BEYOND THE GLOBAL HEALTH CRISIS

Marcus & Millichap

SPECIAL REPORT **HOSPITALITY REPORT** **THIRD QUARTER 2020**

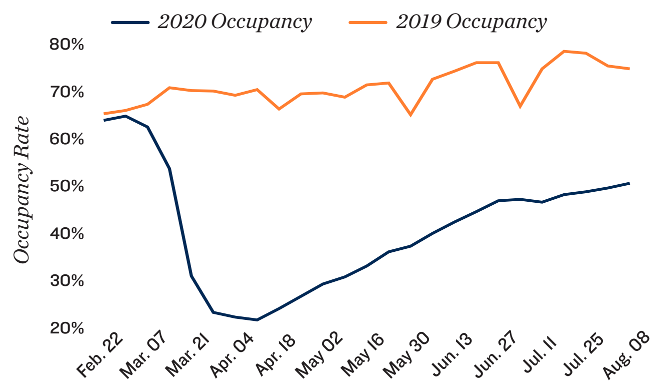
Small-Market and Affordable Hotels See Gains; Long Road to Recovery Lies Ahead for the Lodging Sector

Hospitality's progress slows amid spreading infection. Hotels, along with other businesses, began to see rising foot traffic in late spring as many cities initiated phased reopenings of their local economies. After bottoming out at 21 percent during the week ended April 11, average weekly hotel occupancy for the U.S. has improved to over 47 percent in late July. The pace of growth is slowing, however, as many metros, particularly those in the Sunbelt, have reported surges in coronavirus cases. Amplified health concerns have prompted rollbacks in reopenings, with markets such as Miami, Nashville, and Phoenix reporting modest occupancy contractions in July. Even in settings where the infection rate is dropping, hotel performance remains well below historical averages, driven by COVID-19's profound impact on travel.

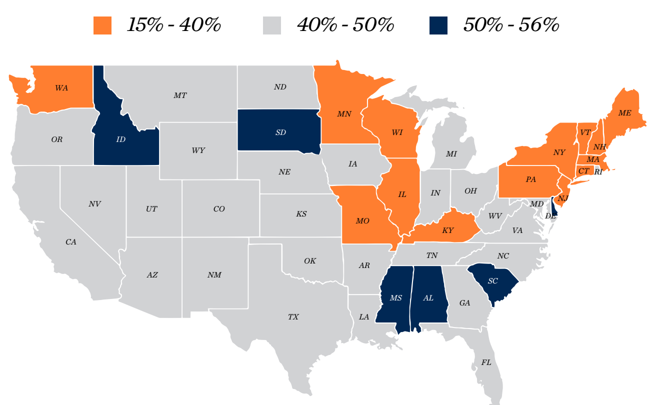
Pandemic travel trends flip hotel demand dynamics. The health crisis has radically shifted the motivations for and methods of travel, with repercussions for hotel room demand. The cancellation of virtually all major domestic business and entertainment events until at least early 2021 has lessened visitation to traditionally prominent destinations. Those who are traveling are avoiding commercial transportation, influencing vacation decisions. Together these trends have temporarily inverted the relationship between hotel performance in large and small markets. States with the highest average occupancy rates in June included Idaho, Mississippi, and Alabama, which historically trail major business and tourism hubs. Hotels along highways and in small cities are benefiting from a renewed focus on road trips to less-populated scenic destinations.

Guests seeking lower room rates benefit limited service hotels. Lost or reduced income is also influencing hotel room demand, aiding properties with lower nightly rates. Economy and midscale hotels have shown more resilience during the pandemic, while full-service establishments have faced steeper challenges. In order to manage costs, many higher-end hotels have suspended certain amenities that normally support a premium rate. Current travelers are instead focusing on sanitized accommodations and features such as kitchens that support physical distancing. Such options are one reason why foot traffic at some extended-stay hotels dropped half as much in April and May as other higher-cost brands. Amid fewer differentiating services and greater financial disruptions, guests are zeroing in on the bottom-line room rate.

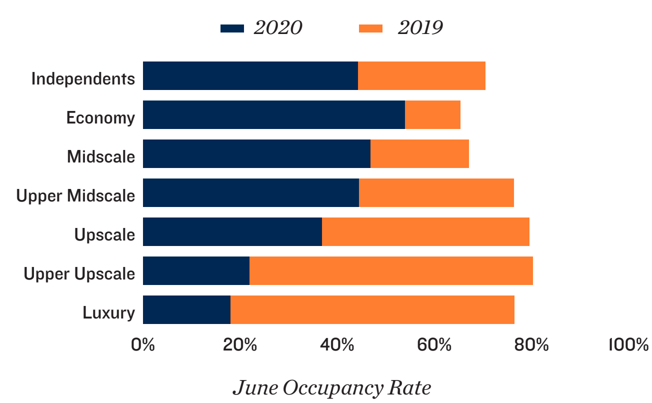
Initial Recovery Slows as Infections Rise



June 2020 Occupancy



Lower-Service-Level Hotels Less Disrupted



Source: STR, Inc.

