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CANADIAN LODGING INDUSTRY OVERVIEW

HOSPITALITY & GAMING

A Cushman & Wakefield Valuation & Advisory Publication



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Has the Expansion of the Canadian Hospitality Industry Stalled or Are We Entering a New Phase in the Cycle?

The industry continues to perform above historic levels but the pace of growth in 2019 has shown a considerable slowdown with seven of the ten largest markets reporting declines in RevPAR. After an impressive 5.3% annual increase in national RevPAR in 2019, results through November 2019 show a 0.2% decline; the first decline in the past decade.

Amongst the top ten markets in Canada, only Montreal, Quebec City, and Vancouver had positive RevPAR growth in 2019. Across much of the country, economic activity has slowed, and room supply has increased, lowering occupancy. The growth of alternative accommodation and new hotel room supply is now being felt in many markets, compounded by slower demand growth.

Results in Alberta and Newfoundland were particularly disappointing in 2019. Alberta saw a drop in RevPAR after posting solid growth in 2018; the decline was largely a result of new supply. Newfoundland saw the largest decline of any province with RevPAR dropping by 4.2%. That market continues to struggle with new supply additions from 2018 and weak economic conditions. Saskatchewan also saw a slower 2019 after posting solid RevPAR growth of 5.6% in 2018.

With these prevailing market conditions, going into 2020, many operators are satisfied to project inflationary top line revenue growth for their stabilized assets.



Despite the slowdown in earnings growth, the demand for hotel investments continues to be strong and asset values continue to rise to all-time highs. Low interest rates, debt availability, and comparatively high hotel yields are compelling reasons to invest in the sector. We continue to see buyer interest from a new generation of hotel investors, and others who have migrated from other successful business ventures. The challenge for new entrants, or those looking to expand their ownership interest, continues to be a lack of assets to acquire. The market has seen very few larger offerings in 2019—the majority of activity involves smaller assets in secondary markets.

As we noted in our 2018 Lodging Industry Overview, new supply will be an issue in the next few years with a record number of hotel projects in the development pipeline. While an issue in major suburban markets such as around the GTA, supply is also impacting many secondary and tertiary markets where, in some cases, new hotels have not been built in more than 30 years.

Supply increases in several markets will have a major impact on the overall performance of the area hotels in the upcoming two or three years.

The following chart illustrates key operating performance indicators of the Canadian Lodging Industry from 2010 through Year-to-Date November 2019.

Canadian Historical Operating Statistics: 2010-2018 and Year-to-Date November 2019								
Year	Supply % Change	Demand % Change	Occupancy	% Change	ADR	% Change	RevPAR	% Change
2010			60.8%		\$128.71		\$78.31	
2011	1.2%	2.9%	61.8%	1.6%	\$127.85	(0.7)%	\$78.98	0.9%
2012	0.5%	1.6%	62.3%	0.8%	\$130.12	1.8%	\$81.08	2.7%
2013	0.5%	2.1%	63.3%	1.6%	\$133.08	2.3%	\$84.21	3.9%
2014	0.5%	3.0%	64.8%	2.4%	\$137.36	3.2%	\$89.06	5.8%
2015	1.0%	0.2%	64.1%	(1.1)%	\$142.98	4.1%	\$91.71	3.0%
2016	0.9%	1.5%	64.4%	0.5%	\$149.02	4.2%	\$95.95	4.6%
2017	0.8%	3.2%	65.7%	2.0%	\$156.72	5.2%	\$102.95	7.3%
2018	1.0%	2.0%	66.3%	1.0%	\$163.40	4.2%	\$108.39	5.3%
Average Annual % Change	0.8%	2.1%		1.1%		3.0%		4.1%
YTD Q1 2018			57.0%		\$146.92		\$83.68	
YTD Q1 2019	1.6%	1.1%	56.7%	(0.5)%	\$148.68	1.2%	\$84.24	0.7%
YTD Q2 2018			62.8%		\$156.06		\$98.06	
YTD Q2 2019	1.5%	1.0%	62.5%	(0.5)%	\$159.22	2.0%	\$99.51	1.5%
YTD Nov 2018			67.6%		\$164.11		\$111.01	
YTD Nov 2019	1.5%	0.1%	66.7%	(1.3)%	\$166.00	1.2%	\$110.80	(0.2)%

