

Valuation & Advisory | Hospitality & Gaming

U.S. LODGING INDUSTRY OVERVIEW

Year End 2019



YEAR END 2019

MORE UNCERTAINTY, FAVORABLE FINANCING & MODERATING MARKETS

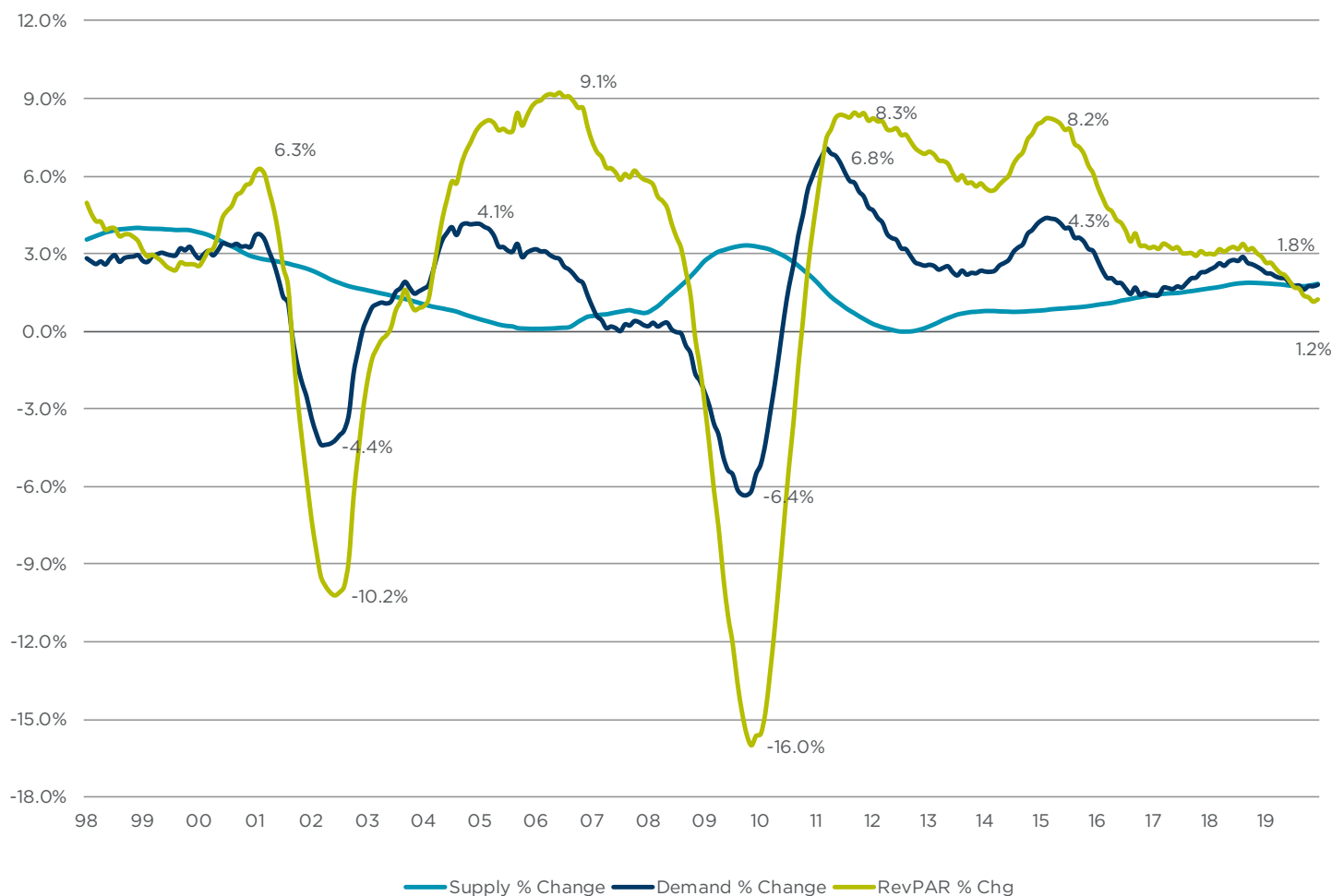
LET'S MAKE A DEAL?

