H2 2022 Hotel Outlook: Balancing Risk Reward

Presented by
Hotels Research

August 3, 2022

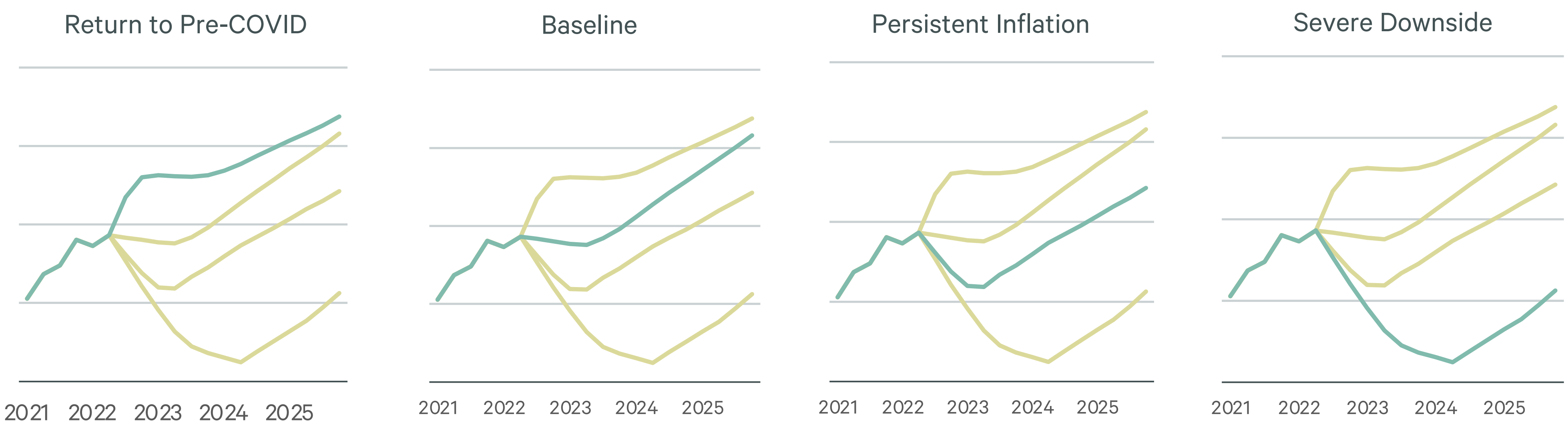
Agenda

Macroeconomic Outlook

Matt Mowell
Sr. Economist
matt.mowell@cbre.com

Scenarios are powerful tools during times of change

U.S. GDP Level by Macroeconomic Scenario

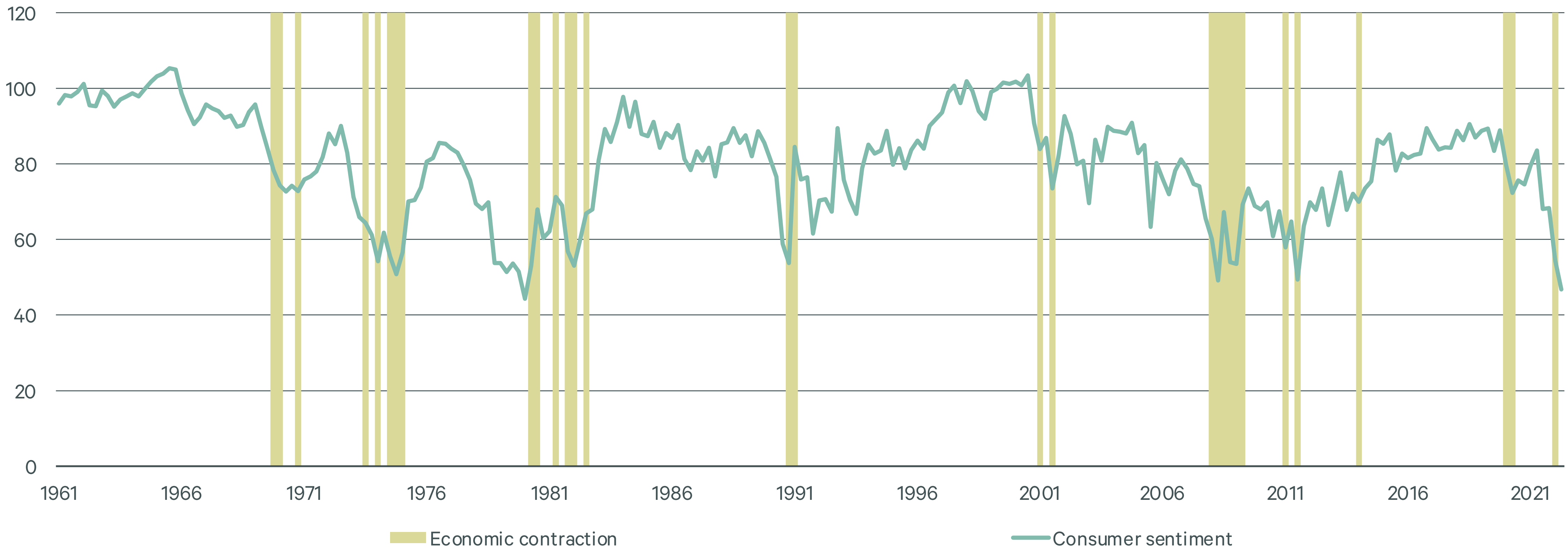


Scenario	Return to Pre-COVID	Baseline	Persistent Inflation	Severe Downside
Likelihood	LOW	STRONG	MODERATE (and increasing)	VERY LOW

CBRE Econometric Advisors

Consumer sentiment is now a signal – not just noise

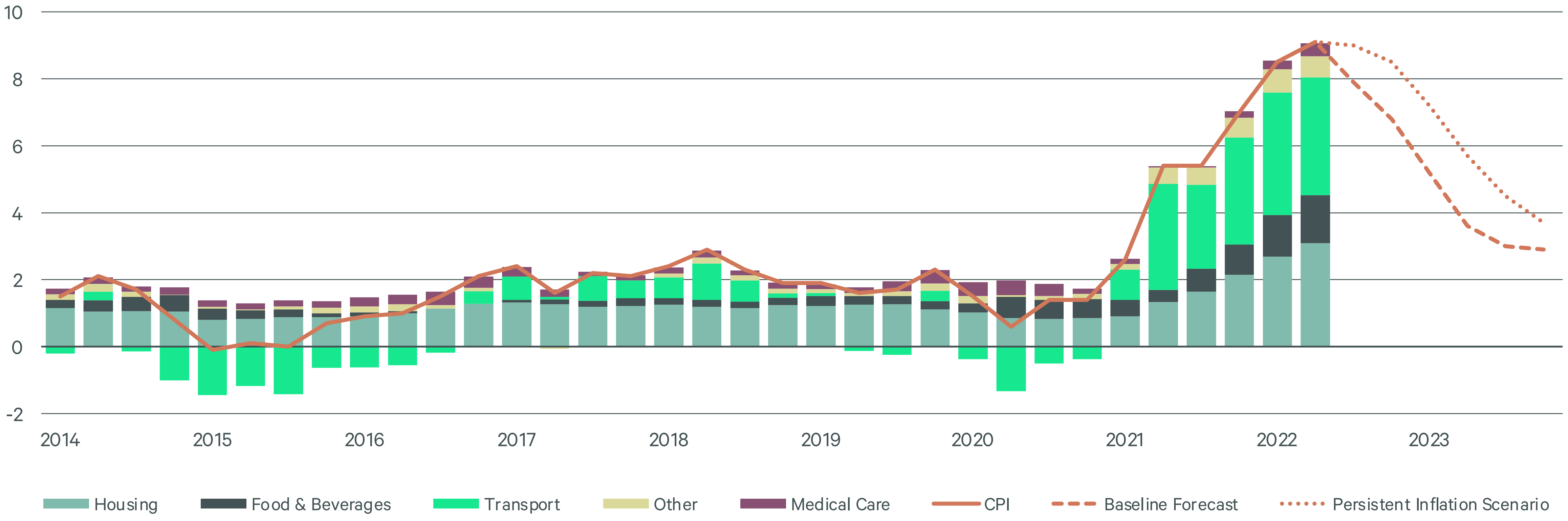
Consumer Expectations Index and Decline in GDP



University of Michigan, U.S. Bureau of Economic Analysis

Has inflation peaked?

