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Outlook for the Hotel Industry

The impact of current events on hotel performance and values for hotel owners

April 2020

Key Takeaways From Our Outlook

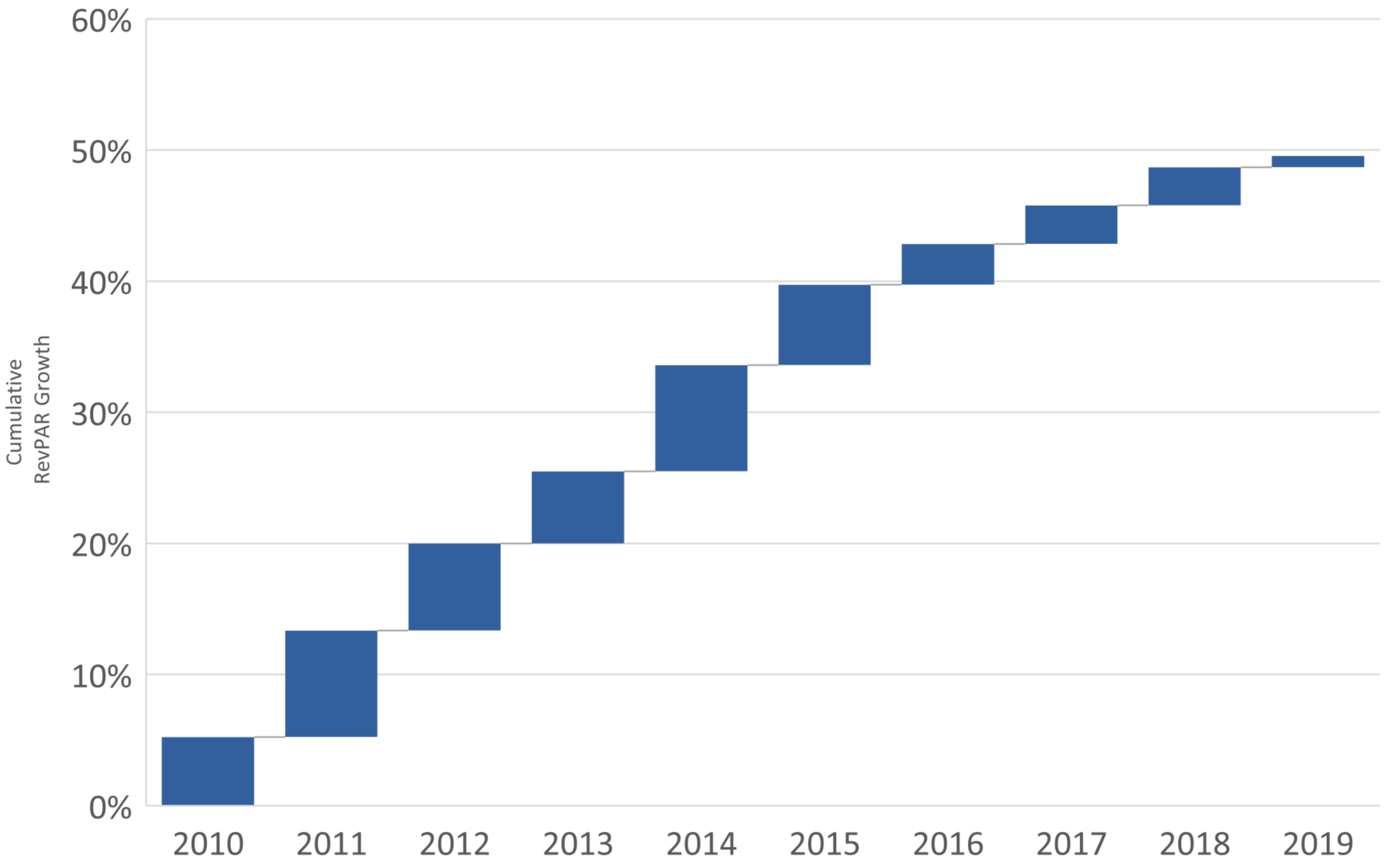
Unprecedented downturn

- Sharp revenue declines will result in significant decreases in EBITDA, with the real possibility of negative EBITDA in the near term.

Performance will recover

- While the severity of the downturn is unprecedented, we are forecasting the recovery to follow the fundamentals of previous cycles.
  - Occupancy will initially recover faster than average rate, as hotels use price as a marketing tool to stimulate demand recovery and attract guests.
  - Capital market disruption may lead to all-cash transactions, seller financing, and other capital solutions that could put downward pressure on values.
  - The acquisition window of opportunity for “good deals” on hotels will also be narrow because of significant buyer interest and constraints of the capital markets.
- We anticipate the “Most Likely Case” is a 27% value decline for 2020. All scenarios show a rapid value recovery in 2021 with EBITDA fully recovering to base-case levels by 2024.

The Longest Hotel Cycle in History Has Abruptly Ended After 10 Years of Consecutive RevPAR Growth



