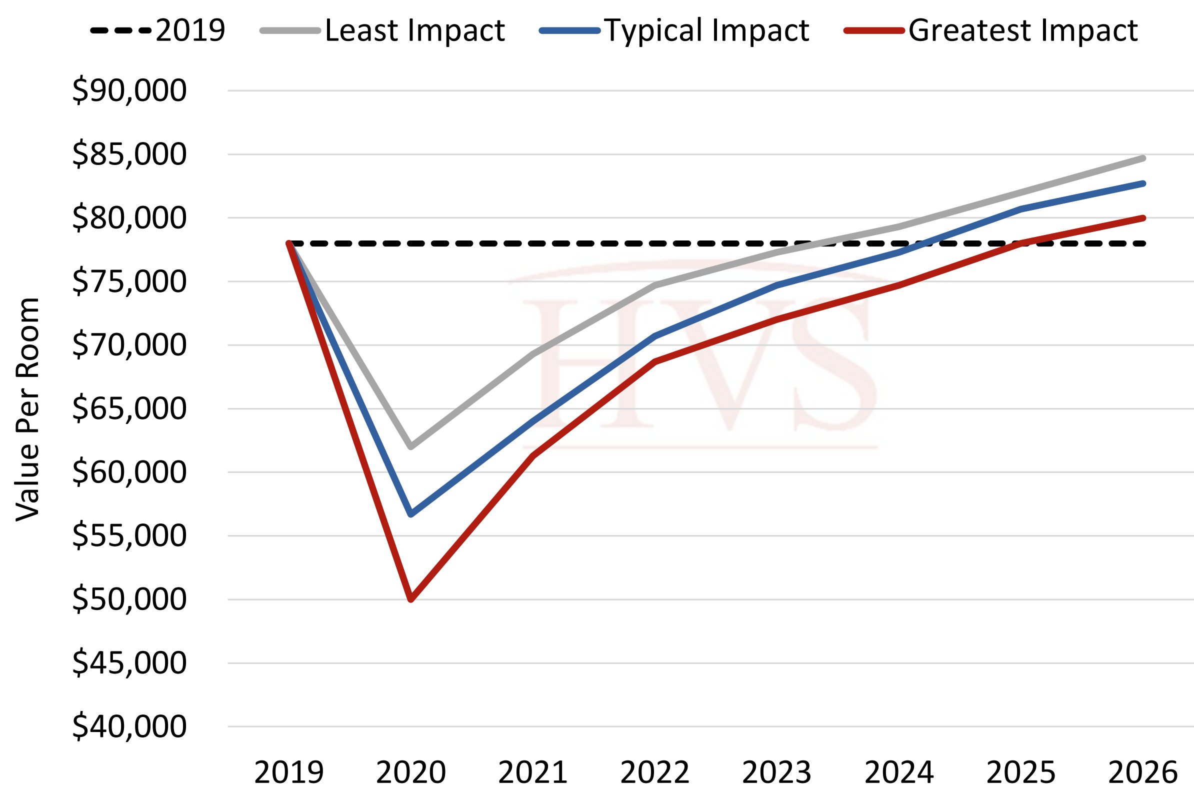
Least Impact – the value decline is **20%** as of 2020. EBITDA recovers to base-year (2019) levels by 2023/24.

Typical Impact – the value decline is **27%** as of 2020. EBITDA recovers to base-year (2019) levels by 2024/25.

Greatest Impact – the value decline is **35%** as of 2020. EBITDA recovers to base-year (2019) levels by 2025/26.

