CUSHMAN & WAKEFIELD

VALUATION & ADVISORY

HOSPITALITY & GAMING U.S. LODGING INDUSTRY OVERVIEW

YEAR END 2020

YEAR-END 2020: WORKING FROM HOME AND DREAMING OF TRAVEL

While expectations of a softening U.S. hotel performance were anticipated at the beginning of 2020, no one was prepared for the uncertainty of the ensuing year. But even as the COVID-19 pandemic lingered and effectively shut down most travel in the U.S. and across the world, smart and experienced investors continued to amass extensive funds to pursue recapitalization and acquisitions—the most substantial market indication that recovery is highly anticipated.

As has been documented on numerous hotel industry webinars and Zoom presentations, the pandemic began to slow U.S. hotel performance at the beginning of 2020 due to inbound Asian travel restrictions. By mid-March 2020, the threat of widespread virus transmission prompted local and state governments to enact measures curtailing most commercial and social activities. As a result, many hotels were suddenly empty and some closed voluntarily for several weeks to months in the spring. Numerous challenges followed, including staffing reductions on property and on the corporate level, chain supply difficulties, new cleaning protocol requirements, and safety standards for staffing and guests. As the industry proved itself resilient, operators have had to manage with fewer supervisors, and customers have learned not to expect their rooms to be cleaned every night. The performance of the U.S. hotel industry in 2020 quantifies all the trials of a year where each month seemed to drag on. The following details the annual changes since 2018 and quarterly changes for 2020.

U.S. HISTORICAL OPERATING STATISTICS - 2018 THROUGH 2020

	YEAR	SUPPLY	% CHANGE	DEMAND	% CHANGE	EQ. INDEX	OCC	% CHANGE	ADR	% CHANGE	REVPAR	% CHANGE
	2018	5,216,000	1.8	1,260,586,980	2.2	0.4	66.2	0.4	129.70	2.4	85.88	2.8
	2019	5,310,981	1.8	1,282,326,605	1.7	(0.1)	66.2	(0.1)	131.21	1.2	86.79	1.1
	2020	5,130,728	(3.4)	824,364,472	(35.7)	(32.3)	44.0	(33.5)	103.14	(21.4)	45.40	(47.7)
	AVG ANNUAL % CHANGE		**1.5 %**		**(0.1) %**	**(1.6) %**		**(1.5) %**		**1.8 %**		**0.2 %**
90	**1Q - 2019**	5,231,265	---	290,761,114	---	---	61.8 %	---	$129.02	---	$79.68	---
90	**1Q - 2020**	5,342,784	2.1 %	249,214,791	(14.3) %	(16.4) %	51.8 %	(16.1) %	$123.76	(4.1) %	$64.14	(19.5) %
91	**2Q - 2019**	5,313,636	---	338,698,303	---	---	70.0 %	---	$133.01	---	$93.17	---
91	**2Q - 2020**	4,776,449	(10.1) %	145,507,097	(57.0) %	(46.9) %	33.5 %	(52.2) %	$83.59	(37.2) %	$27.98	(70.0) %
92	**3Q - 2019**	5,356,020	---	349,165,390	---	---	70.9 %	---	$133.25	---	$94.42	---
92	**3Q - 2020**	5,170,666	(3.5) %	228,268,000	(34.6) %	(31.2) %	48.0 %	(32.3) %	101.25	(24.0) %	$48.58	(48.5) %
92	**4Q - 2019**	5,341,297	---	303,701,798	---	---	61.8 %	---	$128.94	---	$79.69	---
92	**4Q - 2020**	5,233,774	(2.0) %	201,374,584	(33.7) %	(31.7) %	41.8 %	(32.3) %	93.90	(27.2) %	$39.27	(50.7) %
365	**YTD 2019**	5,310,981	---	1,282,326,605	---	---	66.2 %	---	$131.21	---	$86.79	---
365	**YTD 2020**	5,130,728	(3.4) %	824,364,472	(35.7) %	(32.3) %	44.0 %	(33.5) %	$103.14	(21.4) %	$45.40	(47.7) %

Source: STR, Cushman & Wakefield

At the onset of the pandemic, in the first quarter, initial expectations were for a quicker recovery with the hope that leisure travel would resume by the summer. However, as the months unfolded and cases surged, the prospects for a normalized travel environment were extended beyond 2020.