INTRODUCTION

We are now into our tenth year of the current U.S. hotel market expansion and while revenue records are still being set, the overall operating results are shifting downward. Since the beginning of this post-Great Recession cycle, hotel supply in the U.S. has increased 12.2% while demand has increased 34.7% and overall revenue has grown over 80%. Occupancy remains at its highest level (66.2%) in 25 years and the current average rate of \$131.21 represents an approximately 35% increase since the nadir of 2009. But we are now at a notable transition point where the growth rate of RevPAR is slowing compared to the trend lines of supply and demand. Unlike prior downturns, which resulted from external “Black Swan” events, this change in the cycle dynamics has been anticipated for several years. Given that hotel market participants were not surprised by the shifting economic results, investors are still actively seeking deals, but are working harder than ever to be strategic in their transactions.

The following chart, based on the 12-month moving average trends of three primary performance metrics, shows the rate of change for supply, demand, and RevPAR since 1998.

U.S. Supply, Demand, and RevPAR – 1998 to 2019



Source: STR/Cushman & Wakefield

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In 2019, supply increased slightly more than demand, but occupancy was ultimately able to stay at 66.2%, consistent with 2018. From 2016 to 2019, the compound average daily rate growth was 2.3%, compared to 7.1% from 2009 to 2016. The stresses of the national hotel market are manifesting in the average rate results. Although overall average rate has more than doubled in the last decade, the increase is now steadily decelerating. At the same time that hotel performance expectations are slowing, large

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for many, branding options continue to proliferate, and lenders are looking to place debt at still attractive rates. However, this confluence of the slowing growth of hotel income and an expansive market of investors searching for transactions, is impacting the tactics and concerns of owners, managers, and lenders and the ability to complete transactions.

swatches of hotel companies, investors, lenders, and operators are pushing for expansion. Capital remains plentiful

The major conundrum to all those involved in the U.S. lodging market is the lack of pricing power. If the U.S. hotel occupancy is at a consistent peak, why is average rate growth decelerating? The reasons for the lack of pricing power provided by participants are multi-fold, including lower inflation and increasing corporate restraints on business travel and meetings. However, looming large over the discussion of slowing average rate growth is the opaque inventory of alternative lodging. Alternative lodging such as Airbnb, VRBO, Sonder, Ask Alfred, and other non-traditional transient accommodations, are becoming as entrenched in the transient nightly market as Uber and Lyft now are to transportation. According to many, the “disruption” from the sharing economy is believed to be firmly influencing hotel market results and diluting demand for traditional hotel rooms. Quantifying the impact of the alternative lodging sector is challenging due to the lack of verifiable holistic data. Nevertheless, anecdotal commentary and some research is showing that the expanding availability of accommodations and the growing acceptance of this inventory by leisure travelers and a rising business cohort, is dissipating compression during traditional peak periods, resulting in lower and more competitive pricing from hotels.

Overall national hotel performance is shown in the following chart.