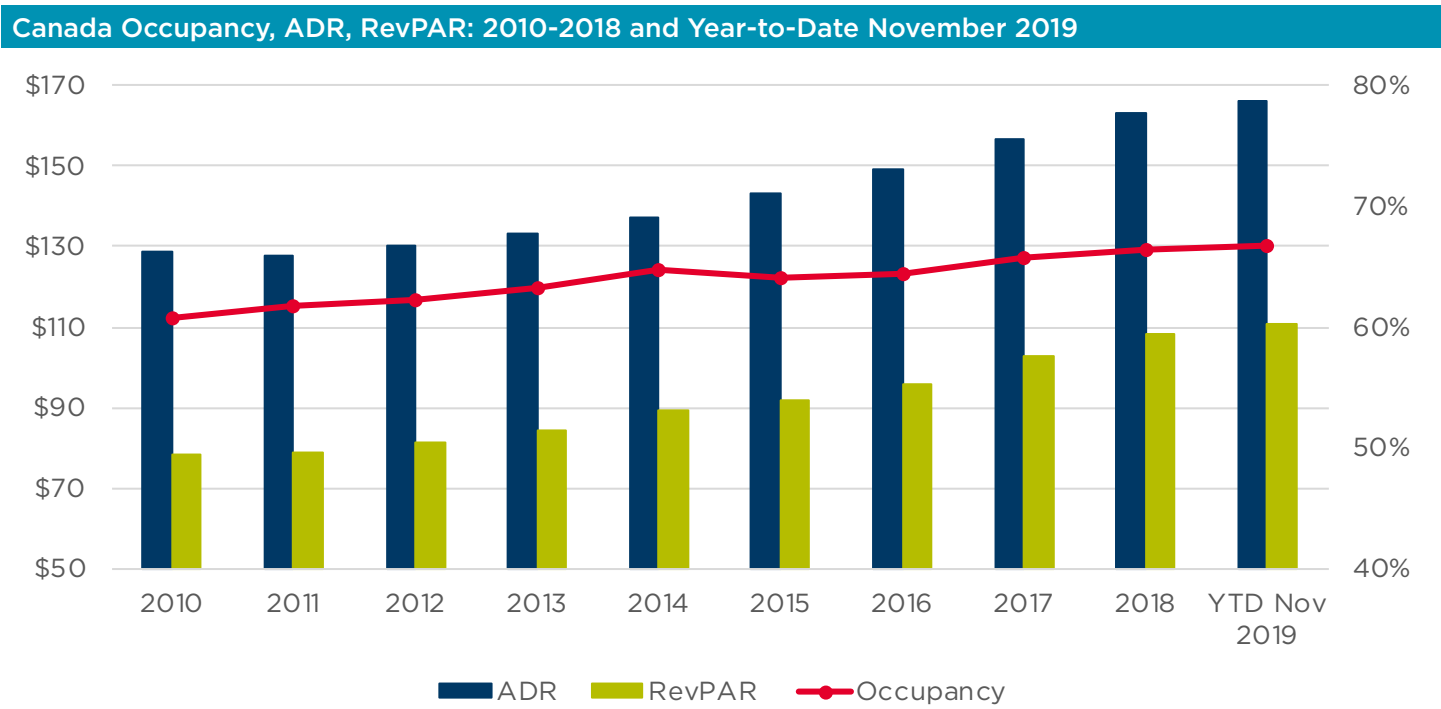
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The 2019 Canadian accommodation market performance shows a marked softening compared to the robust growth of the last few years. Year-to-date November 2019 has shown nominal demand growth paired with only a modest ADR increase. This, combined with relatively strong supply additions, has led to a decline in occupancy and flat RevPAR. If this trend continues through the balance of the year, 2019 market performance would be lower than the previous year, a result which last occurred prior to 2010.