By the end of the year, hotel closures resulted in another record—this time reversing the trend of the eleven-year-long post-Great Recession recovery (2010 to 2019). While temporary, hotel construction was temporarily suspended, and demand and average rate contracted at the largest rates since STR has been tracking performance. As a result, occupancy and RevPAR plunged. Note that the supply basis in the STR trend in 2020 recognizes the reduction in hotel rooms due to temporary closures from the pandemic. Using a full room inventory would result in an even lower occupancy.

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UNCERTAINTY REMAINS

Since the onset of the pandemic, owners, operators, lenders, and guests have looked to widespread vaccinations as the panacea for the U.S. hotel industry's recovery. Optimism has increased as vaccines began to roll out in 2021, but uncertainty remains. In January 2021, because of a post-holiday surge and an inconsistent and insufficient distribution of the vaccine across the nation, the timing expectations for recovery shifted. Reports on new coronavirus strains, challenges in the vaccine logistics, and the efficacy of the immunization concerns, are moderating expectations. Nevertheless, industry participants anticipate that most of these challenges will be overcome by the end of 2021, and hotel performance will continue to recover.

The turnaround timeline for some markets, however, is being pushed as hotel operators and other industry participants are more confident about the level of pent-up demand for travel. As a result, some believe a more robust and quicker rebound for some markets and longer-term improvements in others is on its way.

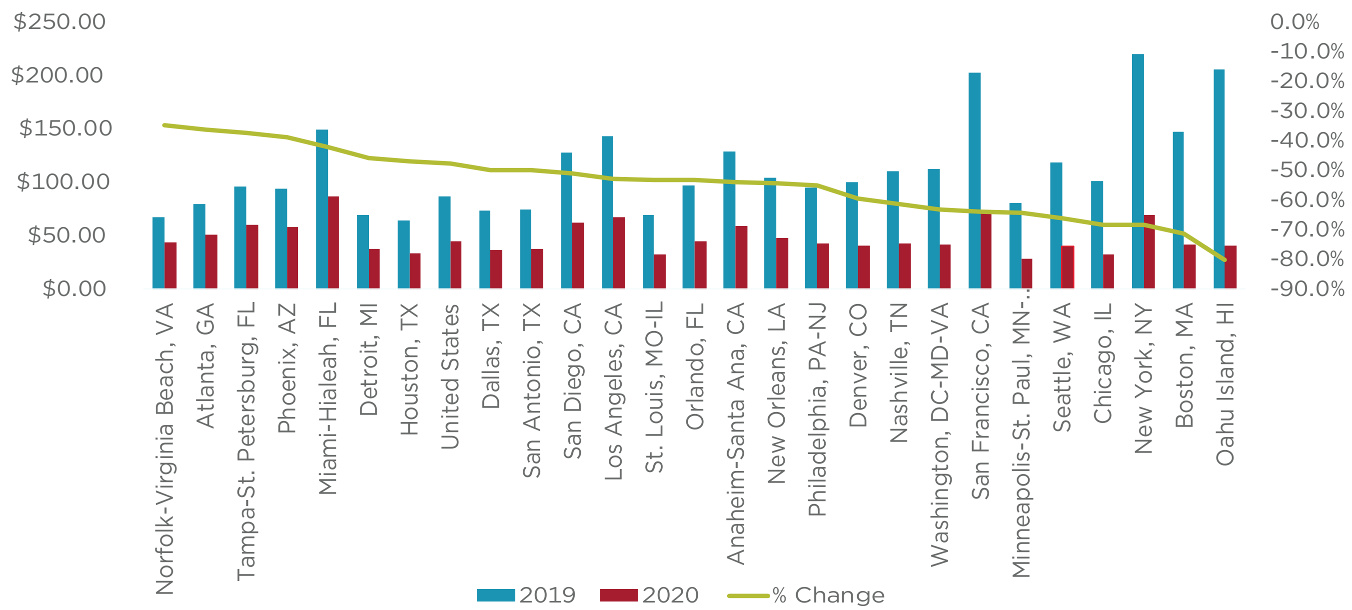
Hotel consultancies and data firms are projecting that the timing of a RevPAR rebound will be four years beginning in 2021, with the basis that 2020 was the performance nadir. Expectations from several firms for 2021 show the U.S. occupancy estimates between 48.6% and 52.7% with average rate estimates between $101.65 and $109.25. While these metrics may seem within a small range, the resultant RevPAR projections represent increases of 12.2 to 28.7% over 2020 RevPAR. This wide range reflects and acknowledges the uncertainty of the current times, but does provide a range for consideration.