U.S. Historical Operating Statistics: 1995-2019 and Quarterly Comparisons													
Year	Room Nights	Supply	% Change	Demand	% Change	Eq. Index	Occ	% Change	ADR	% Change	RevPAR	% Change	
1995	1,296,206,105	3,551,250	---	840,198,343	---	---	64.8 %	---	\$66.51	---	\$43.11	---	
1996	1,327,378,229	3,636,653	2.4 %	857,953,667	2.1 %	(0.3) %	64.6	(0.3) %	70.77	6.4 %	45.74	6.1 %	
1997	1,373,655,064	3,763,439	3.5	880,383,612	2.6	(0.9)	64.1	(0.8)	74.75	5.6	47.91	4.7	
1998	1,428,239,890	3,912,986	4.0	904,625,348	2.8	(1.2)	63.3	(1.2)	78.12	4.5	49.48	3.3	
1999	1,482,967,994	4,062,926	3.8	931,878,372	3.0	(0.8)	62.8	(0.8)	80.84	3.5	50.80	2.7	
2000	1,525,108,531	4,178,380	2.8	965,098,664	3.6	0.7	63.3	0.7	85.19	5.4	53.91	6.1	
2001	1,561,252,452	4,277,404	2.4	932,657,287	(3.4)	(5.7)	59.7	(5.6)	83.96	(1.4)	50.16	(7.0)	
2002	1,585,818,384	4,344,708	1.6	935,753,763	0.3	(1.2)	59.0	(1.2)	82.71	(1.5)	48.80	(2.7)	
2003	1,602,339,641	4,389,972	1.0	948,463,191	1.4	0.3	59.2	0.3	82.83	0.1	49.03	0.5	
2004	1,609,856,123	4,410,565	0.5	987,155,136	4.1	3.6	61.3	3.6	86.26	4.1	52.90	7.9	
2005	1,611,095,859	4,413,961	0.1	1,016,609,518	3.0	2.9	63.1	2.9	90.95	5.4	57.39	8.5	
2006	1,620,521,609	4,439,785	0.6	1,027,327,729	1.1	0.5	63.4	0.5	97.31	7.0	61.69	7.5	
2007	1,630,881,234	4,468,168	0.6	1,030,858,746	0.3	(0.3)	63.2	(0.3)	103.55	6.4	65.46	6.1	
2008	1,673,991,040	4,586,277	2.6	1,011,561,443	(1.9)	(4.5)	60.4	(4.4)	106.48	2.8	64.34	(1.7)	
2009	1,728,062,260	4,734,417	3.2	952,266,656	(5.9)	(9.1)	55.1	(8.8)	97.47	(8.5)	53.71	(16.5)	
2010	1,762,020,903	4,827,455	2.0	1,014,568,881	6.5	4.6	57.6	4.5	97.95	0.5	56.40	5.0	
2011	1,767,355,160	4,842,069	0.3	1,062,135,606	4.7	4.4	60.1	4.4	101.57	3.7	61.04	8.2	
2012	1,769,610,554	4,848,248	0.1	1,087,435,148	2.4	2.3	61.5	2.3	106.05	4.4	65.17	6.8	
2013	1,783,137,587	4,885,308	0.8	1,110,527,243	2.1	1.4	62.3	1.3	110.31	4.0	68.70	5.4	
2014	1,796,907,059	4,923,033	0.8	1,157,230,900	4.2	3.4	64.4	3.4	115.39	4.6	74.32	8.2	
2015	1,814,674,194	4,971,710	1.0	1,189,614,896	2.8	1.8	65.6	1.8	119.97	4.0	78.65	5.8	
2016	1,839,582,345	5,039,952	1.4	1,205,133,146	1.3	(0.1)	65.5	(0.1)	123.90	3.3	81.17	3.2	
2017	1,869,428,066	5,121,721	1.6	1,233,203,792	2.3	0.7	66.0	0.7	126.69	2.3	83.57	3.0	
2018	1,903,840,133	5,216,000	1.8	1,260,586,980	2.2	0.4	66.2	1.4	129.70	2.4	85.88	2.8	
2019	1,938,507,913	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	
Avg Annual % Change			1.7 %		1.8 %	0.1 %		0.1 %		2.9 %		3.0 %	
Q1 2018	463,071,869	5,145,243	---	285,231,209	---	---	61.6 %	---	\$127.37	---	\$78.46	---	
Q1 2019	470,813,848	5,231,265	1.7 %	290,761,114	1.9 %	0.3 %	61.8	0.3 %	129.02	1.3 %	79.68	1.6 %	
Q2 2018	475,472,839	5,224,976	---	333,659,325	---	---	70.2 %	---	\$131.02	---	\$91.94	---	
Q2 2019	483,540,906	5,313,636	1.7 %	338,698,303	1.5 %	(0.2) %	70.0	(0.2) %	133.01	1.5 %	93.17	1.3 %	
Q3 2018	484,064,492	5,319,390	---	343,784,837	---	---	71.0 %	---	\$131.86	---	\$93.65	---	
Q3 2019	492,753,863	5,414,878	1.8 %	349,165,390	1.6 %	(0.2) %	70.9	(0.2) %	133.25	1.1 %	94.42	0.8 %	
Q4 2018	481,230,933	5,230,771	---	297,911,609	---	---	61.9 %	---	\$127.95	---	\$79.21	---	
Q4 2019	491,399,296	5,341,297	2.1 %	303,701,798	1.9 %	(0.2) %	61.8	(0.2) %	128.94	0.8 %	79.69	0.6 %	
Source: STR													
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Quarterly data shows a largely consistent change in performance from 2018 to 2019. With a strong pipeline of hotels expected to be completed in the next few years, hotel real estate and data firms are forecasting modest RevPAR growth in 2020 and 2021 than was achieved in 2019. As of early 2020, STR is forecasting an occupancy decline of 0.4%, an ADR increase of 0.9%, and a RevPAR increase of 0.5% for the year.