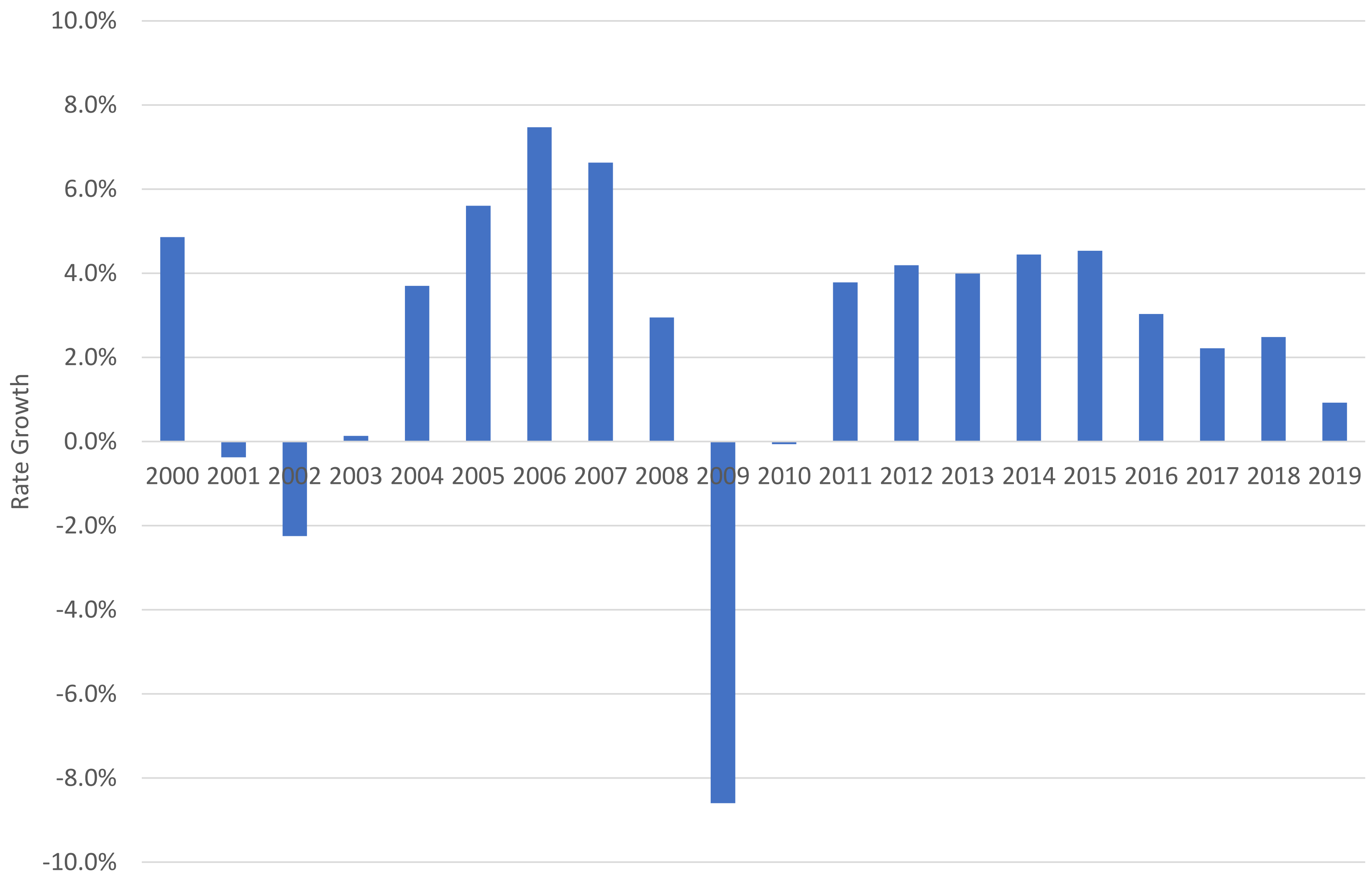
Source: STR

- Typical cycles last eight years
- The length of the prior cycle has provided hotel investors more time to raise cash for recession transactions

Where do we go from here?

What can we learn from prior cycles?

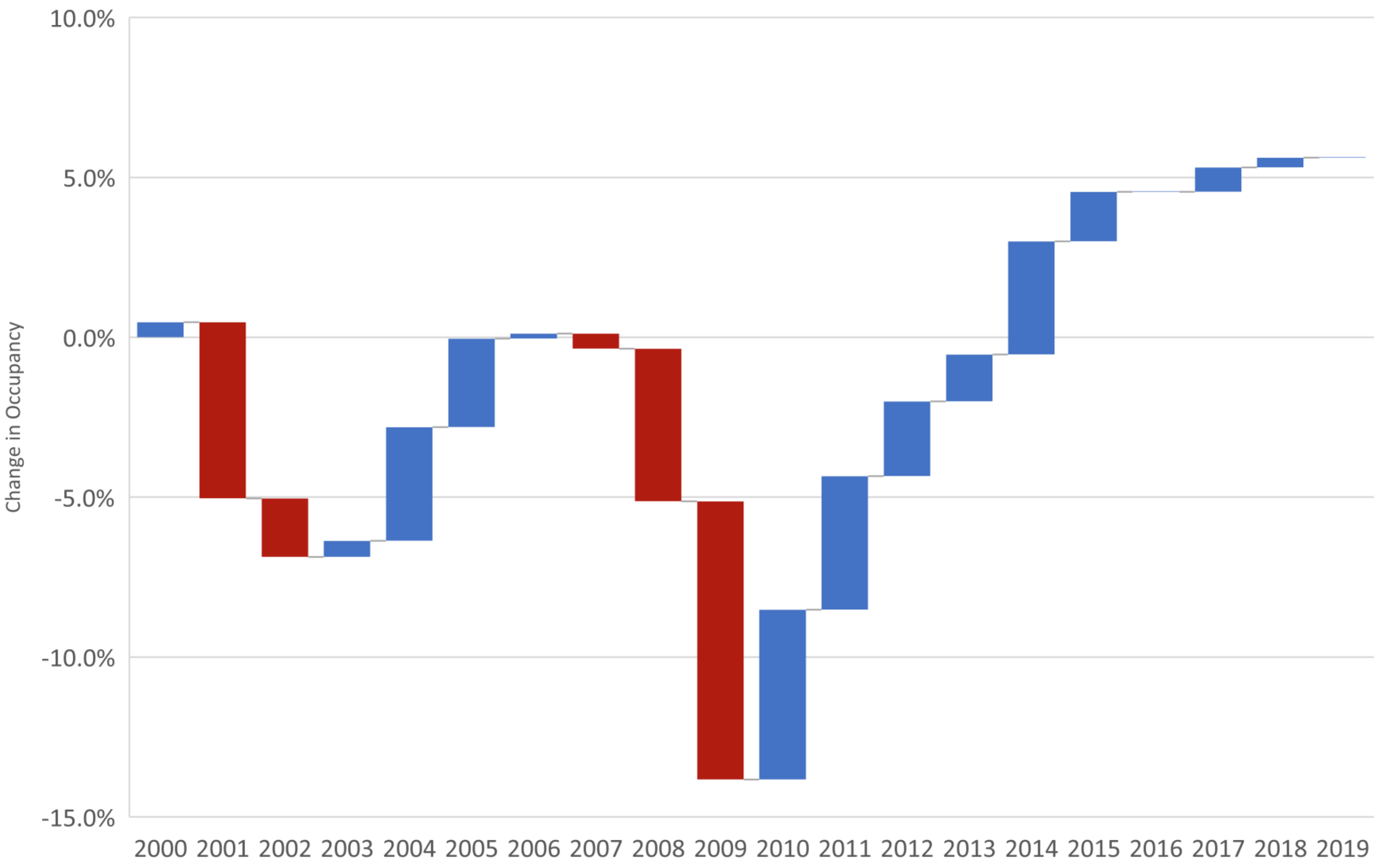
Prior Cycles Illustrate Rates Recover Gradually and Consistently