STR TOP 25 MARKETS

Many investors are focused on the top 25 U.S. markets as defined by STR; however, the impact of the pandemic has varied by region, and has brought some focus to the proposition that the top 25 markets are not representative of the country as a whole. Prior to the pandemic, the relative performance of the top 25 markets had been very consistent. From 2010 to 2019, the RevPAR penetration of the composite 25 markets relative to the U.S. average had ranged from 131 to 137%, driven by occupancy penetrations between 110 and 112% and average rate penetration levels from 120 to 122%. By contrast, the balance of the U.S. hotel market relative to the total US RevPAR levels averaged 88% during this period. However, the COVID-19 pandemic has been more detrimental to the performance of the top 25 markets than to the balance of the country. Because many of the top 25 markets are denser urban areas that rely on business & convention and group travel to support the higher occupancies and yield higher average rates, the cessation of these segments for most of 2020 has been devastating. The average RevPAR decline for the top 25 markets was 54.4% compared to a softer decline of 42.4% for the balance of the country. Total revenue for this group of top 25 markets was 44% of total U.S. hotel revenue in 2019, but only 37% of revenue in 2020.

The following chart shows the magnitude of the impact on the top 25 markets from 2019 to 2020, ranking changes in annual RevPAR from left to right.

TOP 25 MARKETS -REVPAR YOY %CHANGE



Source: STR, Cushman & Wakefield

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All top 25 markets experienced declines in both occupancy and average rates in 2020.

As has been documented by numerous industry groups during 2020, hotel markets that depend upon airlift and group demand have been most affected, while primarily drive-to leisure destinations have fared somewhat better. Many of these leisure-oriented destinations are not part of the top 25 markets.