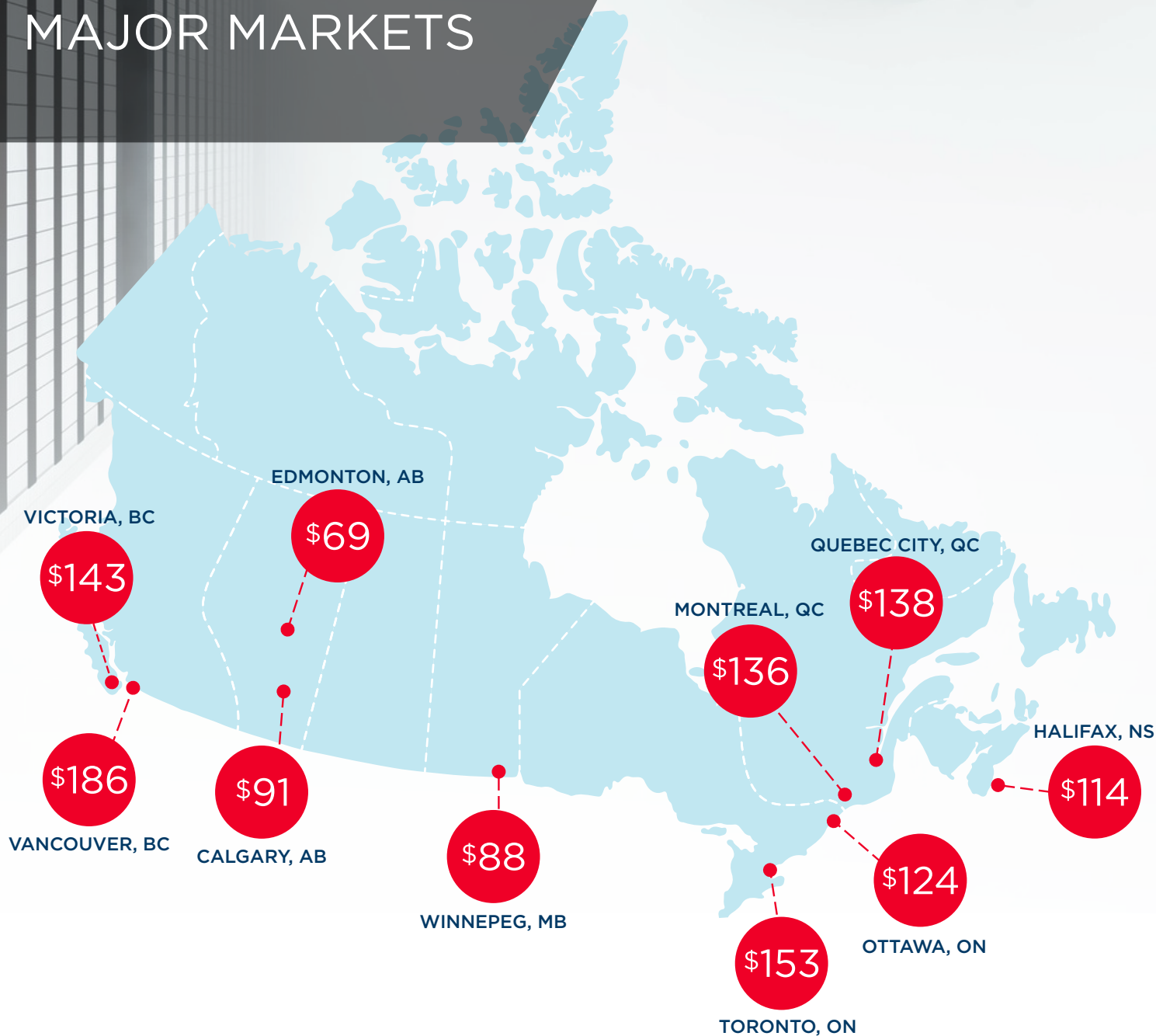
NATIONAL HISTORICAL ANALYSIS

Since 2010, ADR has increased by 27% and occupancy has improved by 5.5 points. The following graph illustrates trends in occupancy, ADR, and RevPAR from 2010 through 2018, as well as through November 2019. This graph shows the overall magnitude of the improvements, particularly in ADR and RevPAR growth.



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REVPAR IN TOP TEN MAJOR MARKETS



TOP 10 MAJOR MARKETS

Vancouver and Toronto continue to lead the 10 major Canadian markets in terms of overall RevPAR. In the first 11 months of 2019, only three major markets have seen RevPAR growth, with the remaining seven being flat or recording declines. The markets with the strongest RevPAR growth have been Montreal, Vancouver, and Quebec City, at 5.6%, 4.3%, and 0.5%, respectively. Montreal and Vancouver experienced strong ADR growth and modest growth in occupancy, resulting in a RevPAR increase.

The remaining major markets, some of which have historically seen several years of strong RevPAR growth, were plagued by influxes of supply, weaker demand, and declines or minimal increases in ADR. Toronto (-1.3%), Halifax (-1.9%), Victoria (-3.0%), and Ottawa (-4.3%) have all historically seen solid RevPAR growth but have experienced declines in year-to-date November 2019. Other markets have continued to struggle without experiencing any real recovery following the oil market downturn in 2015. Looking at year-to-date November 2019 results, these include Calgary (-3.8%), Edmonton (-6.3%), and Regina (-5.5%).

NEW SUPPLY

As of November 2019, STR reported that average supply growth across Canada was 1.5%. Barring a significant slowdown in the last month of the year, the Canadian market is on pace to record the strongest annual supply growth in the last ten years.