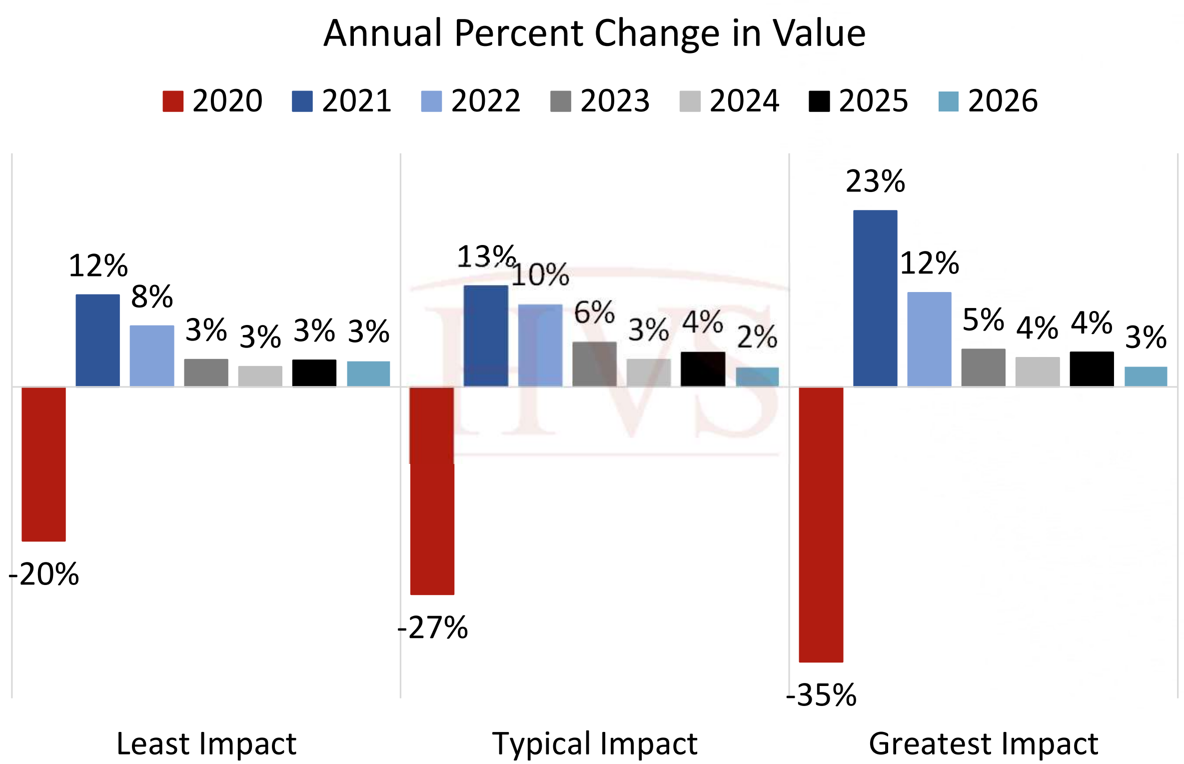
For context, according to the Real Capital Analytics hedonic data, the value of an average hotel declined by **27%** in the last downturn.

Anticipated Pattern of Value Decline and Recovery



Source: HVS

Current Expectations for Market Values



Relationship to 2019 Value			
	Least Impact	Typical Impact	Greatest Impact
2020	79%	73%	64%
2021	89%	82%	79%
2022	96%	91%	88%
2023	99%	96%	92%
2024	102%	99%	96%
2025	105%	103%	100%
2026	109%	106%	103%

Under the "Typical Impact" scenario, hotel values are forecast to recover to 2019 levels by 2024/25.

Source: HVS

Final Thoughts

1. RevPar recovery is expected to extend 4.5 years and reach 2019 levels in 2024/2025.
2. ADR will take longer to recover given the magnitude of the rate declines. The availability of the shadow supply will also influence ADR recovery.
3. Supply growth is expected to be lower, and at a slower pace, than previously anticipated, which should support occupancy and average rate growth.
4. Under the Typical Scenario, hotel values are anticipated to decline 27% and recover by 2024/2025.
5. Positive operating leverage and improved efficiency, with many operational elements reevaluated or reengineered, will support EBITDA recovery.
6. Opportunistic investors will create competition for deals, which is expected to fuel transaction activity and mitigate value declines.

Superior Results Through Unrivaled Hospitality Intelligence. Everywhere.

HVS has been supporting the hospitality industry in the U.S. and around the world for over 40 years. Our senior staff represents a collective 300+ years of experience advising our industry, including through multiple prior cycles and events.

Our expertise covers the full range of hospitality assets and spans the full lifecycle of a hotel, including services that support developers, owners, operators, lenders, and investors. With 40+ offices in markets across the U.S., we offer local insights on a real-time basis.

This knowledge and experience is available to support you as you navigate these challenging times. Our platform is fully functional on a remote basis, so even though we are not currently traveling, our staff can access the full resources of HVS on your behalf.

Let us know how we can assist you.

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Investment Search
Product Recommendation
Financial Projections
Financial Feasibility Analysis
Economic Impact Analysis
Architectural Concept Design
Construction Costs Estimates

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Appraisal for Financing
Debt & Equity Financing
Due Diligence Coordination
Brand Selection & Contract Negotiations
Operator Selection & Contract Negotiations
Interior Design & Project Management
Executive Search
Pre-Opening Oversight

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