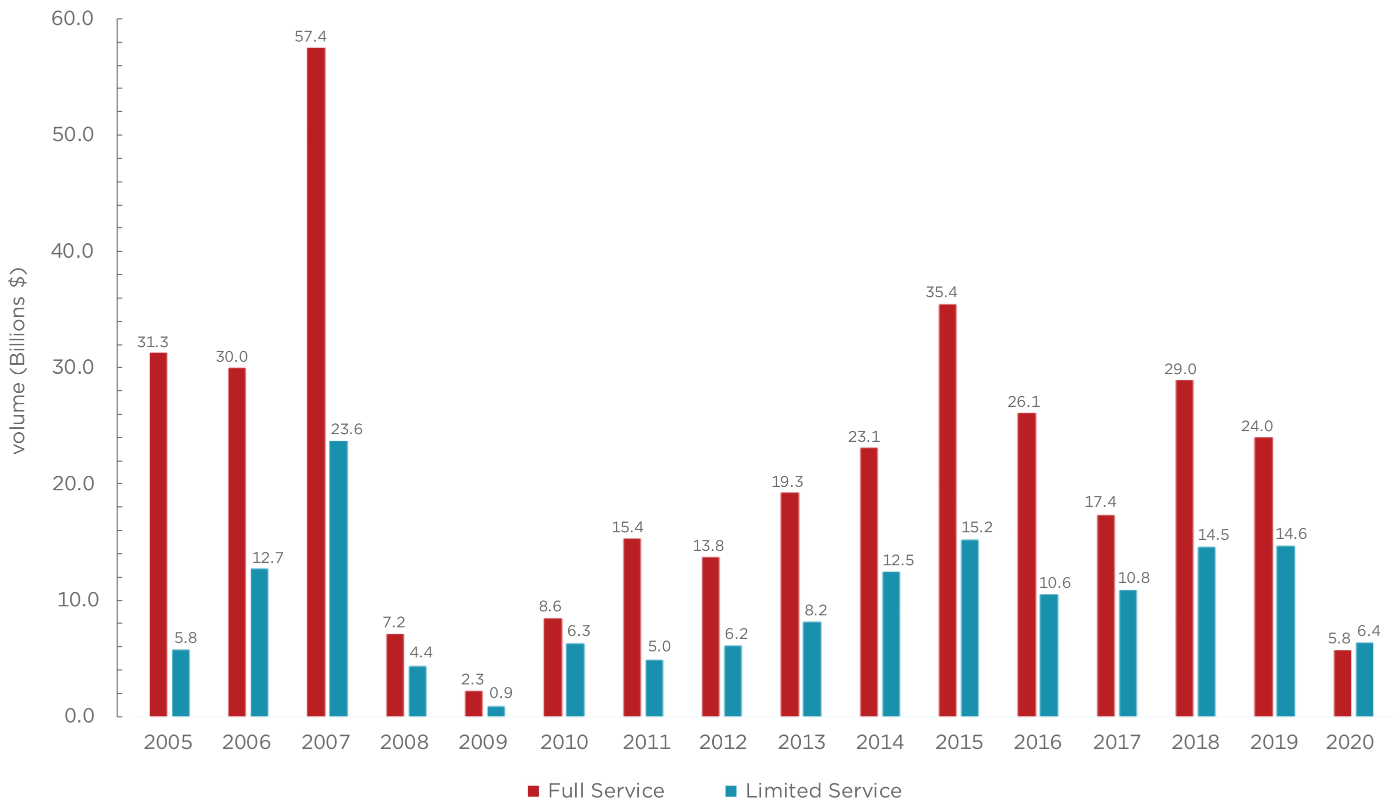
As of the end of 2020, the general expectation for a return to 2019 RevPAR levels is somewhere between late 2023 and 2025 but the velocity of the recovery for the top 25 markets relative to the balance of the U.S. remains uncertain.

HOTEL TRANSACTION OVERVIEW

Hotel sales in the U.S. have been volatile since the Great Financial Recession. As expected, from the onset of the pandemic when fundamentals deteriorated, the hotel transaction market in 2020 was anemic at best. Although transaction volume fell precipitously relative to 2019, the deal flow was much stronger than the last nadir in 2009.

The following chart shows the historical volume of U.S. hotel sales annually since 2005 allocated by full-service and limited-service hotels, as tracked by Real Capital Analytics (RCA).

U.S. HOTEL TRANSACTION VOLUME 2005 - 2020



Source: RCA, Cushman & Wakefield

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RCA reports a total 979 hotel sales in 2020, compared to 2,141 hotels sold in 2019. The expectations for a stronger investment market depend on available inventory to sell at prices that attract both buyers and sellers. Creative refinancing, operational efficiencies, government assistance, and patient lenders all contributed to fewer transactions than expected. Some industry participants are anticipating increased bankruptcy activity in 2021 which may or may not result in sales. Contrary to expectations set in mid-2020, most sales were initiated by sellers, not lenders or special servicers.

Despite the hits to revenue and income, lenders and servicers are not interested in taking back properties and managing the operational challenges with an undetermined recovery timing. Other hotels, with some positive cash flow

(including extended stay hotels and drive-to regional leisure destinations) may not be in as much distress. Those owners who can hold on or recapitalize will likely want to take advantage of a rebound as much as any opportunistic investor.