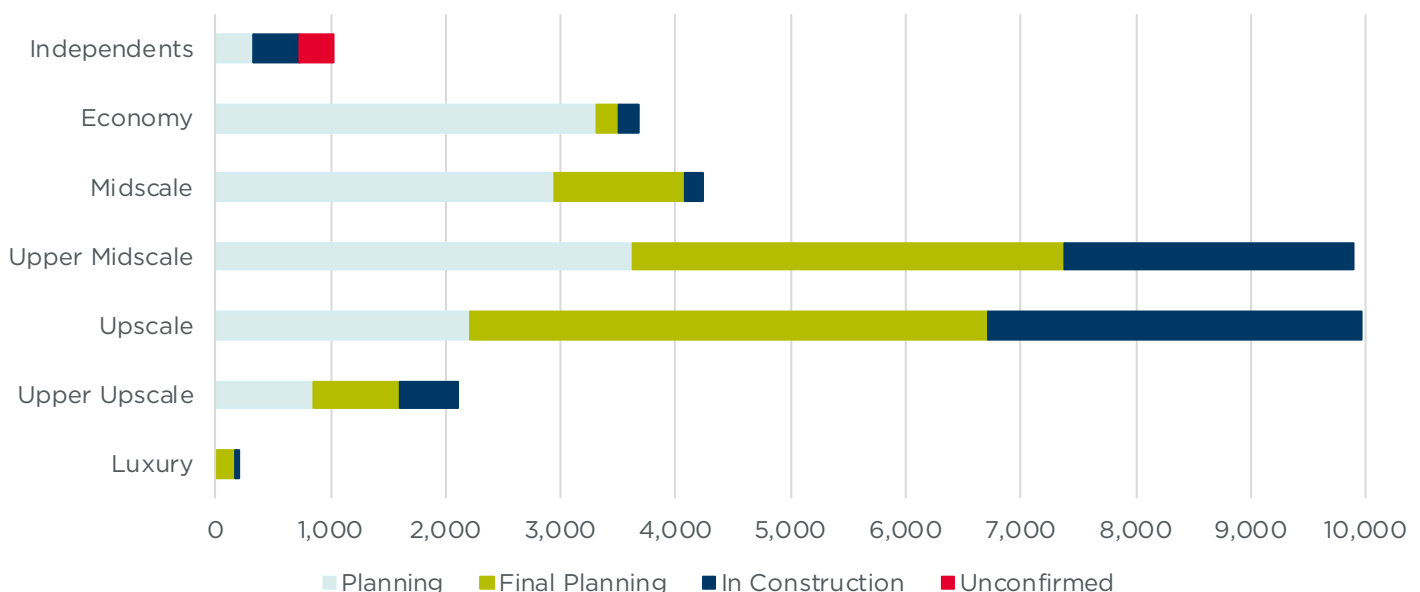
In 2018, Edmonton and Calgary led the country in new hotel development. Notwithstanding their already soft market conditions, hotels opened in the Calgary Airport, Edmonton West, and Edmonton South markets. The impact will likely cause some downward pressure on these markets which had been showing evidence of recovery until the most recent decline in oil prices.

In 2019, Halifax/Dartmouth leads the country in new hotel development as a percentage of existing supply, while Toronto leads the country in terms of absolute numbers.

Vancouver and Toronto—and to a lesser extent, Ottawa—are seeing more hotels in the planning stages as results in these markets now justify new construction, despite high land and construction costs.

The majority of new supply is expected within the focused-service segment. However, there is a large proportion of projects in the early planning stages amongst the economy, limited-service category, indicating that a shift in the type of properties being developed may be underway and possibly led by increasing costs of development. A significant amount of the supply in the pipeline (56%) is in the final planning or construction phases, indicating the country may be in for a few more years of strong supply growth in the short term.