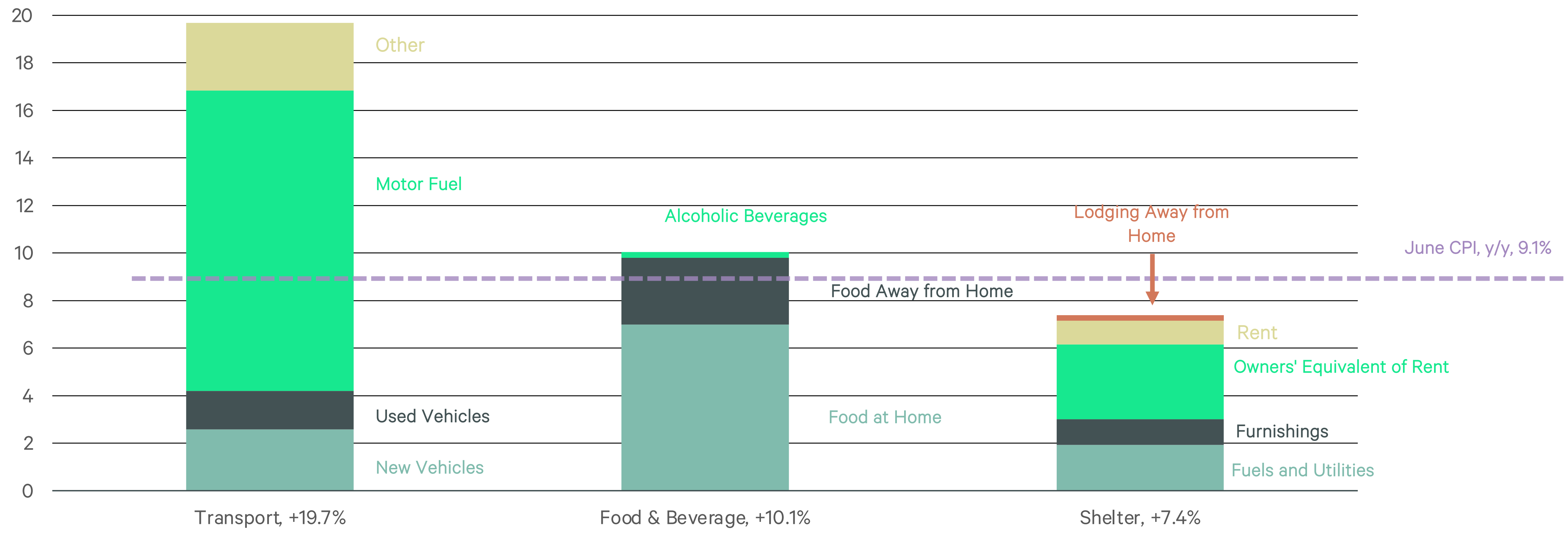
CPI, Y-o-Y Change (%) and Contribution from Key Components



U.S. Bureau of Labor Statistics

Key drivers of CPI are unlikely to accelerate

Contribution to Y-o-Y Price Change by CPI Category, Percentage Points



U.S. Bureau of Labor Statistics

Some evidence that the pace of wage growth is slowing

Average Hourly Earnings, Y-o-Y (%)

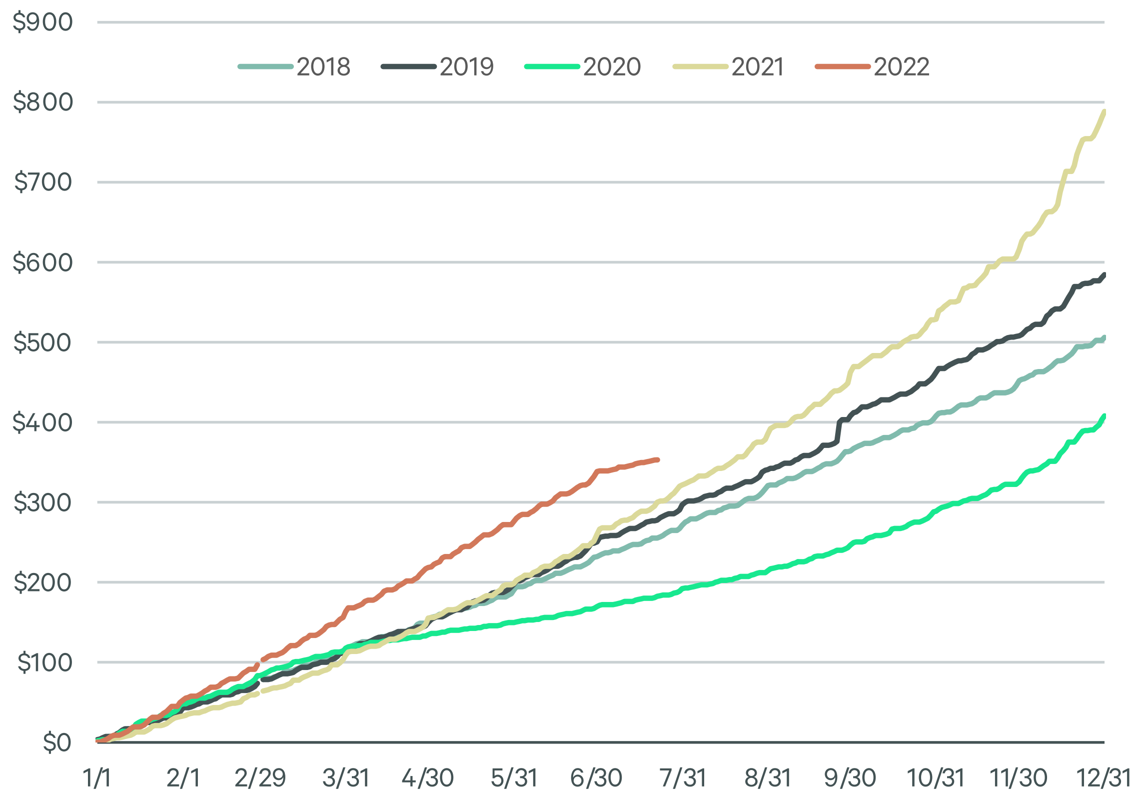
U.S. Bureau of Labor Statistics

Capital Markets & Investment Trends

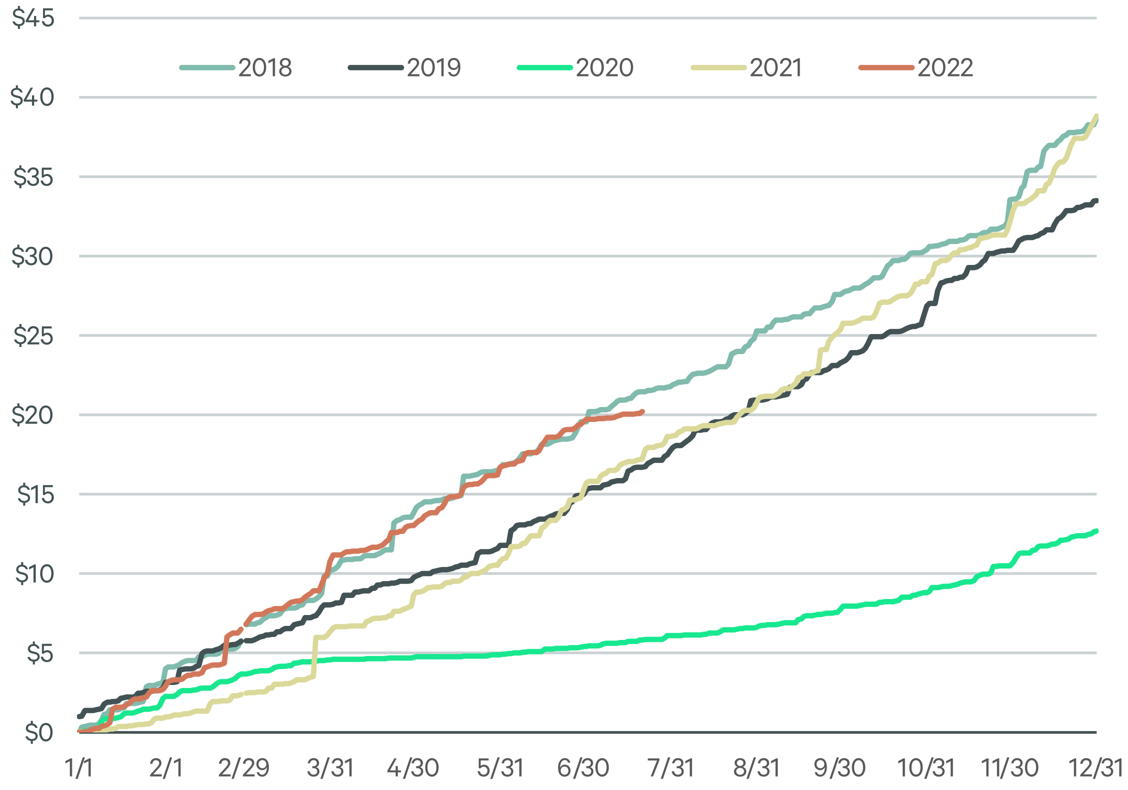
Dennis Schoenmaker, Ph.D.
Principal Economist
dennis.schoenmaker@cbre.com