Source: STR

- Rates immediately decline at the start of a recession
- Rates recover gradually and consistently while reaching prior peak faster than occupancy

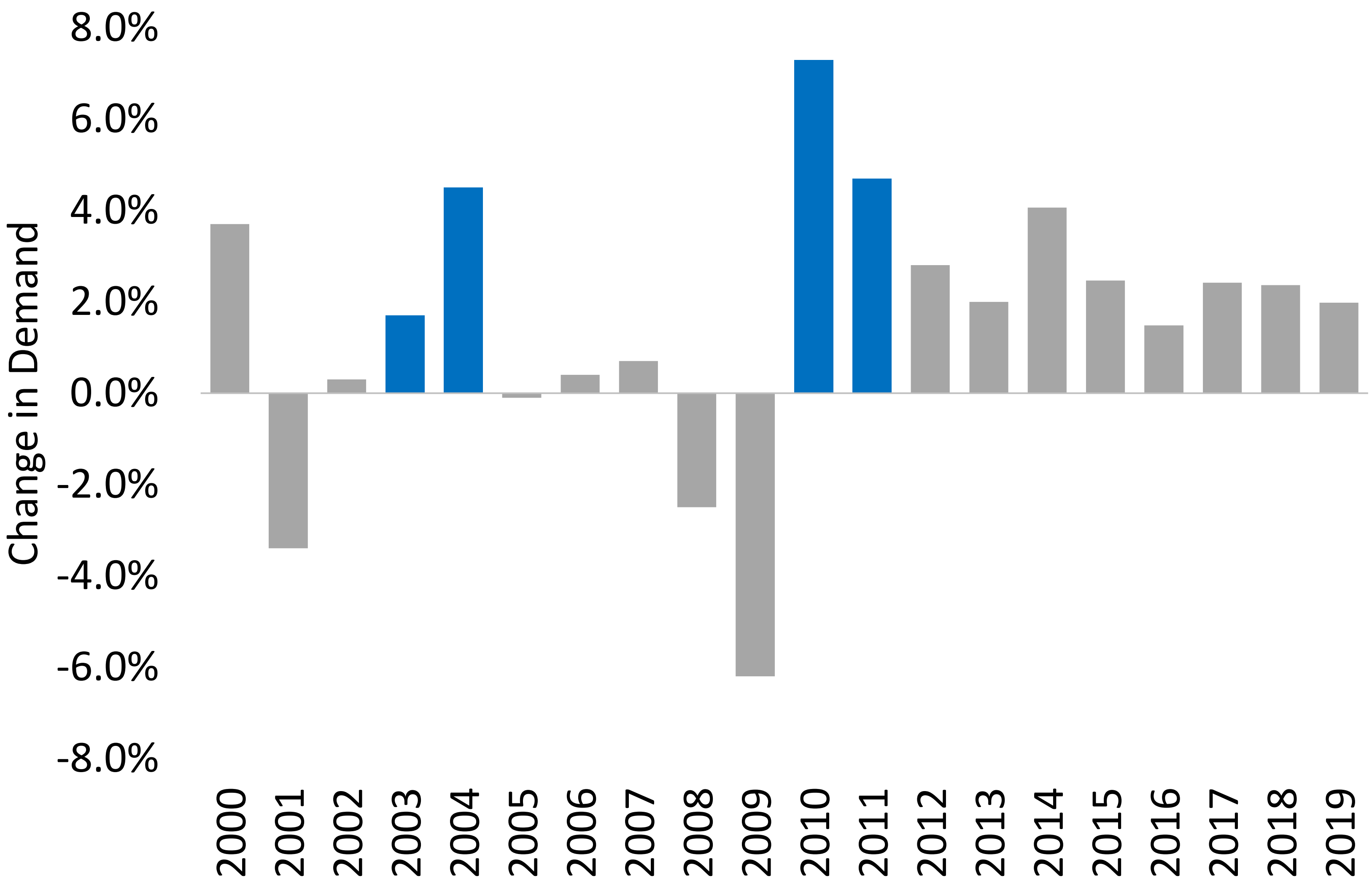
Prior Cycles Illustrate Occupancy Initially Recovers Quickly



Source: STR

- Occupancy immediately declines at the start of the recession
- Occupancy initially recovers quickly and is followed by a slower return to prior peak than rate