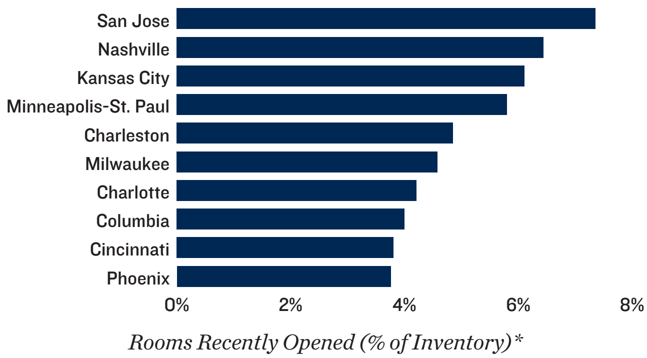
Variety of Factors Affecting the Hospitality Sector and Short-Term Rentals

Tempered supply growth still a factor in hotel performance. New safety procedures, temporary shutdowns at construction sites, and a subdued demand outlook have all contributed to a slowdown in hotel room openings over the past several months. Through the first half of 2020, about 35,900 rooms opened, down about a third from the same period last year. New York City and Dallas/Fort Worth led the country in the total number of new keys, but it was smaller hospitality markets such as San Jose, Nashville and Kansas City that recorded the most supply growth relative to their current size. For most metros, though, the pace of deliveries has slowed, reducing the impact of new competition on an already dampened travel environment. More rooms will continue to come online over time, however, with approximately 214,000 rooms in the construction pipeline. Some of these projects may be reconsidered and most arrivals will be after 2020, but supply pressure nevertheless presents another hurdle for the beleaguered lodging sector.

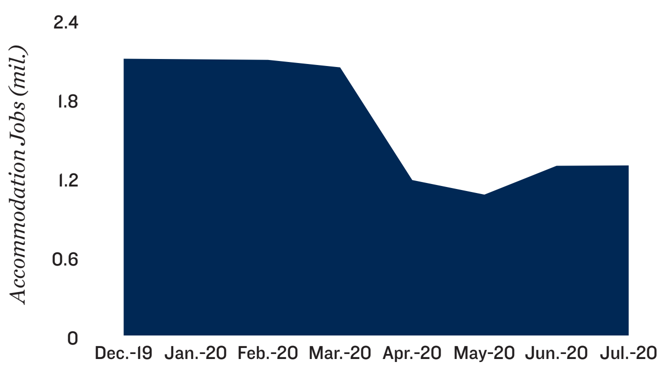
Current federal aid insufficient. Some hoteliers have received modest aid from the Paycheck Protection Program (PPP), designed to help small businesses keep staff by providing loans to cover payroll expenses for a brief period. Through the end of June, approximately $521 billion had been issued via roughly 4.9 million loans. Businesses in the accommodation and food service industries received about 8 percent of that funding, despite accounting for 32 percent of the jobs lost in March and April. While the sector has since recovered about 3 million of the 7 million initially terminated positions, unemployment among hotel workers remains historically high. Given reduced travel, it is unlikely hotel room demand will recover within the intended time frame of the PPP. As such, representatives of the hospitality sector are seeking additional federal aid. Objectives include a hospitality-specific extension of the PPP and a new CMBS relief fund. The likelihood of these measures being enacted is unclear.

Short-term rentals facing their own dilemmas. Concerns over private residences being rented out to host parties in defiance of social distancing precautions have prompted some municipalities such as Miami Beach to temporarily ban peer-to-peer rentals. Perhaps to prevent similar measures being enacted elsewhere, Airbnb has proactively pulled listings in Arizona and New Jersey. The organization is targeting reservations made by guests who live locally. Despite some bookings being taken off the market, peer rental hosts are still having to cut rates, especially in larger cities. Loss of pricing power is not unique to short-term rentals, however. Among traditional hotels, the premium charged in top travel markets compared with other metros has completely vanished.

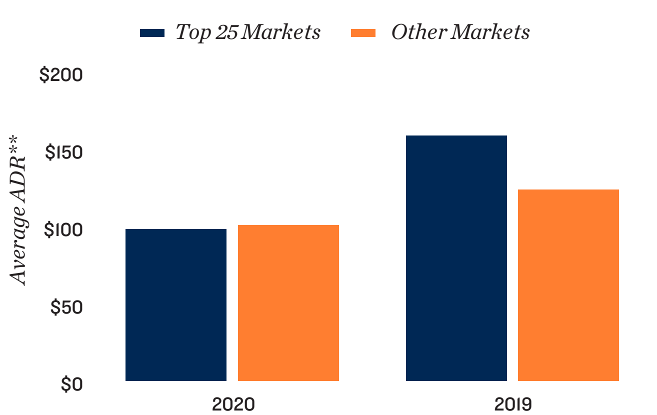
Smaller Midwest and Southern Markets Lead Supply Growth



Hotel Job Recovery Stalls in July



Room Rates Normalize Across Markets



* Rooms opened in the 12-month period ended June 2020
** Trailing 28-day average through Aug. 8
Sources: Bureau of Labor Statistics; STR, Inc.