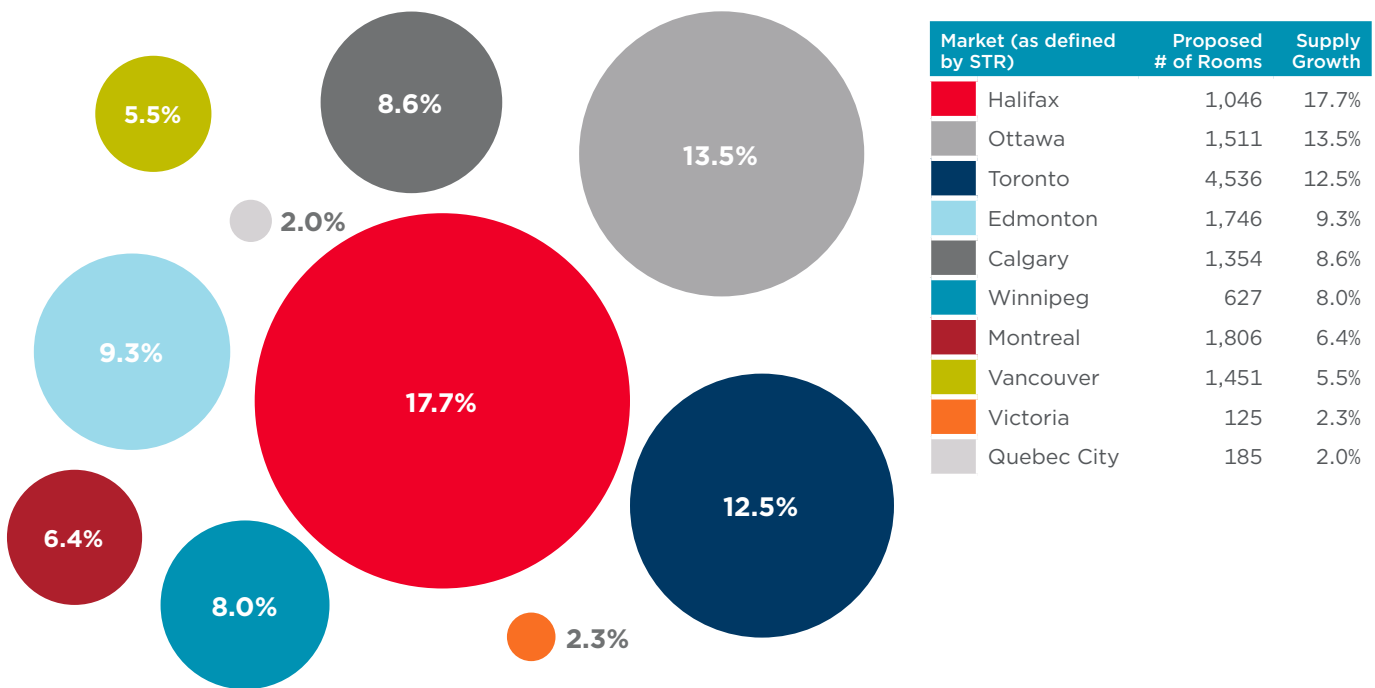
Canadian Hotel Development, Rooms in Pipeline by Scale and Phase



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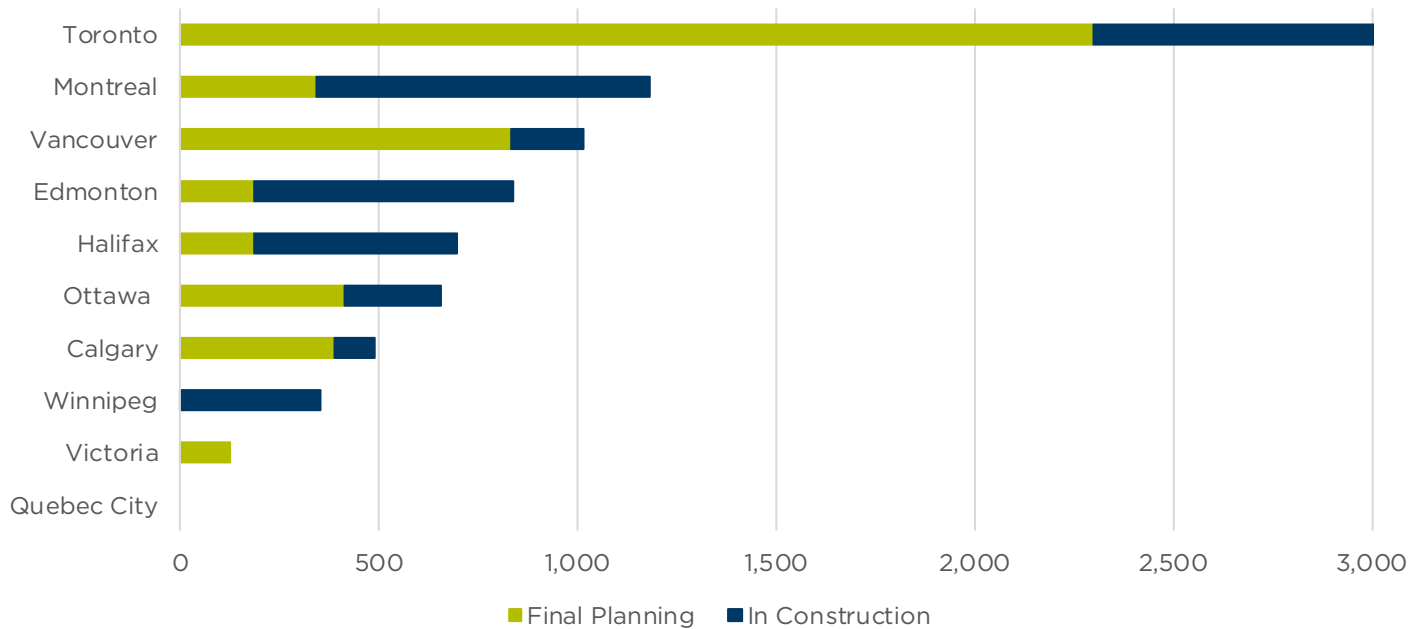


Canadian Hotel Development, Supply % Growth of Major Market by 2022



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Canadian Hotel Development, Rooms in Final Planning or in Construction



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Following years of limited supply growth, Toronto now leads the country in terms of new hotel development by total number of rooms, with a significant amount of development planned or under construction outside of the downtown core. Areas of significant growth include Mississauga, Hamilton, Vaughan, Brampton, and Ajax.