Uncertainty pauses investment market despite strong H1

Cumulative CRE Investment Flows by Day of Year ($ Billions)



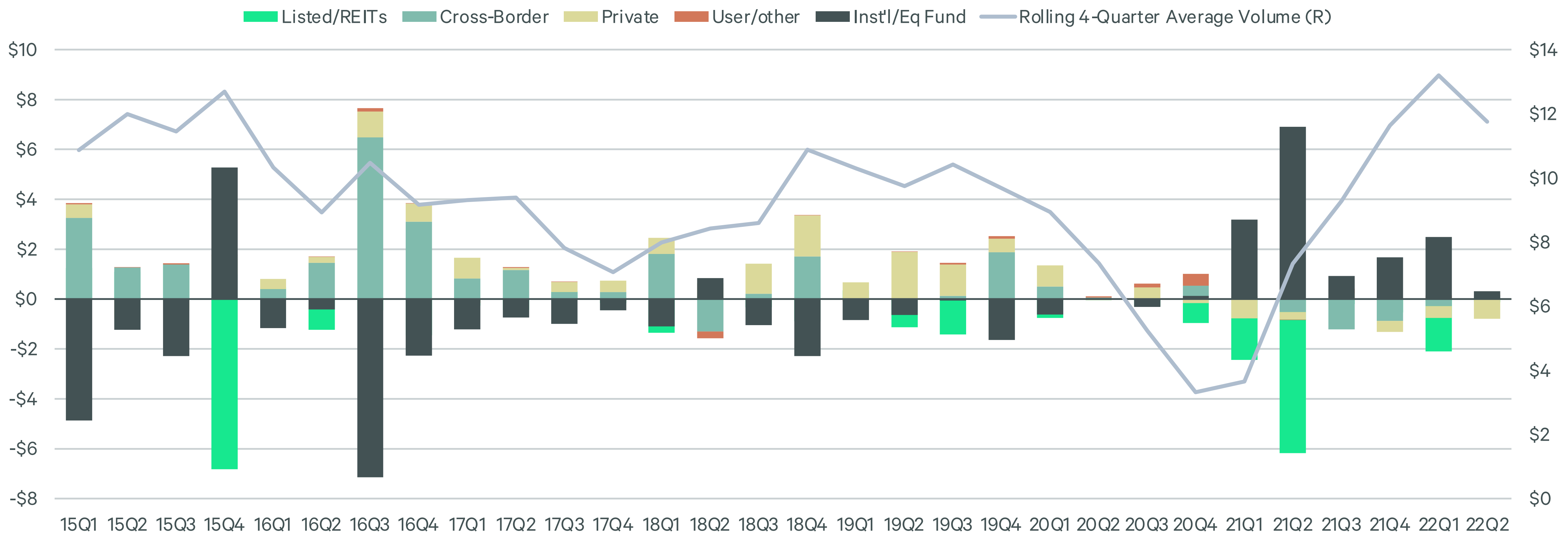
Cumulative Hotel Investment Flows by Day of Year ($ Billions)



Real Capital Analytics, CBRE Econometric Advisors

Institutional investors and equity funds net buyers

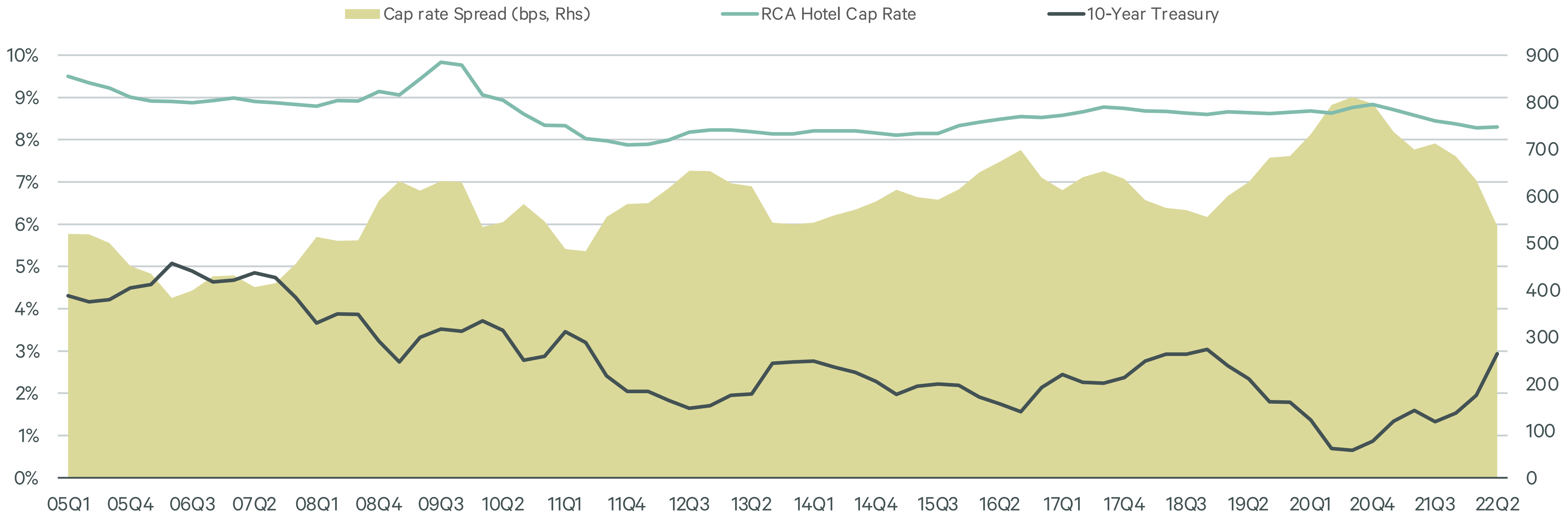
Net Acquisitions by Investor Type ($ Billions)



Real Capital Analytics

Where would hotel professionals like to invest during the next year?

Hotel spread still healthy despite increase in cost of capital



Federal Reserve, Real Capital Analytics, CBRE Research.

Hotel Top-line Performance

Michael Nhu
Global Economist
michael.nhu@cbre.com

CBRE Hotel Horizons® U.S. Lodging Prelim Forecast

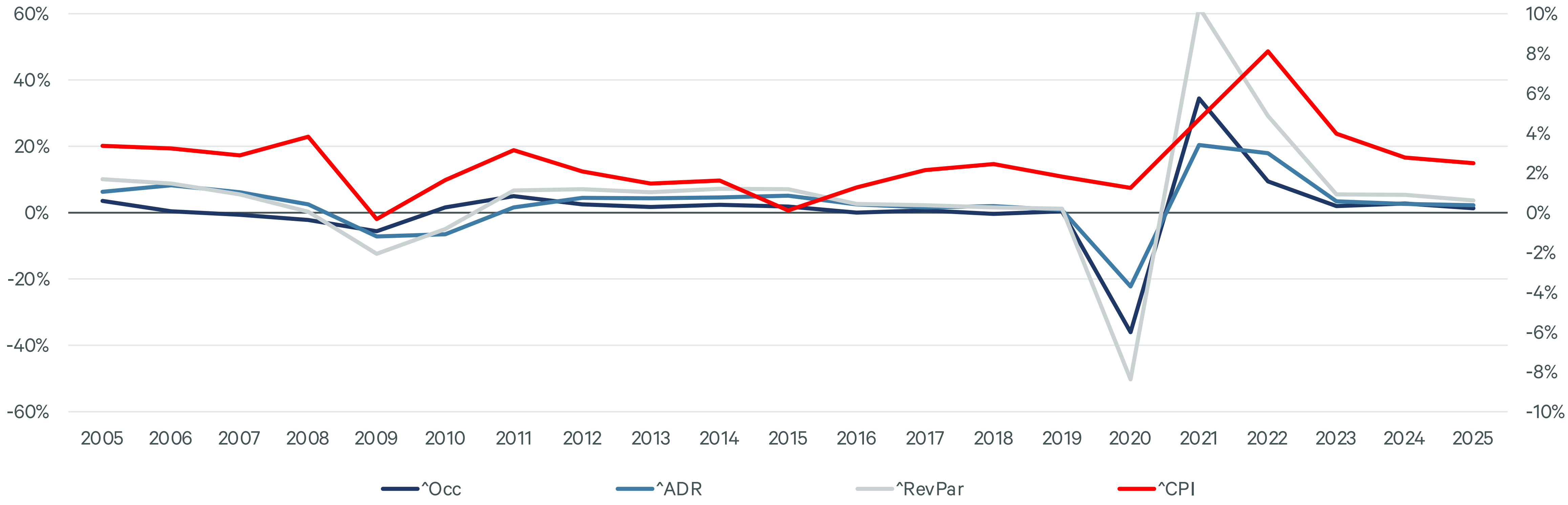
Year	ΔGDP	ΔCPI	Occ	ΔOcc	ADR	ΔADR	RevPAR	ΔRevPAR	RevPAR % of 2019
2019	*2.3%*	*1.8%*	*66.8%*	*0.4%*	*$129.7*	*0.8%*	*$86.6*	*1.1%*	*100%*
2020	-3.4%	1.2%	42.7%	-36.0%	$100.9	-22.2%	$43.1	-50.2%	50%
2021	5.7%	4.7%	57.4%	34.5%	$121.5	20.4%	$69.8	61.9%	81%
2022	1.9%	8.1%	62.9%	9.5%	$143.2	17.9%	$90.1	29.1%	104%
2023	0.1%	4.0%	64.2%	2.0%	$148.2	3.5%	$95.1	5.6%	110%
2024	2.5%	2.8%	65.9%	2.8%	$152.1	2.6%	$100.3	5.4%	116%
2025	2.9%	2.5%	66.8%	1.3%	$155.5	2.3%	$103.9	3.6%	120%

Figures in red mark full recovery to 2019 levels.