Debt for hotel transactions and refinancing, which was scarce in 2020, is anticipated to be somewhat more available in 2021, mostly from private lenders and debt funds. With the subsidence of CMBS issuances for hotels and sluggish interest from banks, active debt funds, high net worth families/funds, and private lenders will have their choice of strategic assets from which to choose, at premium pricing. Owners of smaller properties report some available SBA financing.

For those lenders offering hotel debt, loan-to-value ratios are being quoted at 60 to 65% of value with pricing at LIBOR plus 550 to 600 basis points (bps) and up to 700 bps for high-risk deals, compared to pre-COVID-19 levels of spreads of 275 to 432 bps with loan to cost ratios of 65 to 70%. The mezzanine / rescue capital market is robust, with many lenders seeking to finance up to 70% on acquisitions and provide rescue capital at even higher leverage points.

Transaction volume has the potential to improve in the second half of 2021 as hotel industry performance begins to turn positive coupled with increased pressure from investors to deploy capital. Poorly performing assets with limited near-term prospects and difficult financing situations may come to market, but these still might not be attractive enough to engage active buyers. Institutional quality asset transactions are not expected to materialize in the near-term. A return of sales trends to 2018 and 2019 levels will also require the return of affordable financing from banks, which may not appear until later in 2021.

INFLUENCES AND RESPONSES TO COVID-19

The pandemic's impact is anticipated to be more than just the immediate knee-jerk reaction evidenced in 2020. Some of the observed trends include:

STREAMLINED OPERATIONS

- The pandemic demonstrated to operators that they could manage with fewer employees and offer less services for many product types. Operators are strategizing about how to maintain leaner operating structures with fewer supervisory levels. Fewer housekeeping protocols may become the norm with daily service attached to a fee for service structure.
- Operators are employing more touchless interactions including phone check-ins and text interactions. Educating hotel guests on the evolving technology is part of the process and pre-stay interactions are more commonly part of the trip, presenting an opportunity for hotels to increase the marketing, upselling, and personalization of each stay.

RENOVATIONS AND PROPERTY IMPROVEMENT PLANS (PIPs)

- Repurposing hotels for other uses is top of mind for some buyers and lenders. A fraction of the existing hotels across the U.S. is anticipated to never reopen. Hotels in urban areas including New York, Chicago, Los Angeles, Seattle, and San Francisco are targets for adaptive reuse strategies while economy hotels in secondary and rural areas are being purchased for razed for new projects. Other markets, particularly in California, are seeing government supported acquisitions of hotels, particularly older exterior-corridor properties for subsidized housing.
- Brand conversions are accelerating along the hotel chain scales, both with enhanced upgrading and with a repositioned descending identity. Branding shifts for properties that are already affiliated, and more prevalently for independent properties, provide greater appeal to capital sources who see the change in identity and association with a major hotel company as a means of differentiation, as well as providing some security for capturing demand in the short- and long-term.
- A large proportion of renovations and PIP projects were paused during the pandemic to redirect cash flow to operations or loan repayment during a period when cash flow and capital is limited. Eventually these projects will resurface and allow brands, owners, and operators to reconsider the reconfiguration of existing hotel facilities for working remotely and the need for new amenity concepts. Changes are also being implemented in the layouts of food and beverage facilities in support of more efficient operations—such as expanding grab-and-go and market pantries as an alternative to the traditional breakfast buffet.

CHANGES TO DEMAND SEGMENTS

- Group meetings and social event logistics continue to evolve. While the widespread vaccinations are expected to provide the confidence for a return of groups, larger weddings, trade shows, and conventions, lingering safety concerns, reduced airlift, and cost rationales for online events are likely to continue to affect the structure and size of events. Hybrid options with a combination of onsite and digital sessions are being considered and the success of such events remains to be tested.

