Horwath HTL

Hotel, Tourism and Leisure

MARKET REPORT

USA

Hotel Market Trends in the Covid Era

SEPTEMBER 2020

USA economy continues to be negatively impacted by Covid-19

The principal resources used for this update on the U.S. economy include Associated Press, Bloomberg, Capital Economics, Federal Open Market Committee (FOMC), Federal Reserve Bank of St. Louis, First Trust, Goldman Sachs, Internal Revenue Service, Kiplinger, New York Times, Oxford Economics, RobertDouglas Market Pulse, Trading Economics, U.S. Bureau of Economic Analysis (BEA) and the U.S. Bureau of Labor Statistics (BLS).

Pre-Covid, the U.S. economy expanded and remained in record-setting territory for 31-½ quarters. Real GDP growth remained positive throughout 2019 due to high levels of personal consumption expenditures (PCEs) buoyed by a 50-year low unemployment rate, steady increases in home prices and double-digit gains in equity prices.

The pre-Covid state of the two main pillars of the U.S. economy— consumer spending, which remained robust throughout 2019, and business capital expenditures, which began slowing in Q2 2019—occasioned a cautious outlook for real GDP growth in 2020: It would remain positive at an annualized rate of 1.8% but decelerate from its 2019 average of 2.3%.

Since the January 31, 2020 declaration of a U.S. public health emergency, the Covid-19 pandemic has reversed the trajectory of the U.S. economy. Following 10-plus years of real GDP growth, Q1 2020 annualized GDP decreased at a rate of -5.0%.

Q2 2020 ended with the U.S. economy experiencing its worst quarterly plunge ever: annualized GDP contracted at a record-breaking rate of -32.9%. For each of the 16 consecutive weeks ended June 30, more than one million new unemployment claims were reported and the quarter ended at an 11.1% unemployment rate.

As 70% of U.S. economic activity is attributable to consumer spending, these high levels of unemployment—especially when coupled with public fear and government-mandated restrictions and closures of restaurants, bars, retail establishments and entertainment venues—account for the -34.6% Q2 collapse in personal consumption expenditures (PCEs). Unsurprisingly, Q2 travel and hotel stays all but froze.

Q2 2020 also saw sharp declines in business investment and residential housing, down -27% and -38.7%, respectively. Though Q2 benefitted from the passage of debt-heavy stimulus bills, start-and-stop reopenings created additional pressures on businesses of all sizes, especially those with anemic balance sheets, and on states, counties and municipalities beset by tight liquidity conditions, even as the Federal funds target interest rate remained at 0.25%, a full 225 basis points lower than the same period last year.

Projections for the U.S. economy during the now-protracted first wave of the Covid-19 pandemic are of increasingly questionable value due to the continuing lack of a national consensus on containment, disturbingly high increases in new cases, hospitalizations and deaths, the impending onset of the fall-winter flu season, and the ensuing reality of above-average hurricane activity. That said, during its June meeting, the FOMC projected year-over-year annualized real GDP growth rates to decline -6.55% in 2020 and increase 5.25% and 3.75% in 2021 and 2022, respectively.

The FOMC's projected contraction for 2020 is expected to be of shorter duration than those experienced during the Great Depression of the 1930s—an event triggered by the speculation-driven stock market crash of 1929 and exacerbated by increased taxes and tariffs, and the Great Recession of 2008—an event believed by most economists to have been caused by an asset bubble and excessive deregulation of the financial industry. Unlike these events, the Covid-19 pandemic is a random event, an external shock that has resulted in an on-again/off-again series of self-induced government and business freezes on economic activity, growth-stifling curtailments which are expected to end only once a vaccine is found and widely distributed.

USA hotel industry is profoundly impacted by Covid-19

The principal resources used for the update on the USA hotel industry include CoStar News, Hotel News Now (HNN), Hotel News Resource, Kalibri Labs, Lodging Magazine, RobertDouglas Market Pulse, STR and Tourism Economics.

Hotel occupancy bottomed out at 21% the second week of Q2 2020 (April 11) before embarking on a slow recovery that remains well off pre-pandemic levels.