CBRE Hotels Research, CBRE EA, Kalibri Labs

Recovery in demand slows but inflation helps top line recover quicker

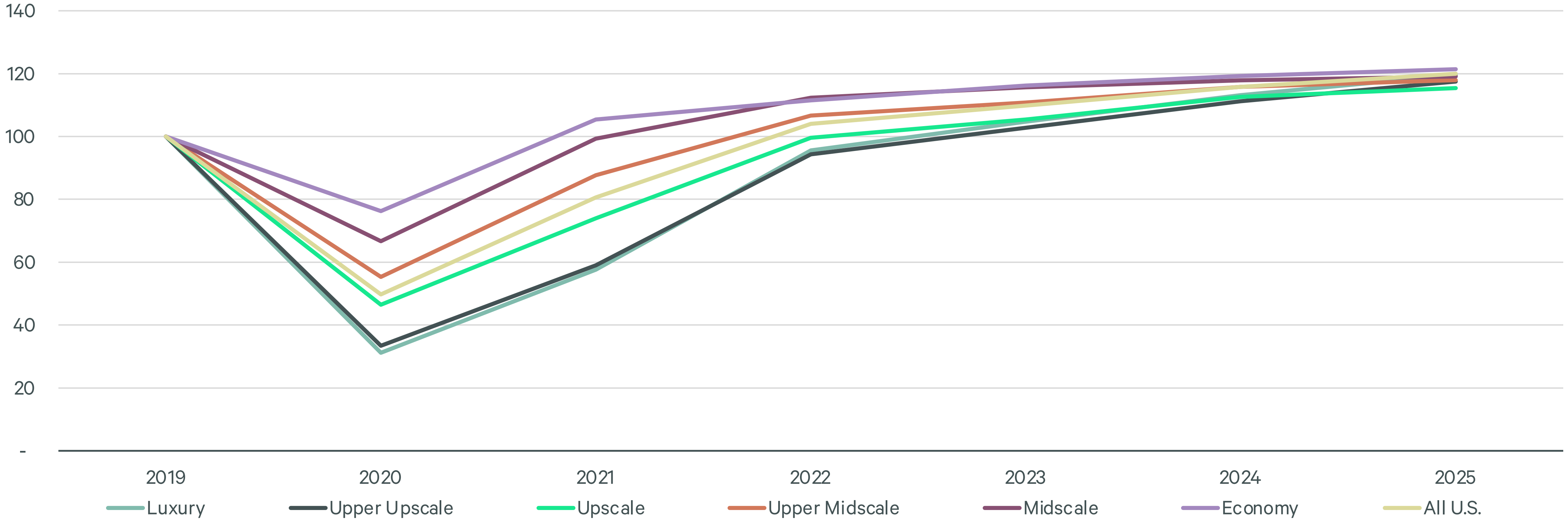
% Y-o-Y Changes in Hotels Fundamentals vs CPI



CBRE Hotels Research, Kalibri Labs, CBRE EA Q2 2022

Speed of recovery will accelerate further across chain scales in 2022, led by Economy and Midscale

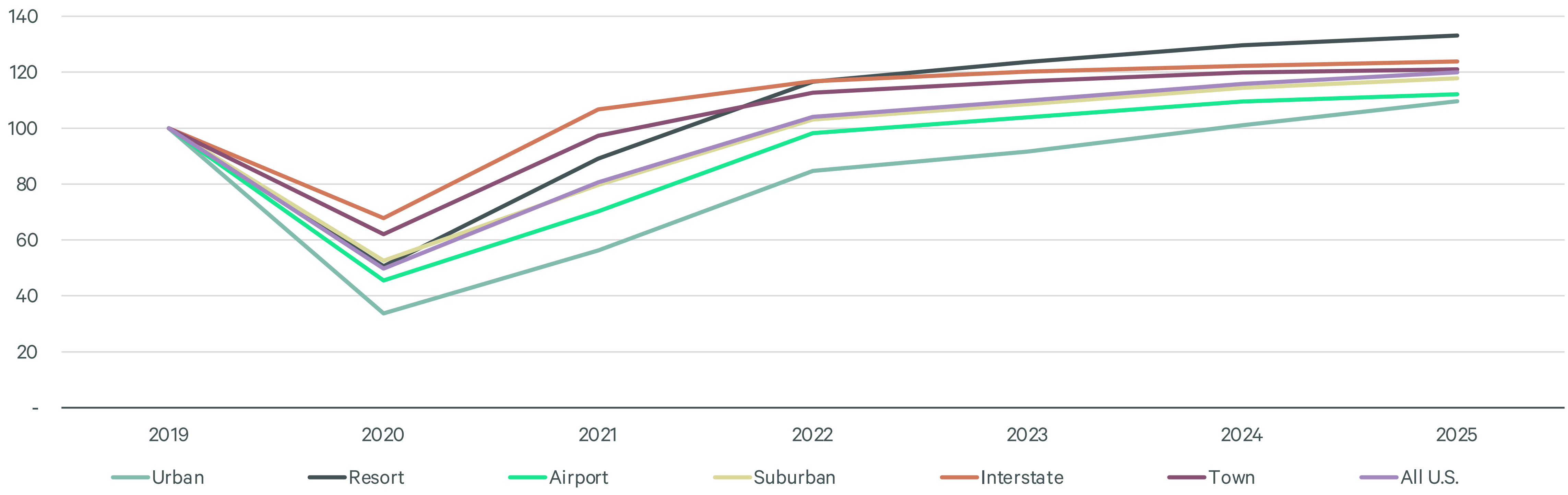
RevPAR Indexed to 2019 Levels by Chain Scale