Montreal and Vancouver show the second and third strongest hotel development pipelines, indicating strong performance in the top three major markets has signaled to investors a good opportunity for investment in new development.

Following four years of weak market performance and an influx of new hotels, supply pipelines in Calgary and Edmonton have finally softened following the completion of a number of new projects.

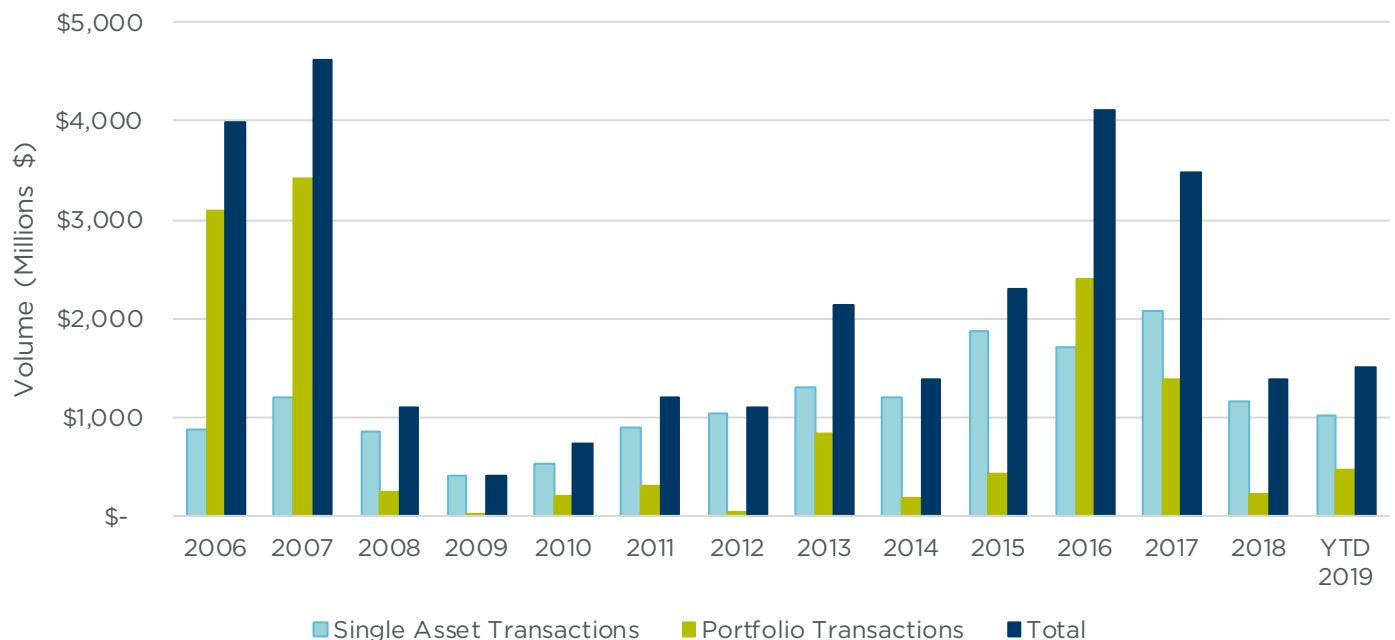




TRANSACTIONS MARKET

The following three years of high sales volumes, driven by portfolio deals. In 2018, transaction activity slowed dramatically following three years of high sales volumes. Total 2018 transaction volume approached \$1.4 billion (including traditional single transactions, portfolios, and redevelopment sales)—a 60% decline from the year prior.

Canadian Hotel Transaction Volume: 2006 to Year-to-Date November 2019



Source: Cushman & Wakefield, CBRE, and Colliers

As of year-to-date November 2019, demand for hotel investment continues, with the pace slightly higher than in 2018. Year-to-date 2019 transaction volume has approached \$1.5 billion, surpassing 2018 levels before year end. The increase is driven by portfolio volume, which has increased by 117% to \$477 million. Single asset transaction volume has remained relatively stable, seeing a modest 2% decline to \$992 million.

Although traditional transaction volume has declined, the number of traditional hotel sales as of year-to-date November 2019 has increased to 122 from 116. The reduction in traditional transaction volume is a result of an increase in limited-service hotel sales. Approximately 69 of the 122 traditional sales sold for \$5 million and under, with the majority of the assets being under 80 rooms and located in tertiary markets.