- Some training practices and trade shows pose a unique challenge as the hands-on nature of these events cannot be replicated online. Tradeshow operators see this type of event returning more readily than other group functions which can be conducted virtually.

- The competitive nature of business and the desire for person-to-person exchange is expected to drive some resumption of commercial travel for transactional purposes. However, the impact from corporate work-at-home on business travel is still uncertain and there are different schools of thought. Some industry leaders anticipate this will reduce face-to-face meetings while others think that the need for supporting corporate culture, training, deal making, and innovation will require additional onsite meetings.

- Drive-to leisure travel, which flourished for many destinations during the pandemic, may be challenged when competitive travel opportunities open up once the vaccines are implemented in larger numbers. Widespread recovery of the hotel industry depends on airlift and the airlines' recovery includes cost and demand factors which can diverge or lag demand for hotels in particular locations. Passenger testing and vaccination requirements for plane travel may be different than for hotel guests constraining fly-to travel that requires hotel stays. Attractions such as theme parks and national parks will have to be able to open at greater capacities to accommodate demand.

CHANGES TO NEW HOTEL SUPPLY

- During 2020, the decline in travel and challenges to operations effectively halted or postponed many new hotel projects and dissuaded lenders from new construction commitments. According to STR, hotel rooms under construction peaked in March. The 213,000 rooms currently under construction represent about 4% of the 2019 supply, still a notable amount.

- The impact of the pandemic on construction costs is becoming clearer, and indications point to a decline in costs. The Turner Building Cost Index, which measures costs in the U.S. nonresidential building construction market, fell to a value of 1171 in the third quarter of 2020, a 1.5% quarterly reduction from the beginning of the year. This year marked the first time the index from Turner Construction was reduced in value since 2010. Concurrently, the volume of construction is down as fewer hotel projects enter the pipeline. Supply chain issues remain difficult, and a lack of government revenue and spending is expected to continue to challenge infrastructure and incentives that traditionally supported some hotel projects. According to construction industry firms, COVID-19 has accelerated the labor shortage as some workers are reportedly preferring unemployment benefits rather than return to jobs from which they were laid off from earlier in the year. The slowdown in new hotel construction may help many markets during the post-pandemic recovery.

ALTERNATIVE HOTEL PRODUCTS

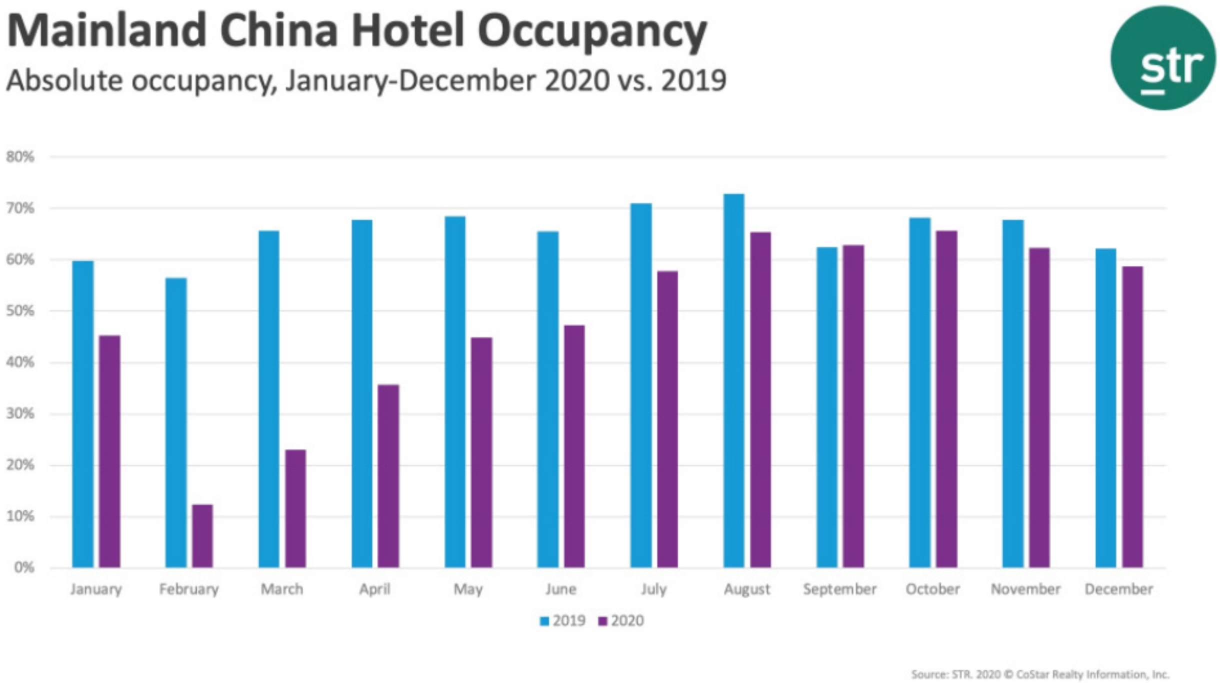
- Some travel providers are exploring the longer-term potential of subscription-based travel. A concept that originated in 2017, the models require travelers to pay a set monthly fee for a number of stays or discounts on hotel services and stays. Some models limit the number of stays per month. For example, Citizen M Hotels are offering annual or monthly options that include a fixed fee for hotel day use, three nights per month, and upgraded WiFi with additional amenities. The luxury travel firm Inspirato offers a $2,500 monthly subscription which allows for no-nightly fee stays with a seven-day interval between bookings. TripAdvisor will be offering a subscription service with an annual $99 fee that provides discounts for hotel rooms, airfare, cruises and other travel options. As subscription plans for all types of online and delivery services are now part of our daily lives, some hotel ventures are betting on this type of service for frequent travelers.