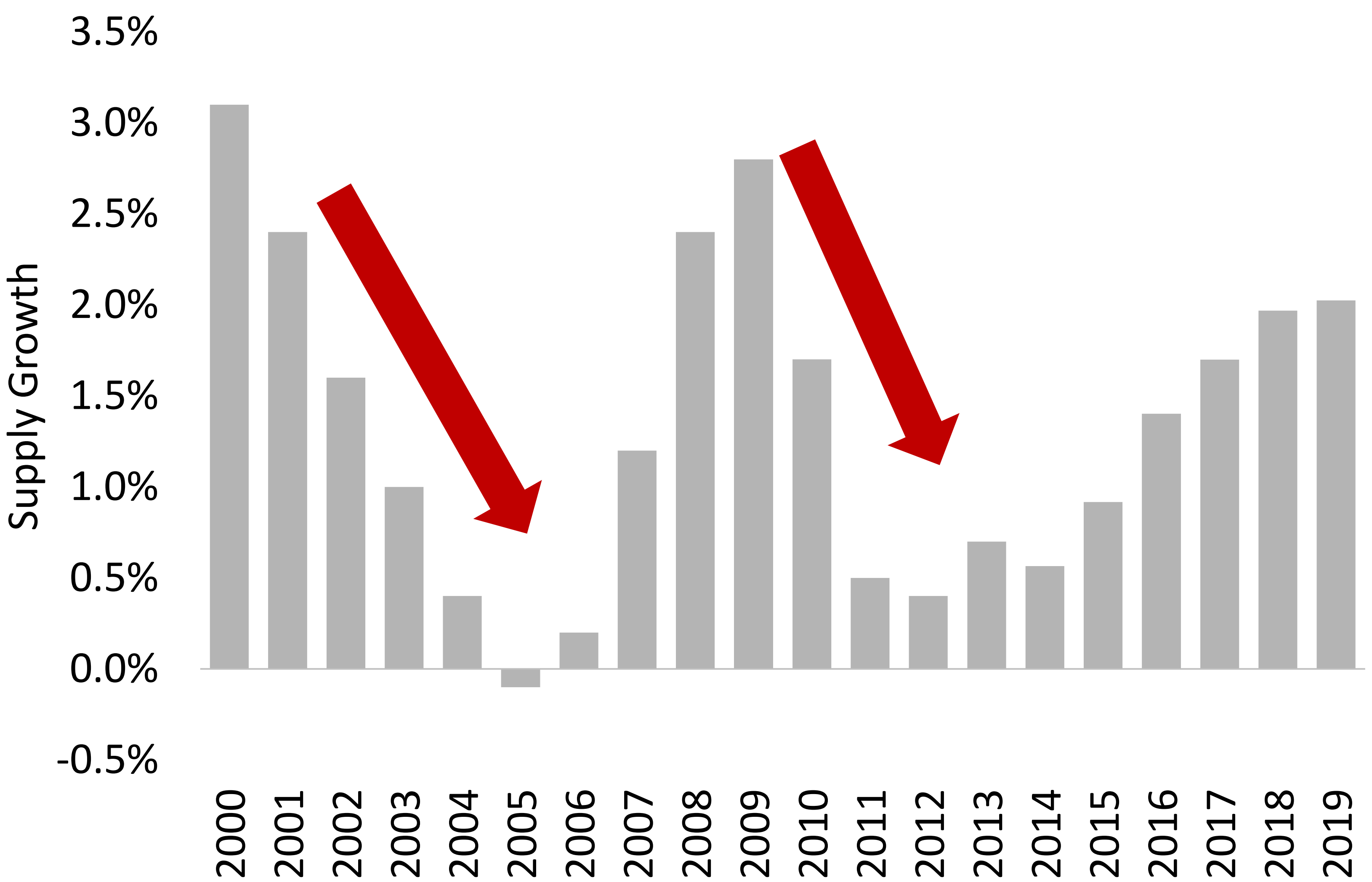
Prior Cycles Illustrate Strong Demand Recovery Following a Downturn



Source: STR

- Both the 2001 and 2009 recession snapped back with strong demand recovery

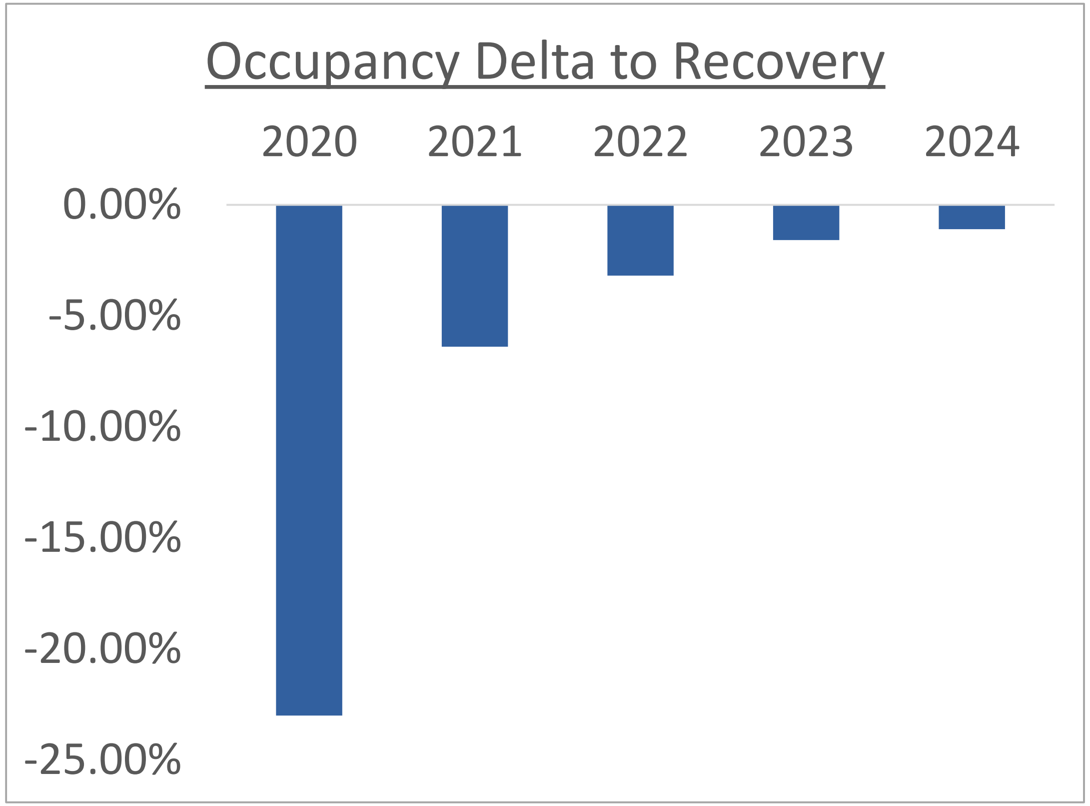
Prior Cycles Illustrate Delayed Supply Growth Following a Downturn