A comparison of year-over-year key performance indicators (KPIs) for July, month one of Q3 2020, versus the same period last year shows the following[1]:

- Occupancy declined -36.1% to 47.0% (up 11.4% from 42.2% occupancy in June)
- ADR declined -24.8% to $101.76 (up 10.4% from $92.15 ADR in June), and
- RevPAR declined -52.0% to $47.84 (up 23% from $38.88 RevPAR in June).

[1] *Source: USA Hotel Performance for July 2020, an STR press release dated 19 August 2020*

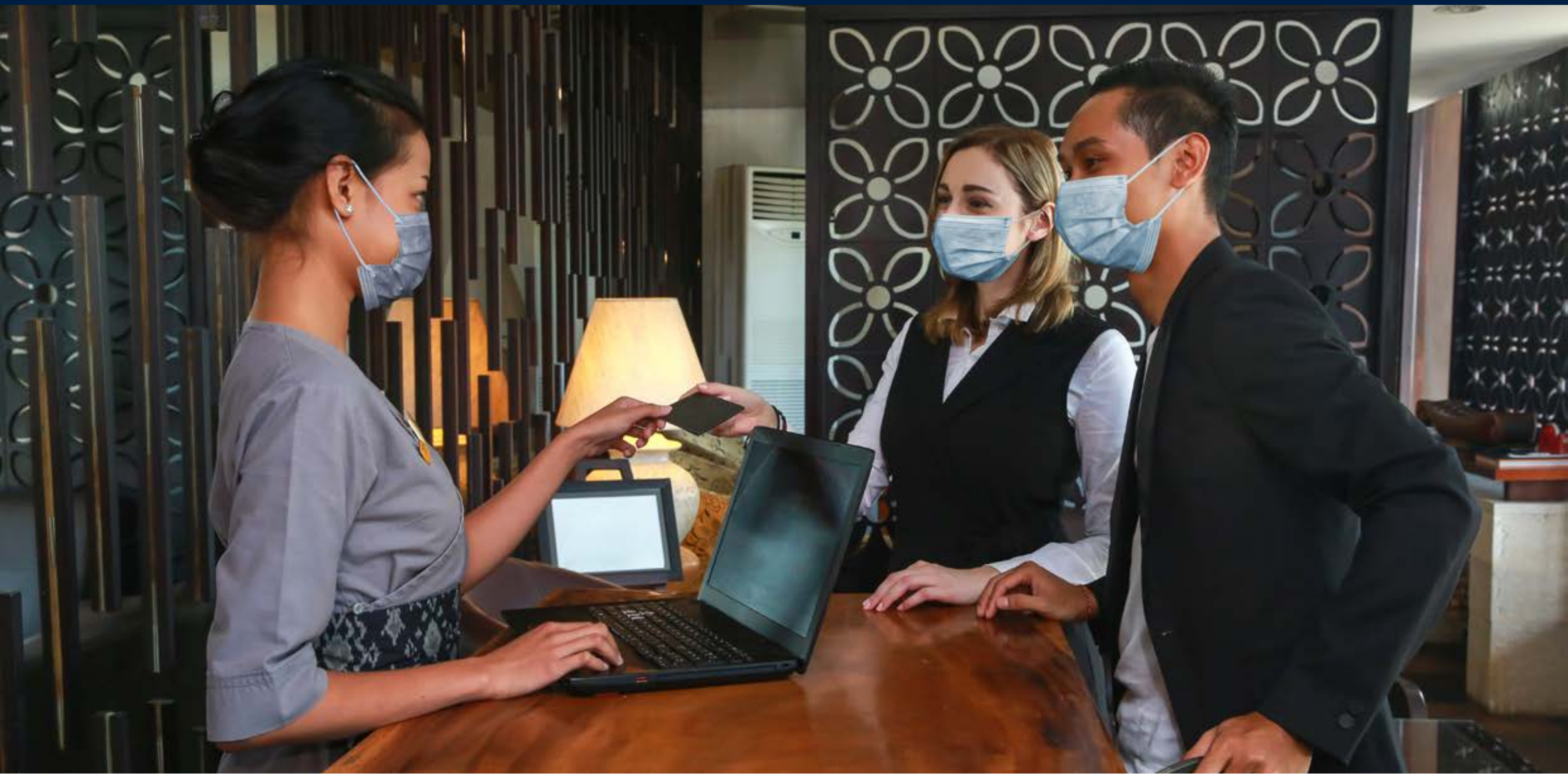
Though all three KPIs are up over June 2020—which experienced the lowest occupancy rate for any June on record—all remained down versus prior-year July.