CBRE Hotels Research, Kalibri Labs

Resort & drive-to hotels leading the recovery

RevPAR Indexed to 2019 Levels by Locations



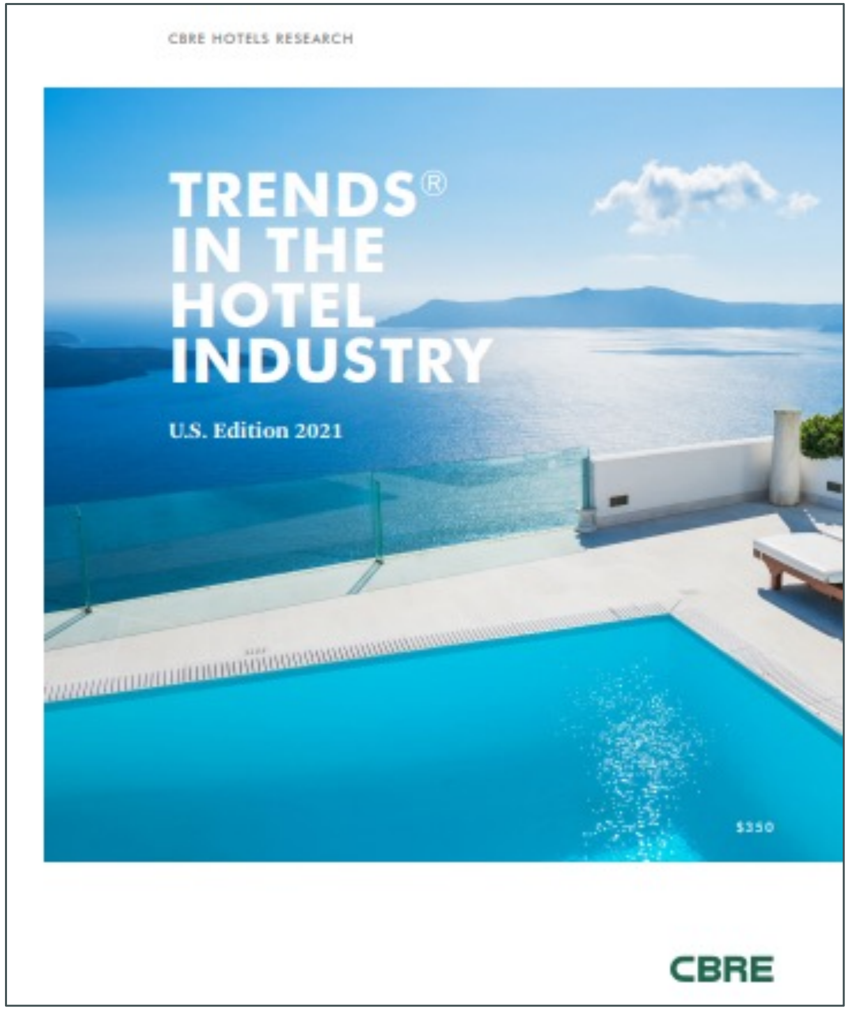
CBRE Hotels Research, Kalibri Labs

Hotel Profits

Robert Mandelbaum
Research Director
robert.mandelbaum@cbre.com

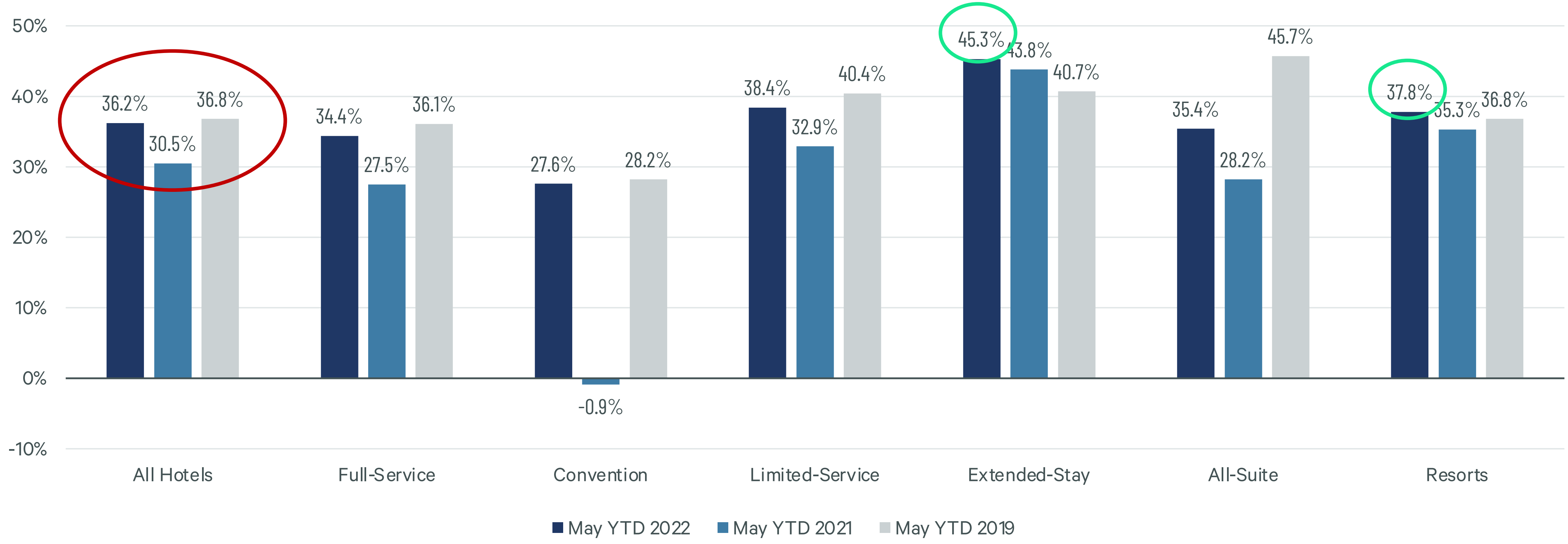
Trends® in the Hotel Industry

– Annual and monthly voluntary survey of thousands of U.S. hotel financial statements
– Data from 1937 – Current



U.S. Hotel Operating Performance – GOP Margins

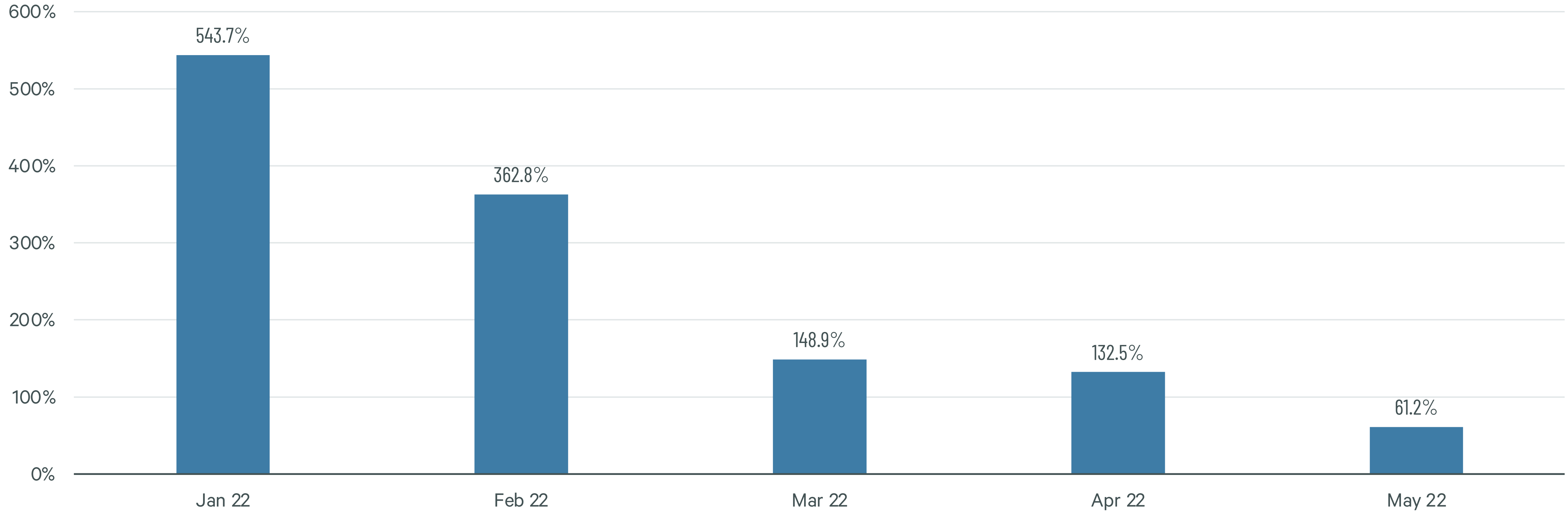
Percent of Total Operating Revenue
YTD May 2022, YTD May 2021, and YTD May 2019



CBRE Hotels Research

U.S. Hotel Operating Performance – Change in GOP

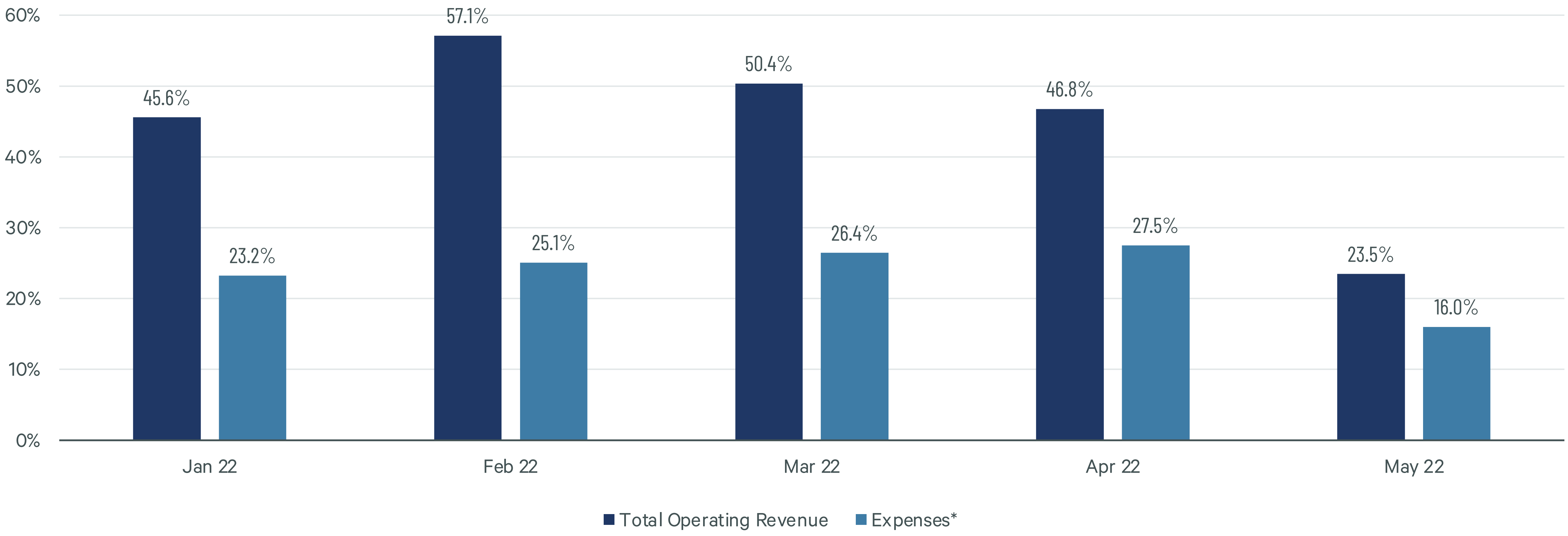
Gross Operating Profit – Dollars per Available Room
Monthly Year-over-Year Change from Same Month of Prior Year