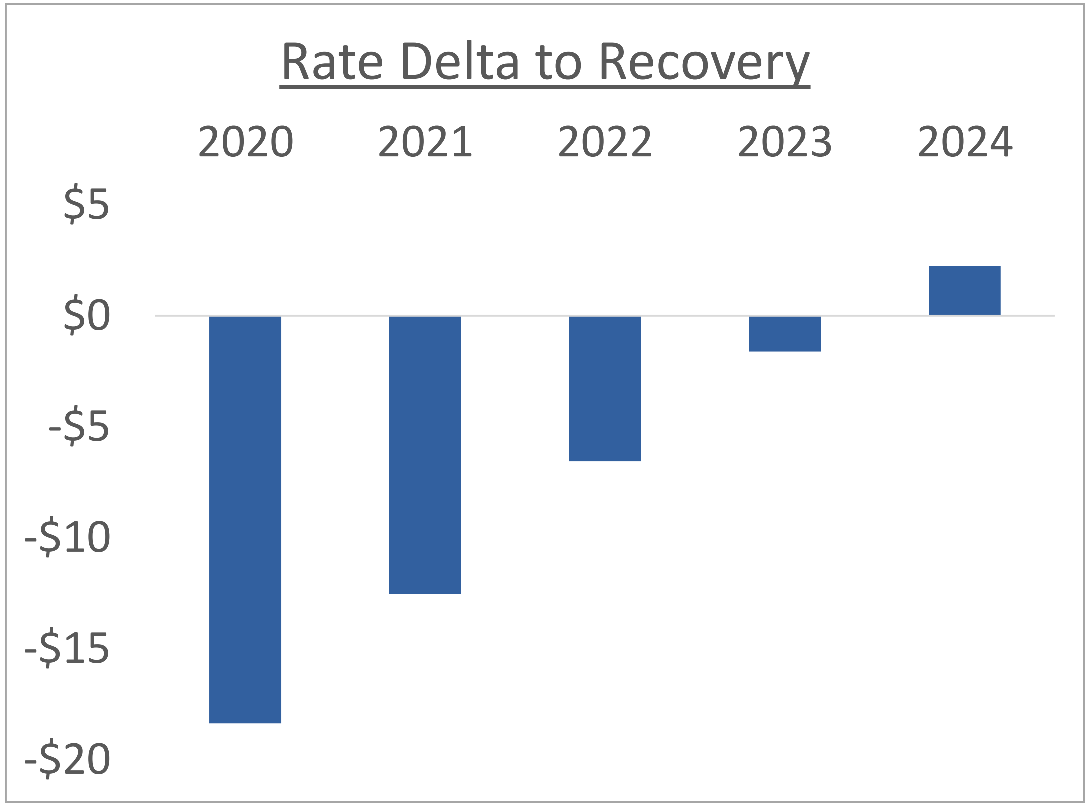
Source: STR

- Supply growth immediately slows down after a recession
- It took four years for supply growth to reach bottom after the 2001
- It took three years for supply growth to reach bottom after the 2001

We Are Forecasting Occupancy and Rate Recovery Will be Fully Recovered in 2024



Source: HVS



Source: HVS

Outlook for Supply Growth

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 may face delays with materials/FF&E, which will push back planned opening dates.
- Market conditions will likely lead to delayed openings; some projects may be placed on hold.
- Financing challenges will delay construction start dates.
- Changes in market conditions may render proposed projects infeasible; as a result, some projects may be postponed or canceled.
- Some properties may close and not reopen, resulting in negative supply growth.

Outlook for the U.S. Lodging Industry

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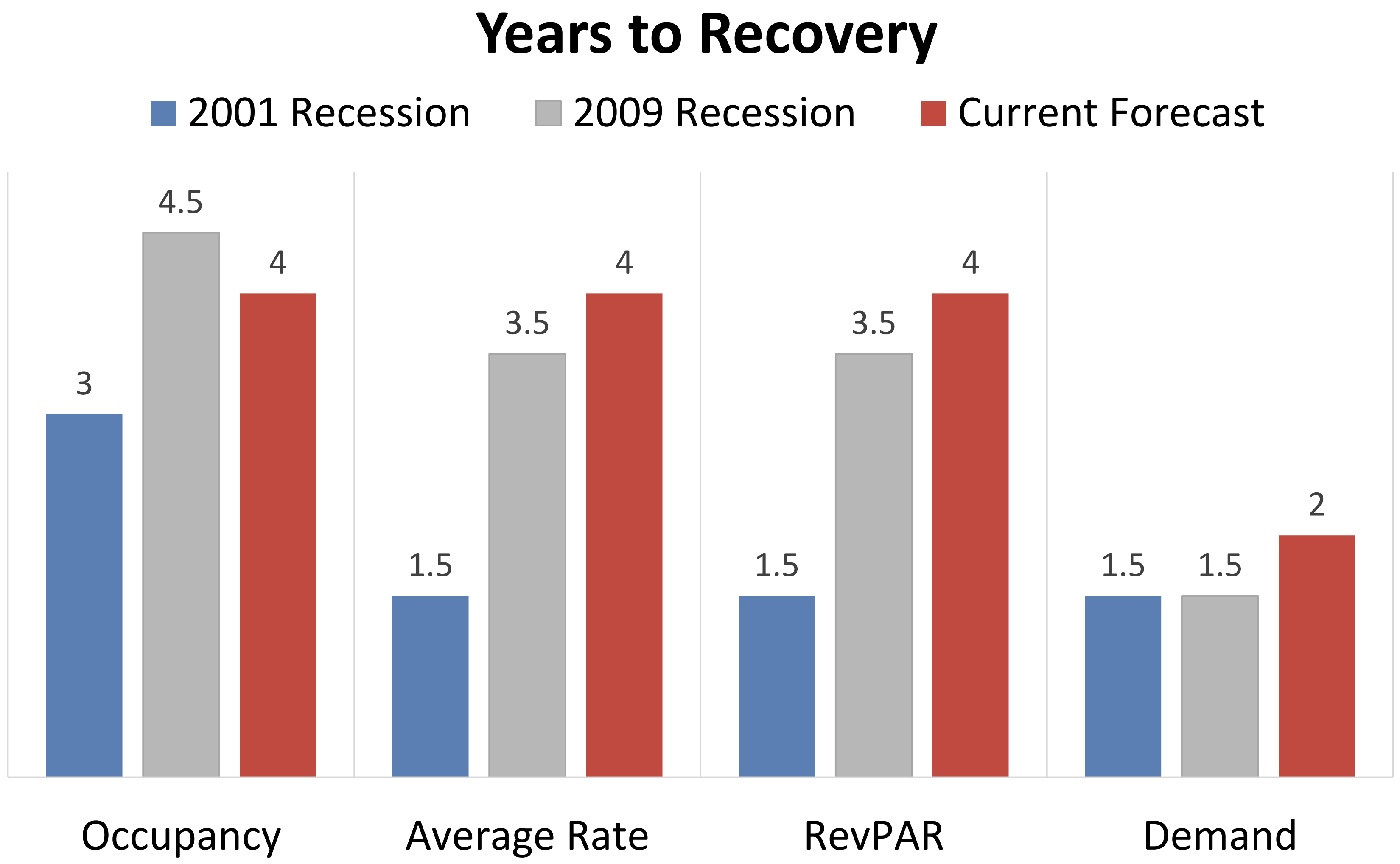
The following forecasts for the U.S. lodging industry reflect the current outlook of market participants, assuming recovery from COVID-19 begins in the second half of 2020.