Additionally, after reaching 50% occupancy for the first time since mid-March during the second full week of Q3 (9-15 August), USA hotel occupancy again decreased to a three-week low of 48.8% for the period ending 22 August.[2]

- Occupancy: 48.8%, down -30.3% versus comparable period in 2019[2]
- ADR: $100.08, down -22.7% versus comparable period in 2019[2]
- RevPAR: $48.81, down -46.1% versus comparable period in 2019[2]

[2] *Source: STR, in Hotel News Resource dated 27 August 2020*

Prior to this 16-22 August 2020 decline, USA room demand had increased week over week since mid-April. The physical and virtual reopening of schools effectively ended vacation travel, such that for the seven-day period ended 22 August, week-over-week room nights sold had decreased by 492,000, or -2.7%. Considering pre-vaccine increases in corporate, group and international demand are expected to remain de minimis, STR expects similar challenges to a full recovery going forward. Though there are positive signs—strong occupancy rates in the economy extended-stay segment, modest increases in air travel, and “toe-in-the-water” upticks in corporate-transient travel—indications are it will remain difficult over the near term to replace the aforementioned loss of school-impacted leisure demand.



USA Hotel Industry Observations and Forecasts

Due to such unknown variables as government regulations and containment measures related to Covid, forecasting USA hotel performance comes with several caveats.

While overall economic activity is showing signs of improvement, sustained economic recovery depends on successful containment of the Covid outbreak. Considering hotel performance correlates strongly with GDP growth, which in turn is influenced by consumer spending and unemployment, full recovery in USA hotel demand and room revenue remains unlikely until 2023 and 2024, particularly in urban markets largely reliant on corporate group and international traveler demand.

That said, economists and industry experts currently forecast:

- GDP and consumer spending will not regain Q4 2019 levels until Q4 2021.3
- Unemployment will not return below 6% until 2022.[3]
  [3] Viewed in tandem, these factors create an overhang on hotel performance and travel industry activity due to substantial shocks to income, wealth and the confidence experienced by the heads of businesses and households.
- Regional virus outbreaks are expected to continue through Q1 2021, resulting in gradual but uneven progress in restoring traveler confidence.
- Hotel and travel demand will improve only as the economy improves.
  - Small group events and essential meetings will resume at different rates across different regions, though restrictions will reduce attendance.
  - Group demand—particularly large corporate, association, trade-show and SMERF events in gateway markets—will continue to be significantly impacted into 2022-23 due to longer advance booking requirements and participant reluctance to congregate in large settings.
  - International tourism is expected to decline 60-80% on an annualized basis by year-end 2020 and take until 2024 to return to 2019 levels.
  - As hotel demand is down due to an external shock and traveler concerns about personal safety, it is unlikely that sacrificing rate will appreciably drive incremental occupancy.
  - Suburban, small-town and interstate hotels will recover a higher percentage of their respective 2019 demand more quickly than hotels in urban or resort destinations.
  - Corporate-transient demand will remain sluggish while companies adopt and employees adapt to new liability-limiting travel policies.

KPI Forecasts[4]

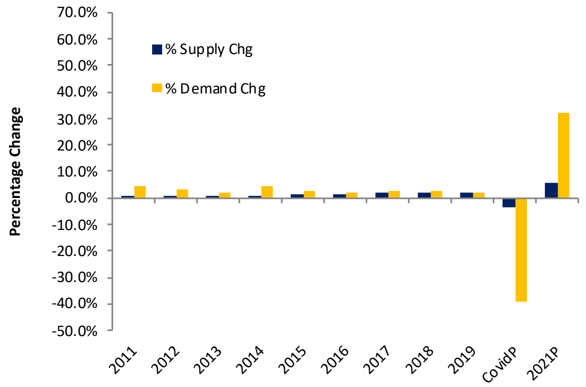
- Occupancy: 39.8% Y-E 2020 and 52.0% in 2021
- ADR: $103.71 Y-E 2020 and $109.56 in 2021
- RevPAR: $41.31 Y-E 2020 and $56.95 in 2021