CBRE Hotels Research

U.S. Hotel Operating Performance – Revenues and Expenses*

Total Operating Revenue and Expenses* – Dollars per Occupied Room
Monthly Year-over-Year Change from Same Month of Prior Year

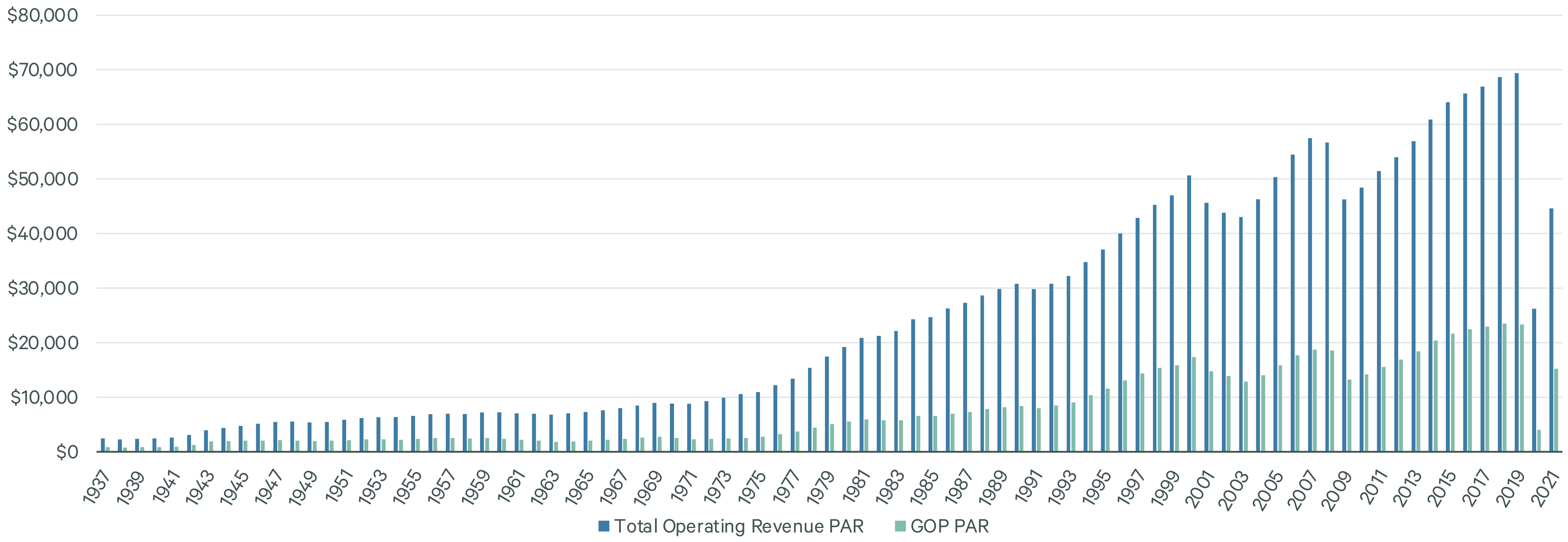


Note: * Before deductions for management fees and non-operating income and expenses.

CBRE Hotels Research

U.S. Lodging Industry - Recession Revenue and Profit Recovery

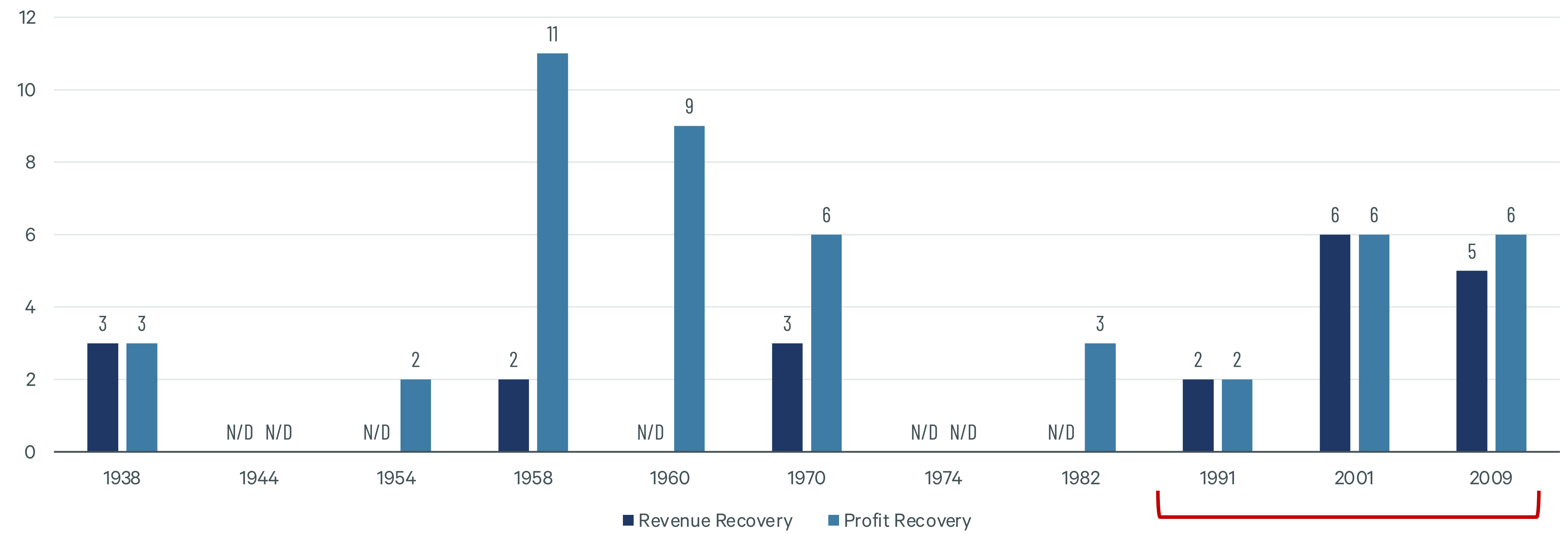
Total Operating Revenue and GOP – Dollars per Available Room