	Historical		Forecast				
	2018	2019	2020	2021	2022	2023	2024
Occupancy	66.1%	66.1%	43.1%	59.7%	62.9%	64.5%	65.0%
Percent Change		*0.0%*	*-34.7%*	*38.5%*	*5.3%*	*2.5%*	*0.8%*
Average Rate	$129.97	$131.17	$111.61	$117.45	$123.42	$128.36	$132.21
Percent Change		*0.9%*	*-14.9%*	*5.2%*	*5.1%*	*4.0%*	*3.0%*
RevPAR	$85.96	$86.76	$48.15	$70.17	$77.68	$82.79	$85.94
Percent Change		*0.9%*	*-44.5%*	*45.7%*	*10.7%*	*6.6%*	*3.8%*

This represents the current expectation for the timing and pattern of recovery, with occupancy expected 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 reflects the time from the trough year to the peak (i.e., a return to prior levels).
- HVS's occupancy forecast anticipates a rebound in demand once travel restrictions are lifted, the COVID-19 virus is contained, and consumers resume business and leisure travel.
- HVS anticipates 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, and others), which was not a factor in prior cycles, will also influence ADR recovery.

What's the Impact on Hotel Values and Transactions?

The Current Downturn Will Have a Significant Impact on Hotel Values for One Year

Sharp revenue declines result in even more significant decreases in EBITDA, with the real possibility of negative EBITDA in the near term.

The debt market has pulled back from the hotel sector, with lenders reporting lower loan-to-value ratios and/or higher spreads that could result in higher interest rates, despite the cuts by the Federal Reserve.

Capital market disruption may lead to all-cash transactions, seller financing, and other capital solutions that could put downward pressure on values.

How Will Individual Hotels and Markets Be Affected?

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More Vulnerable

- Full-service hotels, dependent on group 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 are expected to hold up better and trade at a smaller discount to 2019 values.

Gateway and top 10 metro markets will be more volatile; larger value declines are anticipated in the near term, with greater potential for accelerated appreciation thereafter.

Less Vulnerable

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

How Will Hotel Values Be Affected in the Current Downturn?

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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.

Base Case

Reflects the anticipated values over time, based on stable market conditions; this case assumes that the capital market conditions as of 1/1/2020 remain in place.

Best Case

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

Most Likely Case

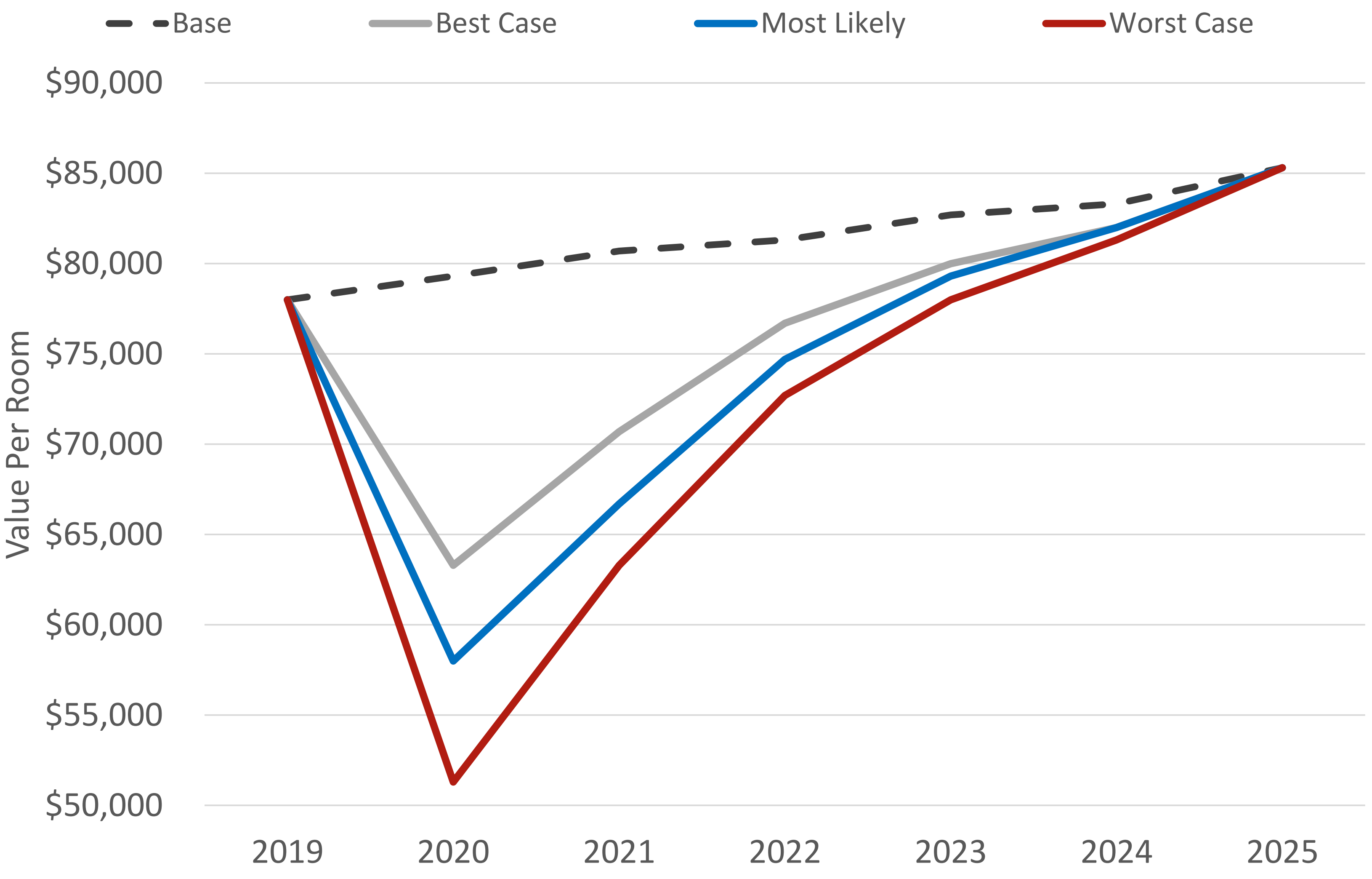
Assumes more significant impact in the first year (breakeven EBITDA). The degree of the impact and declines are assumed to diminish over time as the market recovers.