- Initially, vacation rentals gained popularity during the pandemic as travelers sought private accommodations to provide a safe retreat. Rental properties in drive-to destinations profited in the summer of 2020, and while some travelers may have been converted, others may revert back to traditional hotels and resorts. Vacation rentals have become a more established form of lodging in recent years, with Marriott joining in the practice, but are expected to remain a fraction of hotel use based on supply and demand fundamentals.

LESSONS FROM HOTEL PERFORMANCE IN CHINA

Most industry participants have expressed a depth of pent-up demand that will help support hotel recovery. While much of the discussion is anecdotal, the recovery in China is often cited. The country's hotel occupancy steadily rose in 2020 as the virus was contained and hotels reopened. Demand segments have been similar to the U.S. with the strongest performances in drive-to leisure and mid-to-upscale hotels while group hotels and luxury international properties remain more challenged. This rapid improvement in monthly occupancy as shown in the following chart has promoted confidence for U.S. operators.

CHINA HOTEL OCCUPANCY PERFORMANCE



As can be noted above, monthly occupancy approached pre-pandemic levels near the end of the third quarter of 2020 and remained relatively flat during the fourth quarter of 2020.

SUMMARY AND OUTLOOK

Beginning in March 2020, the unforeseen pandemic altered the trajectory of the hotel industry, resulting in startling record declines. The industry responded with strategic operational changes such as staffing reductions and new cleaning protocols that are expected to lead to both short- and long-term benefits for hotel performance.

With a new year comes new hope in the form of a vaccine rollout. Yet, despite overall optimism for a recovery, uncertainty remains. New strains of COVID-19, the long-term effectiveness of the vaccines, the ability to vaccinate enough people, and the economic and personal safety confidence, may derail expectations at any time. Industry pundits talk about an uneven recovery and that is likely to be true based on the location, property type, operator approach and available capital for any particular hotel.

As with recent recoveries, occupancy is expected to return first before operators can support sustained average rate recovery—but both measures will require time and patience as we navigate this pandemic's challenges. Nevertheless, long-term expectations remain positive for the hotel industry to "bounce forward," rather than bounce back—as can be evidenced by the adoption of leaner operating models and the significant amount of capital sitting on the sidelines.

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