A more immediate threat to the slowing hotel market performance is the shadow of the Coronavirus. Industry expectations and sentiment about 2020 and 2021 did not factor Coronavirus into

estimates. At the time of this writing, occurrences of the virus are escalating in Asia, and casinos, airlines, and cruise ships are implementing isolating practices as a reaction. Chinese visitation to the U.S. has grown exponentially over recent years and become a reliable source of hotel use, particularly in coastal markets in California and the New York area. The short- and long-term impacts of the virus on human health, travel, manufacturing supply chains, and other business practices are an unknown but potentially large threat to the U.S. lodging market. News about the virus is changing daily.

TOP 25 MARKETS

The national trends are useful as a snapshot of macro issues but are not necessarily representative of what is happening in individual markets. The national average rate in 2019 was \$131.21 and 17 of the top 25 markets had average rates that exceed that amount. Consistent with historical data, the top performing areas of the U.S. continue to be dominated by New York, Oahu, and San Francisco, with their high average rates and occupancies. The average rates in these three markets are \$42.00 to \$56.00 or 21% to 43% higher than for Boston which has the fourth highest rate in the U.S. Factoring in occupancy, the RevPAR difference between the top three markets and the fourth-place market, represented by Boston, was 38% to 50%. New York in particular has been notably impacted by new supply but still maintains its presence as one of the top three markets. Even though RevPAR growth for these markets is more muted than prior years, their overall performances still reflect a rarified position. These markets are anticipated to retain their premier positioning relative to other markets, and over the long-term remain attractive for investors.