Worst Case

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.

Anticipated Pattern of Value Decline and Recovery



Source: HVS

- **Best Case** – the value decline is 20% as of 2020. EBITDA recovers to base-case levels by 2024.
- **Most Likely Case** – the value decline is 27% as of 2020. EBITDA recovers to base-case levels by 2024.
- **Worst Case** – the value decline is 35% as of 2020. EBITDA recovers to base-case levels by 2025.

Value Recovery Will be Swift, Even in the Worst-case Scenario

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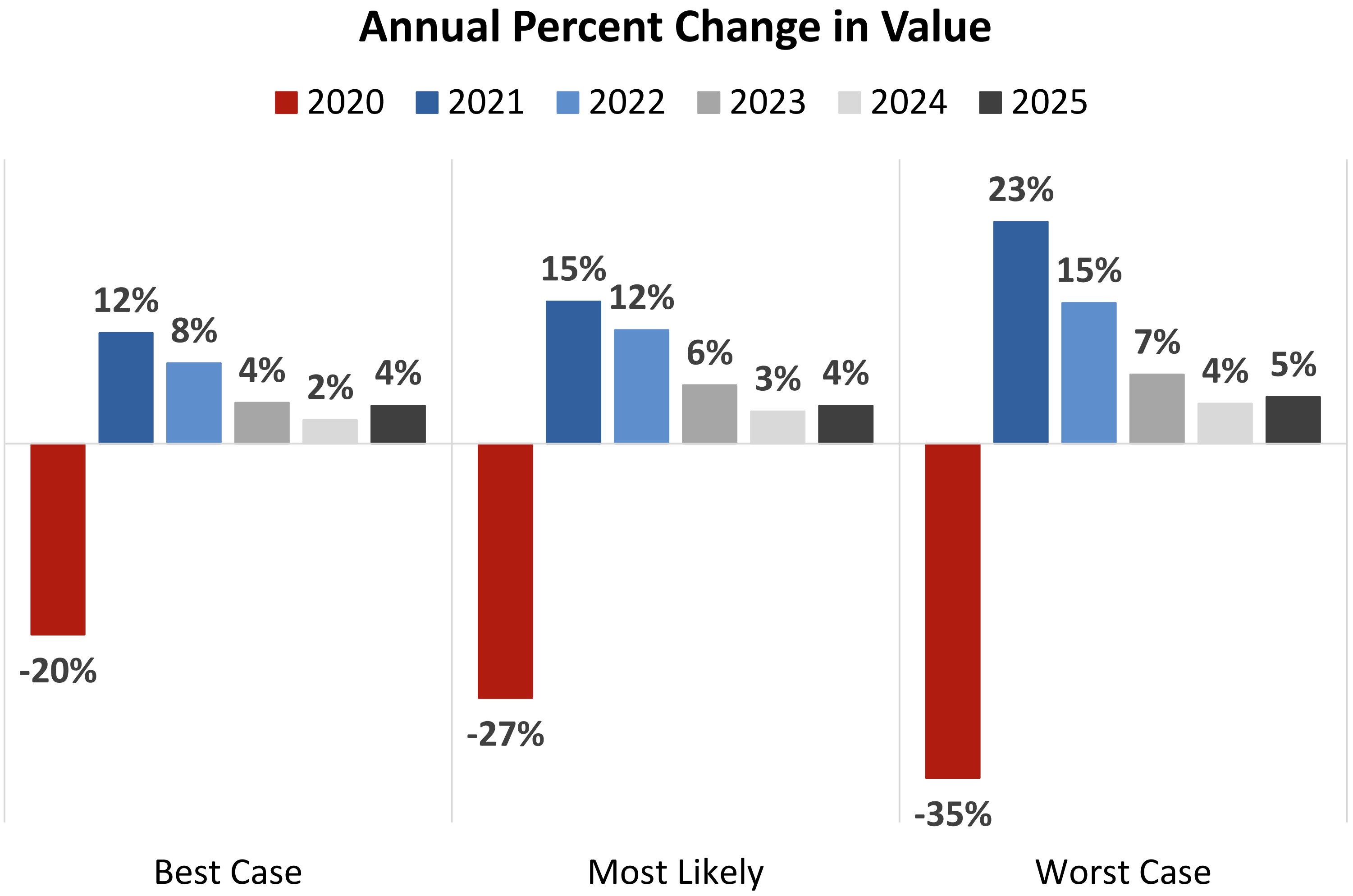
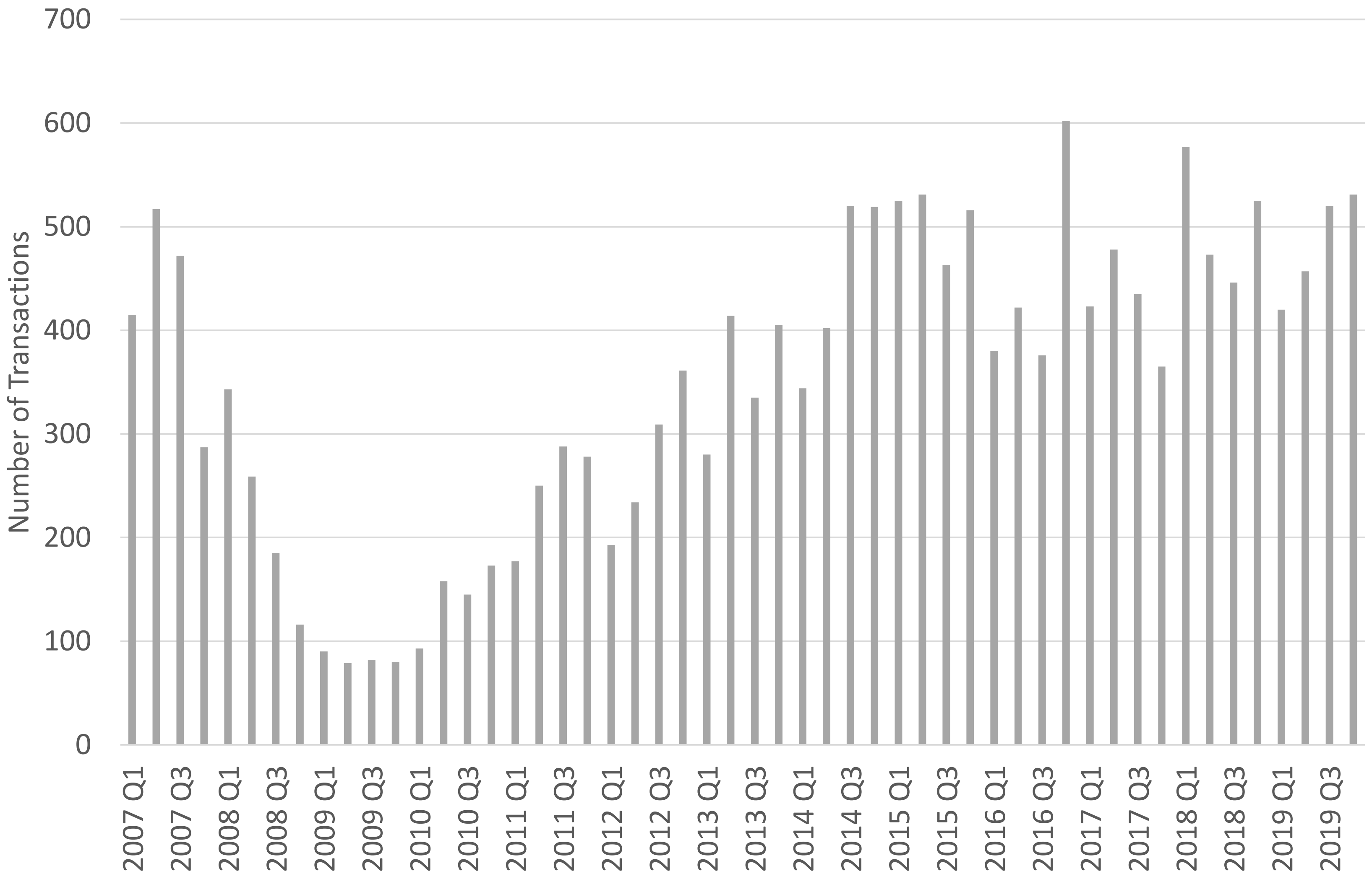