Ontario continued to lead transaction activity, representing 47% of hotel sales across the country. British Columbia and Alberta saw an uptick in transaction volume over the year prior, increasing by approximately 5% and 86%, respectively. Atlantic Canada has gained traction, particularly in Nova Scotia and New Brunswick, with transaction activity increasing by 60% over year-to-date 2018.

FEATURED TRANSACTIONS

Notable transactions as of year-to-date November 2019 include:

Notable Transactions			
Property	Price	# of Properties	# of Rooms
Westin Portfolio (Calgary, Edmonton and Ottawa)	Confidential	3	1,433
Mountain Park Lodges Portfolio in Jasper	\$99,000,000	7	735
Residence Inn Montreal Downtown	\$63,000,000	1	210
Hôtels Gouverneur Montréal	\$59,500,000	1	353
Clayoquot Wilderness Resort	\$55,206,000	1	20

Transaction Volume by Region Year-to-Date Traditional Sales		
Province	Properties	%
Ontario	57	47%
British Columbia	20	16%
Quebec	17	14%
Alberta	13	11%
Nova Scotia	7	6%
Manitoba	4	3%
Saskatchewan	3	2%
New Brunswick	1	1%
Year-to-Date Total Traditional Sales	122	100%
Year-to-Date Total Rooms	8,566	

Year-to-Date Total Traditional Sales Volume		
Total \$ Volume	Price per Room	# of Sales
\$991,590,172	\$115,759	122





HOT TOPICS

KEY PERFORMANCE INDICATORS TO WATCH—2020 AND BEYOND

While it is concerning that markets have softened in 2019, it is worth considering some of the underlying factors that are slowing growth and that are likely to influence the hotel sector over the near to mid-term:

General Economic Conditions

- Canada's real GDP growth has slowed from an impressive 3.0% in 2017 to 1.9% in 2018. Growth is forecast to moderate further, to 1.6% in 2019, 1.8% in 2020, and returning to 1.9% in 2021.
- Tight labor markets are seeing some acceleration in wage inflation, but this has a negative impact on profitability, particularly in the manufacturing sector. According to the Conference Board of Canada, the Canadian manufacturing sector as a whole is forecast to expand at 1.8% in 2019, 1.2% in 2020, and 1.4% in 2021.
- Foreign direct investment is flowing to Canada at levels not seen since oil prices collapsed while the growth in the stock of Canadian direct investment abroad in 2018 was significantly higher than in the previous two years, the majority of that increase was due to valuation gains from a weaker Canadian dollar, which resulted in a \$72 billion upward revaluation of Canada's direct investment position. In 2018, the Canadian dollar depreciated by 8.7% against the U.S. dollar, 3.7% against the euro, and 2.8% against the British pound. By December 2019, the Canadian dollar was sitting at \$0.76 against the U.S. dollar, relative to \$0.73 at year-end 2018. In 2020, analysts are predicting a stronger loonie, increasing to \$0.765.
- Consumer confidence is declining with 56% of Canadians indicating it seems "somewhat likely" there will be a recession in 2020, which is expected to impact consumer spending in the near term.
- Canada-U.S.-Mexico Agreement (CUSMA), to replace NAFTA, was signed December 10th. Expected to be ratified in 2020, the new agreement will restore certainty to more than \$1 trillion of trade between the countries after two years of negotiations.

Office Vacancy

- In the GTA, the future 6-month availability rate is projected to increase to 6.7% from 6.0% in the current quarter, representing an increase to 3.0% from 2.2% in the downtown and midtown areas, and an increase to 10.6% from 10.0% in the suburban areas.
- Calgary's 6-month future availability rate is projected to rise from 20.0% in the current quarter to 22.2% in the next six months.

Oil

- The price of West Texas Intermediate (WTI) fell 15.6% between year-to-date October 2018 and 2019 (-23.7% in October alone).
- According to Deloitte's price forecast for oil, gas & chemicals released September 2019, the price of WTI is expected to increase from \$57.00 (USD/bbl) in 2019 to \$59.00 in 2020, \$62.00 in 2021, and remain around \$65.00 from 2023 to 2026.
- The Canadian Oil & Natural Gas Producers' annual Crude Oil Forecast, Markets, and Transportation report provides a long-term outlook for Canadian crude oil production. The 2019 edition of the report projects serious constraints over the forecast period from 2019 to 2035. Although production will increase by 1.27 million barrels per day by 2035, that growth rate is about 6% less than CAPP's 2018 forecast.
- Total annual production is expected to increase by an average of 3% until 2021, then slow to an average growth rate of 1% annually. Oil sands production is expected to reach 4.25 million barrels per day by 2035 from 2.9 million barrels per day in 2018—a 12% decline in the growth rate over last year's forecast.