Occupancy Recovering Across Major Markets; Most Still Trailing 2019 Levels

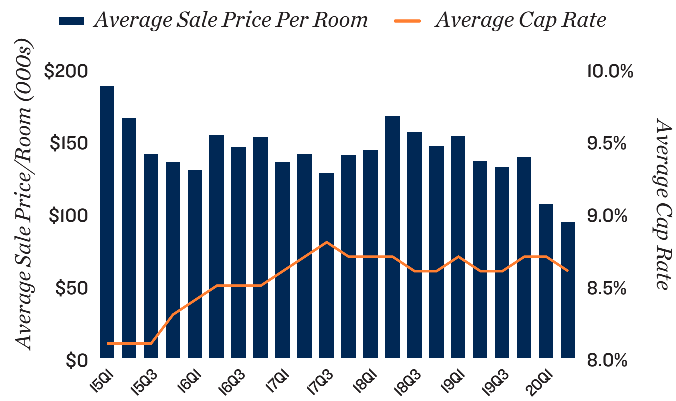
Graph compares the average occupancy rate for all of 2019 against 2020's lowest weekly average and the average for the week ended Aug. 8, 2020.
2020 trough dates are unique to each market.
Source: STR, Inc.

Hotel Investors and Lenders Contended With Ample Challenges in Second Quarter

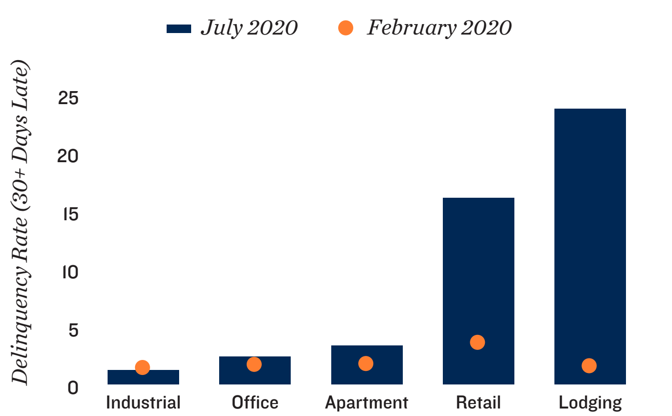
Investment activity drops as property mix shifts. Global travel disruptions and the resulting negative impact to hotel operations slowed transaction velocity in the second quarter. The total number of properties that changed hands in the three-month span was down more than 60 percent from the same period last year, with private, independent trades declining less than for portfolio or entity-level deals, which were minimal. This shift in buyer activity was partly reflected in the variety of hotels that were exchanged, which included few higher-end establishments. Greater resiliency among limited-service hotels, particularly along highways and in destinations popular with road travelers, may have also influenced investor sentiment. A greater focus on assets lower on the chain scale in non-primary locations contributed to the decline in the average per room sale price in the second quarter. Individual transaction terms remain in flux, though, as investors adapt to the changing environment. Slightly stronger sales volume in May and June over April suggests that buyers are adjusting to closing trades remotely, but limited capital liquidity is constraining deal flow.

Lenders provide leniency, but debt concerns mount. Declining hotel revenues and investment sales volume highlight capital market concerns. Amid the drop in room demand and temporary property closures, many lenders and servicers worked with borrowers to find solutions. Steps taken include payment deferrals, often for three-to-six month durations. Even with these measures, however, the number of hospitality loans in default is rising, especially among CMBS lenders. The share of CMBS hotel loans in delinquency rose from 1.6 percent in February to 24.3 percent in June before dipping to 23.8 percent in July. That is still the largest jump among property types, however. Real Capital Analytics has also reported an increase in the number of distressed hotel sales, representing about 4 percent of deal volume last quarter. This trend may actually push the hospitality sector into a new phase of price discovery, which could ultimately help sales velocity recover earlier.

Changing Sales Composition Affects Price



CMBS Delinquencies Hit Lodging Hardest



Sources: Real Capital Analytics; Trepp

National Hospitality Division
Skyler Cooper
National Director | Hospitality Division
Tel: (303) 328-2000 | skyler.cooper@marcusmillichap.com

For information on national commercial real estate trends, contact:
John Chang
Senior Vice President, National Director | Research Services Division
Tel: (602) 707-9700 | john.chang@marcusmillichap.com

Prepared and edited by
Cody Young
Research Analyst | Research Services

Price: $1,000

Sources: Marcus & Millichap Research Services; AirDNA; Bureau of Labor Statistics; STR, Inc; Real Capital Analytics; Trepp