Relationship to 2019 Value			
	Best Case	Most Likely	Worst Case
2020	81%	74%	66%
2021	91%	86%	81%
2022	98%	96%	93%
2023	103%	102%	100%
2024	105%	105%	104%
2025	109%	109%	109%

Value is forecast to recover to and exceed 2019 value by 2023

Source: HVS

The Transactional Market Takes About 6-9 Months to Recover



Source: RCA

- Transaction volume in this cycle is expected to mirror the 2008/09 downturn and recovery.
- Volume of transactions will be low in 2020, with deal volume expected to accelerate in 2021.
- Pending deals may close but are likely to be re-traded. The closing of some pending sales is being extended to allow the parties to evaluate the transaction as market conditions evolve.

Investor Strategies in the Current Environment

In the current market, hotel acquisitions will be motivated by the opportunity to buy at depressed prices, as both cash flows and debt availability are well below prior norms. The expected EBITDA recovery following the downturn should enable buyers to achieve high returns.

With debt less readily available, transactions may require one – or a combination – of the following options:

%

Third-party financing at lower leverage and a higher interest rate

Seller financing

All-cash purchase

Buyers acquiring hotels in the current environment do so with the expectation that the hotel's cash flow will improve and that the availability of debt for hotels will return to prior levels. At that point, the buyer would either sell or refinance the hotel.

The Transactional Perspective

- We anticipate that most hotel owners will not sell unless necessary.
- Prices will be driven down for those assets that have to sell in the current environment.
- Financing options are constrained as lenders pull back from the hotel sector:
  - CMBS market is currently closed to the hotel sector
  - Lenders who are still active are decreasing loan-to-value ratios and increasing spreads
  - SBA lenders have temporarily paused new originations in anticipation of new guidelines related to higher government guarantees (not to be confused with the SBA disaster loans, which are still are active)
- Conditions create opportunities for all-cash buyers, which will put downward pressure on prices as sellers seek certainty of execution.
- All-cash and low-leverage buyers will anticipate refinancing when conditions improve, enhancing the ROI potential.

The Transactional Perspective

- Sophisticated and disciplined hotel investors have been preparing for the end of cycle by not over-leveraging and saving cash for the next buying spree.

- While the decline has been sharper and more sudden than anyone could have envisioned, the acquisition window of opportunity for “good deals” on hotels will also be narrow because of significant buyer interest and current constraints of the capital markets.

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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.

Stephen Rushmore | +1 617 868-6840
Srushmorejr@hvs.com

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Operator Selection & Contract Negotiations
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Pre-Opening Oversight

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