[4] Source: STR and Tourism Economics, as presented at the 2020 Hotel Data Conference and released to the press by STR 13 August 2020 announcing "STR, TE slightly downgrade USA hotel forecast"

Room Supply and Demand Forecast

For the year ending 31 December 2020, room supply is projected to decrease -3.7% and demand -38.9%. By year-end 2021, supply is forecast to increase 5.8% and demand 32.2%, resulting in a state of positive disequilibrium wherein demand growth outpaces supply growth—in this case by a multiple of 5.6 times.

Lodging Industry Supply and Demand Growth

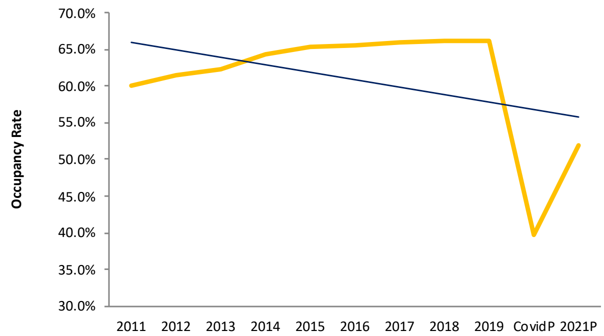


Source: STR & Tourism Economics

Occupancy Forecast

Covid-influenced occupancy rates are projected to end 2020 at 39.8%, a decrease of -39.7% from 66.1% in 2019. For 2021, occupancy rates are forecast at 52%, a year-over-year increase of 30.5%.

National Occupancy Rates

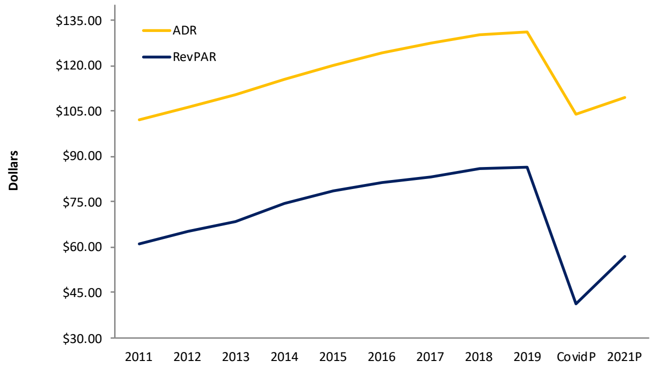


Source: STR & Tourism Economics

ADR and RevPAR Forecast

Covid-influenced ADRs are projected to decrease in 2020 by -20.9% to $103.71 from $131.13 in 2019. RevPAR is forecast to decrease -52.3% in 2020 to $41.31 from $86.64 in 2019. For 2021, year-over-year ADR growth is forecast to increase 5.6% to $109.56 and occupancy-driven RevPAR growth is forecast to increase 37.9% to $56.95.

National ADR and RevPAR



Source: STR & Tourism Economics

Authors

Mike Cummings MAI ISHC
Managing Director
Horwath HTL Norfolk
mcummings@horwathhtl.com

Michael Cummings, MAI ISHC, is a Managing Director in the USA with offices in Norfolk, New York, Orlando, Miami, Denver and Mexico. He brings over 20 years of professional consulting experience to Horwath HTL.

He holds a Bachelor of Science in Business Administration, with concentrations in Finance and Real Estate from Old Dominion University, is a Designated Member of the Appraisal Institute (MAI), a member of the International Society of Hospitality Consultants (ISHC), and actively holds appraisal licenses in over twenty states.

Richard Keegan
Senior Associate
Horwath HTL Orlando
jrkeegan@horwathhtl.com

Richard Keegan is a Certified General Appraiser and Senior Associate in the USA, based in Orlando. He brings over 35 years of hotel management, development, consulting and appraisal experience to Horwath HTL. Richard holds a Bachelor of Arts Degree and Master of Business Administration (MBA) Degree from the University of Wisconsin. He is a Practicing Affiliate of the Appraisal Institute.

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