Conventions & Events

- Metro Toronto Convention Centre: 493 total events in 2018-2019, down from 508 events in 2017-2018 and 569 events in 2016-2017. A total of 525 are currently on the books for 2020.
- Vancouver: 27 citywide events in 2019 down from 35 in 2018, with 26 events on the books for 2020.
- Upcoming international sporting events are primarily occurring in Western Canada, with a number of international ski and snowboarding competitions in Calgary in 2020.

Air Traffic

- Air traffic continues to show healthy gains. Total enplaned/deplaned passengers through year-to-date October 2018 vs year-to-date October 2019:

Total Airport Passengers (Annual Change)			
↑ Toronto	1.9%	↑ Montreal	4.4%
↑ Calgary	3.8%	↑ Vancouver	1.5%
↓ Edmonton	(1.0)%	↑ Winnipeg	4.7%*
↑ Ottawa	2.7%	↓ Halifax	(4.4)%

*YTD June 2019

Travel Outlooks

- Conference Board of Canada is predicting the following growth in total overnight visits in 2020 and 2021:

Conference Board of Canada: Growth in Overnight Visits		
Province	2020	2021
Toronto	2.6%	2.7%
Calgary	2.3%	2.4%
Edmonton	2.0%	2.2%
Ottawa	2.3%	3.0%
Montreal	2.2%	2.2%
Vancouver	3.1%	3.2%
Winnipeg	1.8%	1.9%
Halifax	1.9%	1.9%

FINANCING AND THE HOTEL INVESTMENT MARKET

Canadian hotel real estate is a relatively safe and transparent investment with attractive risk-adjusted returns. More and more lenders are coming to this realization and are acting on it. The availability of debt for hotel owners and investors is perhaps more robust than ever, and borrowers are benefiting from the competition amongst lenders to provide financing. Lower benchmarks, tighter spreads, longer amortization periods, lengthier terms, and increased leverage are some of the key areas where borrowers can benefit from aggressive financing terms with lenders. These financing trends are not only applicable to existing and performing hotels, but have also positively impacted new hotel construction and repositioning opportunities in certain markets. Despite the competition, lenders will remain prudent

in their deal underwriting to ensure it receives internal credit committee approval.

Be mindful that business cycles fluctuate, and this robust debt environment will not remain forever; a period of constraint will likely follow. It is important to consider this in your selection of a lender as Patrick Schofield, Senior Manager, Hotels-Eastern Canada, CWB Franchise Finance points out:

“While I encourage all owners to leverage the benefits of this current environment, it is also important to maintain a focus on debt structure and to partner with a lender, like CWB, who understands the hotel space at a granular level. This will help ensure the debt security and stability of your portfolio through both positive and negative economic cycles, which is essential for long term success in the hotel industry.”

Unlike previous years, 2019 was a year that the hotel sector saw new sources of capital enter the Canadian market place. The Equity, Debt & Structured Finance Group, a division within Cushman & Wakefield’s Capital Markets Group, saw a distinct increase in available capital through either the high value achieved on dispositions or appraisals for the financing of hotel assets. “For primary markets, we’ve seen a large increase in debt

capital available for this asset category in 2019,” said Scott MacPherson, the Managing Director of EDSF for Canada. He adds, “we’ve seen our debt sources underwrite deals with pricing in the low 3s, with LTVs as high at 70-75% and dropping debt service coverage ratios to as low as 1.30 for assets in primary markets.”

Secondary markets have also seen the benefit of new capital entrants. LTVs have increased to north of 60% and a lowering of debt service coverage ratios to 1.40. Pricing, too, has remained relatively close to that of primary markets, coming in a mere 50-75 basis points higher on fixed term rates. Tertiary markets continue to have less sources of capital available and less interest from recognized lenders; hotels in these markets face higher financing restraints. Generally, they are priced a good 200 basis points higher than primary markets, have much lower LTVs and require higher debt service coverage ratios.

The coming year should continue to present attractive financing options for hotel owners and investors. Evaluating the pros and cons of all suitable options to establish a financing strategy is prudent and worthwhile, especially if there are some expected economic headwinds in the distance.



CONCLUSION AND OUTLOOK

WILL 2019 REPRESENT THE TURNING POINT FOR HOTELS?

After ten years of strong revenue and value growth, the market appears ready to pause. Will low interest rates and ample debt availability continue to fuel the market in the face of weaker economic conditions, supply growth, and geopolitical uncertainty? The coming year could mark the beginning of a new phase in the industry, one which will require owners and investors to refocus on monitoring and managing their investments through the cycle.



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