CBRE Hotels Research

U.S. Lodging Industry – Recession Revenue and Profit Recovery

Years to Recover – Nominal Dollars

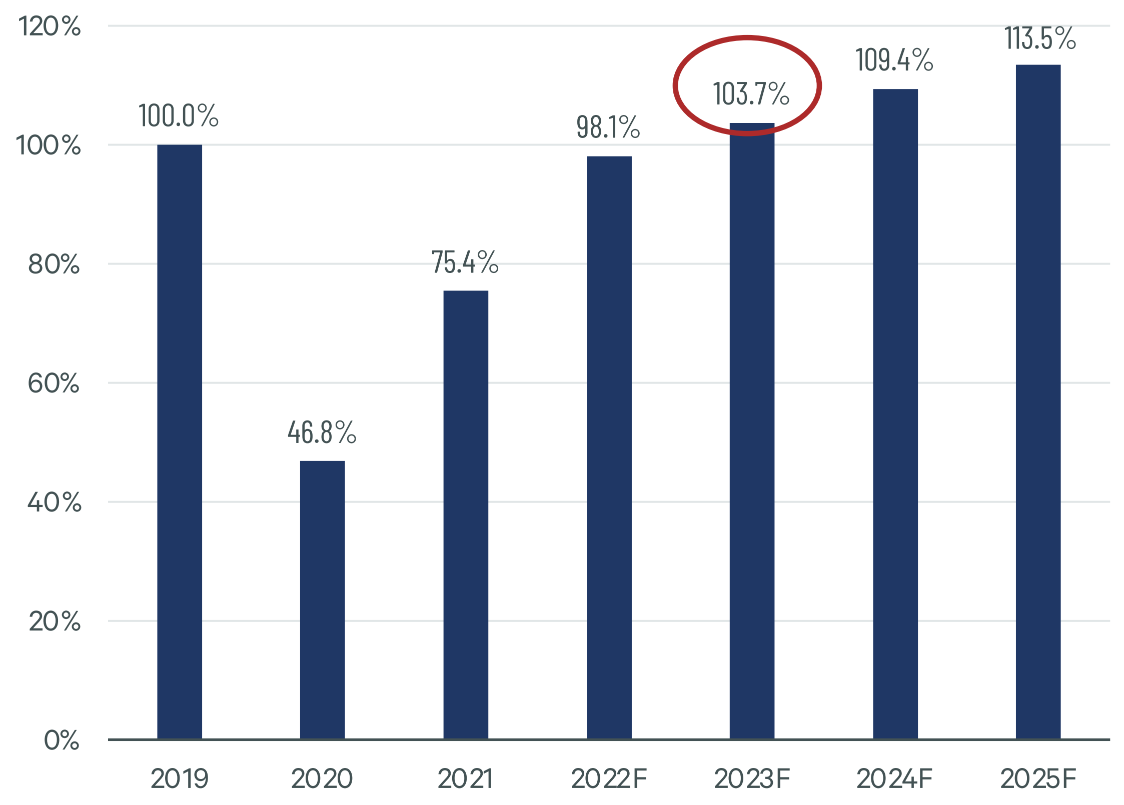


CBRE Hotels Research

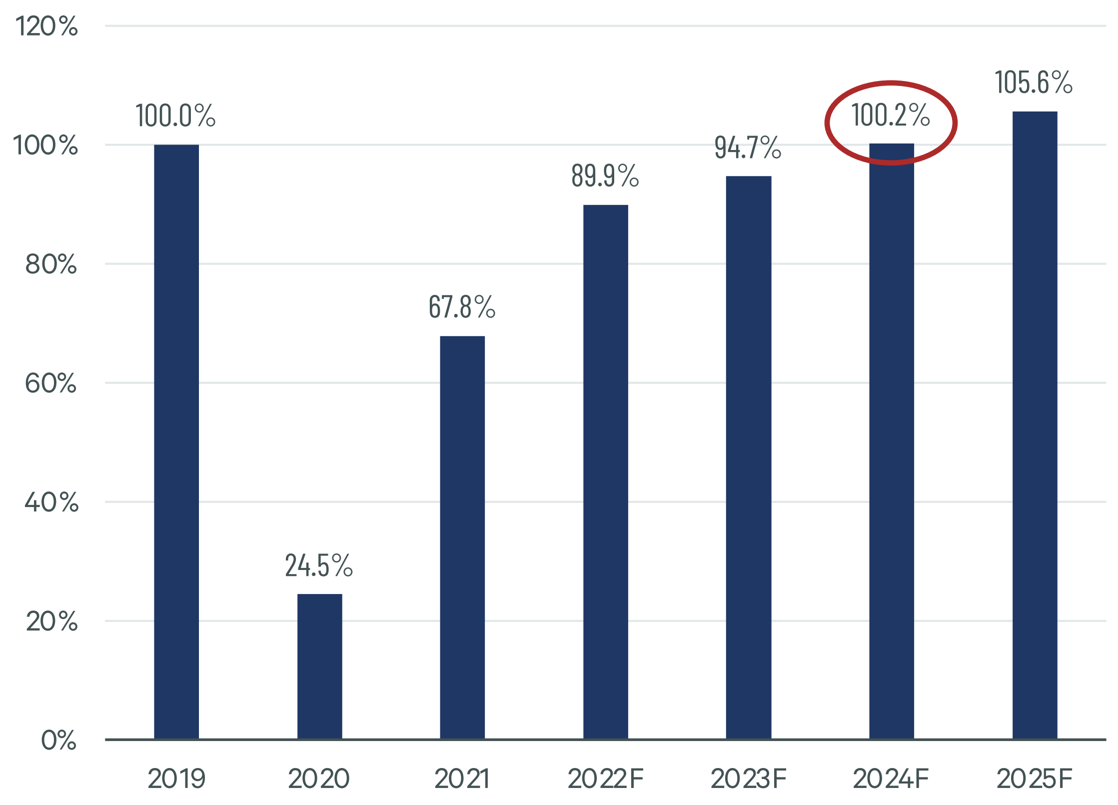
N/D – No decline

Revenue and Profit Recovery

Total Operating Revenue – Percent of 2019



Gross Operating Profit – Percent of 2019

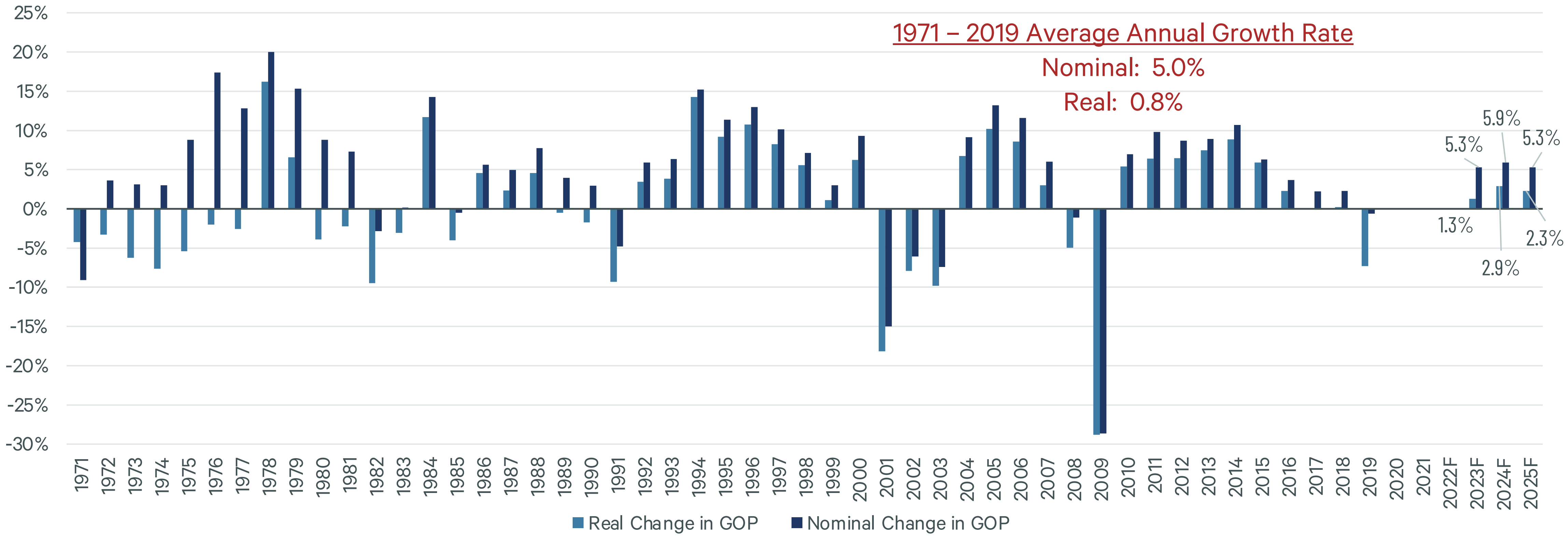


CBRE Hotels Research, Preliminary forecast

CBRE

U.S. Hotel Operating Performance – Change in GOP

Annual Nominal and Real Change in GOP per Available Room



CBRE Hotels Research (preliminary forecast) and BLS

Q&A

Answering the top 10 submitted questions.

Rachael Rothman

Head of Hotels Research

Rachael.Rothman@cbre.com

Dennis Schoenmaker, Ph.D.

Principal Economist

Dennis.Schoenmaker@cbre.com

Matt Mowell

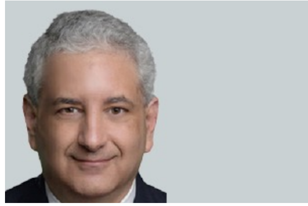
Sr. Economist

Matt.Mowell@cbre.com

John Avanzino

Associate Vice President

John.Avanzino@cbre.com



Robert Mandelbaum

Research Director

Robert.Mandelbaum@cbre.com

Michael Nhu

Global Hotel Economist

Michael.Nhu@cbre.com

Question 1

How much more will the Fed raise rates?

What are the economic risks and potential upside surprises?

Answer 1

Answered by Matt Mowell

The path that the Fed will take will absolutely be dependent on the path we see for inflation, so if inflation does indeed keep this summer, then we can expect more rate hikes through early 2023. There probably will not be a series of more 75-basis-point rate hikes, but in a scenario of inflation peaking this summer, we would see the Fed funds rate top out somewhere between 3.5 to 3.75 by 2023. If inflation is much harder to control (it stays at 9% or even accelerates a bit over the next several months) I think by the second quarter of 2023 we would see a Fed funds rate of 4% or even north of that.

In terms of potential upside risk, if the situation in Ukraine and Europe's energy challenges don't tip us into a recession, I would call that a serious upside risk, because right now there are a lot more downside issues top of mind. Focus on our baseline and downside scenarios in the coming quarters.

Question 2

What are the major economic drivers of hotel fundamentals and what do they mean for the mix of business going forward?

How will record ADRs impact the mix shift?

Answer 2

Answered by [Michael Nhu]

The growth in GDP, employment and inflation in the demand source markets are considered the key economic drivers for hotel fundamentals. Given the economic headwinds and recent signs of business travel recovery, we expect the demand shares of Brand.com & OTAs, which has been strongly driven by pent-up leisure demand, to gradually moderate.

However, from a revenue perspective, record ADRs across the channels, especially in Brand.com & OTAs, will likely prolong mean reversion.

Question 3

What is your outlook for cap rates across property types and for foreign capital flows?

Answer 3

Answered by Dennis Schoenmaker, Ph.D.

It depends on the trajectory of inflation, cap rates, yields and interest rate hikes. Earlier this year we published our cap rate series and at that time we forecasted decompression of cap rates by approximately 25 basis points on average, across the different property types, including hotels, until the end of 2023. Since then, we have done our next version of this report which will come out in the next few weeks. I expect to be in the ballpark of 50 to 75 basis points decompression, depending on the sector, property type, location, and the fundamentals. Hotels could be favorable in this environment.

Since COVID, the percentage of foreign capital from total capital is diminishing quite a bit. It is now approximately around 13% and before 2020 it was around 20%. This is partially because of the currency and interest rate differential. With more interest rate hikes, we could expect a larger interest rate differential, and that has repercussions for hedging costs. If hedging cost increases that will be negative carry-on return. I expect that to remain for the unforeseeable future, but at one point there might be a mean reversion, meaning that a lot of investors might look again into U.S. real estate, but the expensive dollar is probably the difficulty for many investors right now.

Question 4

How are the broader debt market conditions impacting hotel capital markets?

Is the current dislocation viewed as a short-term or long-term trend?

How will transactions be impacted going forward?

Answer 4

Answered by John Avanzino

The broader capital markets are currently in a peculiar period of dislocation. The hotel lending universe is experiencing the same market lag that economists point to following a series of recent Fed rate hikes. We have witnessed one-month term SOFR (Secured Overnight Financing Rate) steadily increase from 5 basis points in March to 228 basis points this week.

Typically, you would expect to see spread compression account for benchmark expansion but there are several fundamental drivers delaying this inverse relationship. One of the key drivers is the meaningful contraction from warehouse lenders, thus driving up pricing and constraining LTV/LTC levels for lenders levering their position.

This cost ultimately gets passed through to the borrower. We believe that heading into fall and winter 2022, lenders that have been on the sidelines due to human capital constraints, required payoffs on existing loans, or simply in price discovery mode, will be more likely to deploy competitive capital.

Question 5

Which chain scales or asset types are most defensive when it comes to inflation and the economy and why?

Answer 5

Answered by Dennis Schoenmaker, Ph.D.

I think the evidence is quite mixed, especially when I look at the empirical evidence. However, Econometric Advisors together with Hotels Research published a publication earlier this year in which we found the luxury chain scale is most resilient to inflation, i.e. the best inflation hedge.

The reason why that is all comes back to Matt Mowell's introduction today about discretionary and non-discretionary spending. People in the luxury segment have more spending available and are not that squeezed in their disposable income. If I look at other property types, maybe multifamily, but that is just due to the lease structure.

Question 6

When and how do labor shortages ultimately resolve, especially in ‘High Cost of Living’ areas?

Answer 6

Answered by Matt Mowell

In many ways the labor shortage situation is not going to resolve because we have already hit peak labor force growth for the country overall, but the workforce is aging like most Western European and a lot of East Asian economies. I think we need to realize it's important to pace the labor force and that growth will not be what it was in the 1980s and 1990s. What is interesting, though, is a lot of young people are already back to near full labor force participation, but the 55+ crowd is not.

There will be a lot of differentiation across the country. A lot of Sun Belt cities, due to domestic migration, are going to see much stronger labor force growth. What's a potential solution to all of this? I'm not trying to drive a political narrative, it's just mathematics. More immigration will help these high-cost building areas. Domestic residents have always left the San Francisco Bay Area, LA, New York, that's not new. These areas are struggling now because they don't have the international migration to make up for those domestic people leaving.

Question 7

Given the tight labor market and double-digit wage increases in hospitality, how are operators managing margins?
How sustainable are these efficiency efforts, and what is the impact on guest satisfaction?

Answer 7

Answered by Robert Mandelbaum

The increase in wage rates has been offset by reductions in the hours worked. This has kept labor costs as a percent of total revenue within the long-run range of 30% to 35%.

The reduction in hours is the result of the struggle to attract and retain employees. Available job openings at hotels are 50% above what they were pre-COVID. The labor shortage has forced hotels to reduce services and amenities.

Unfortunately, the reduced levels of services and amenities has resulted in lower guest satisfaction. This is a challenge when hoteliers are attempting to continue the strong growth in ADR we have observed in 2021 and 2022.

For the near term, rising labor costs will be a contributing factor to the profit margin erosion we discussed. However, GOP will still increase at a pace above the long-run average, and above inflation.

Question 8

Given what you are hearing regarding hotel revenues and profits, aside from CMBS, which lender profile is most likely to emerge for non-recourse financing for existing assets?

Answer 8

Answered by John Avanzino

Since Q1 2021, CBRE Hotels Debt & Structured Finance closed 59 transactions with 47 different lenders (please reference the lending dashboard). The wide range of hotel lender profiles underscores the inefficiencies in the lending market, and the need to run a comprehensive marketing campaign.

Please see the key considerations for the various lender profiles.

CMBS

- Provides the most efficiently priced capital
- Drives aggressive loan economics on securitized executions
- Significant changes in the broader debt capital markets has led to pricing and execution risk
- Limited flexibility in structure post- closing relative to a balance sheet execution

Money Center Bank

- Provides the second most efficient source of capital
- Favorable flexibility around structure, including the ability to upsize the loan facility post-closing
- Some lenders may require amortization during the life of the loan, de-levering Sponsor's position
- Low repricing risk

Life Insurance Company

- Very efficiently priced floating rate source of capital
- Significant flexibility around loan structure
- May require amortization during the life of the loan, de-levering Sponsor's position
- Limited group of LifeCos that can provide large hotel loan executions
- Low repricing risk

Debt Fund

- Higher leverage loan executions, at a slightly higher cost of capital than other debt providers
- Most flexibility around loan structure
- No amortization required, interest-only over the full term
- Limited number of debt funds available for large hotel loan executions
- Moderate repricing risk, partially levered funds

Question 9

Given high inflation and declines in both the national savings rate and disposable income, how long can this dramatic growth in leisure travel continue?

If leisure falters, how much of a slowdown or shortfall can we expect?

Answer 9

Answered by Michael Nhu

We are not expecting the dramatic growth in leisure travel to continue given economic headwinds. Our call for slowing occupancy growth in H2 2022 and 2023 is mainly driven by an initial shift to business travel dependence in the fall, and slower leisure travel growth in 2023.

However, given the continued recovery in inbound international arrivals, improvements in group travel, and modest pick-up in business travel for offsites, this might not necessarily mean a decline is inevitable, but a slowdown certainly is.

Question 10

What are your thoughts on new construction and construction lending?

Answer 10

Answered by John Avanzino

The current market dynamics of increasing construction costs and decreasing availability of construction financing has limited new hotel development. The cost of raw materials, specifically steel and iron (77% above the long-run average) and lumber and wood (52% above the long-run average) have delayed new supply growth across the United States. Construction wage growth of 6.3% from May 2021 to May 2022 was 2.3% lower than the CPI of 8.6%, possibly resulting in workforce migration out of construction, thus creating labor shortages.

Recent figures show that construction jobs have rebounded to pre-pandemic levels but remain below pre-GFC levels, indicating room for growth. Historical trends show that lodging supply significantly decreases after downtowns, while demand historically outpaces prior peak, resulting in greater pricing power for durable existing assets. Despite increased cost of materials and labor shortages, we are cautiously optimistic that for best-in-class sponsors with proven track records, lower leverage levels, and locations with strong fundamentals, hotel construction financing remains available.

Thank you

CBRE

Subscribe Now

Monthly Hospitality Market Update Newsletter

Receive our exclusive U.S. Hotels State of Union report and timely industry insights directly to your inbox.
Sign up for our monthly newsletter today.

FOR MORE INFORMATION:

Rachael Rothman, CFA

Head of Hotels Research
Rachael.Rothman@cbre.com

Dennis Schoenmaker, Ph.D.

Principal Economist
Dennis.Schoenmaker@cbre.com

Robert Mandelbaum

Research Director
Robert.Mandelbaum@cbre.com

Matt Mowell

Sr. Economist
Matt.Mowell@cbre.com

Michael Nhu

Global Economist
Michael.Nhu@cbre.com

John Avanzino

Associate Vice President
John.Avanzino@cbre.com

Celeste Santangelo

Sr. Account Executive
Celeste.Santangelo@cbre.com