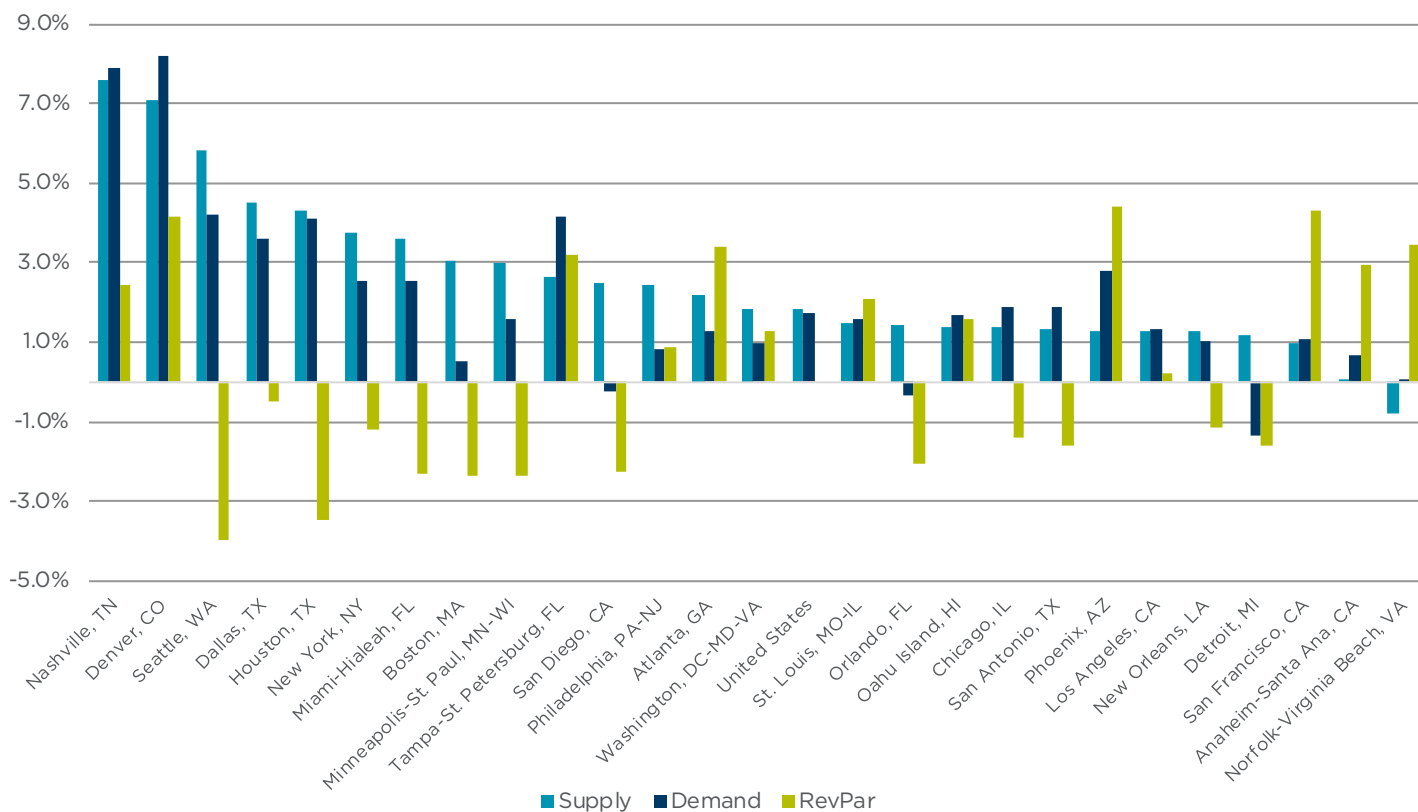
In 2019, the performance of the top 25 markets was evenly split. Roughly half of the top 25 markets had positive RevPAR growth, while the remaining 12 markets declined from 2018, compared to



only three markets that recorded a decline at the end of 2018. The Phoenix, San Francisco, and Anaheim markets benefitted from relatively lower supply growth and strong convention demand showing positive RevPAR growth. Anaheim's hotels were helped by the opening of the Star Wars attraction in the summer of 2019. Other areas such as Boston, Seattle, Miami, and San Diego saw RevPAR declines ranging from 2.3% to 4.0%.

New supply remains a primary concern for most of the top 25 markets. The following charts compare the changes in supply, demand, and RevPAR for these areas for 2018 and 2019.

Top 25 Markets Ranked by Supply Growth 2018 to 2019



Source: STR / Cushman & Wakefield

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New hotel rooms continued to open in all but two of the top 25 markets in 2019. Occupancy declined in 15 of the top 25 markets, slightly more than the 12 markets with occupancy declines in 2018. National average rate growth was 1.2% in 2019. Nine markets showed lower average rates in 2019, with an average decline of 1.8%. Of the 12 markets showing RevPAR declines in 2019, the average decline was 2.2%. The average RevPAR increase for markets with gaining revenue was 2.6%.

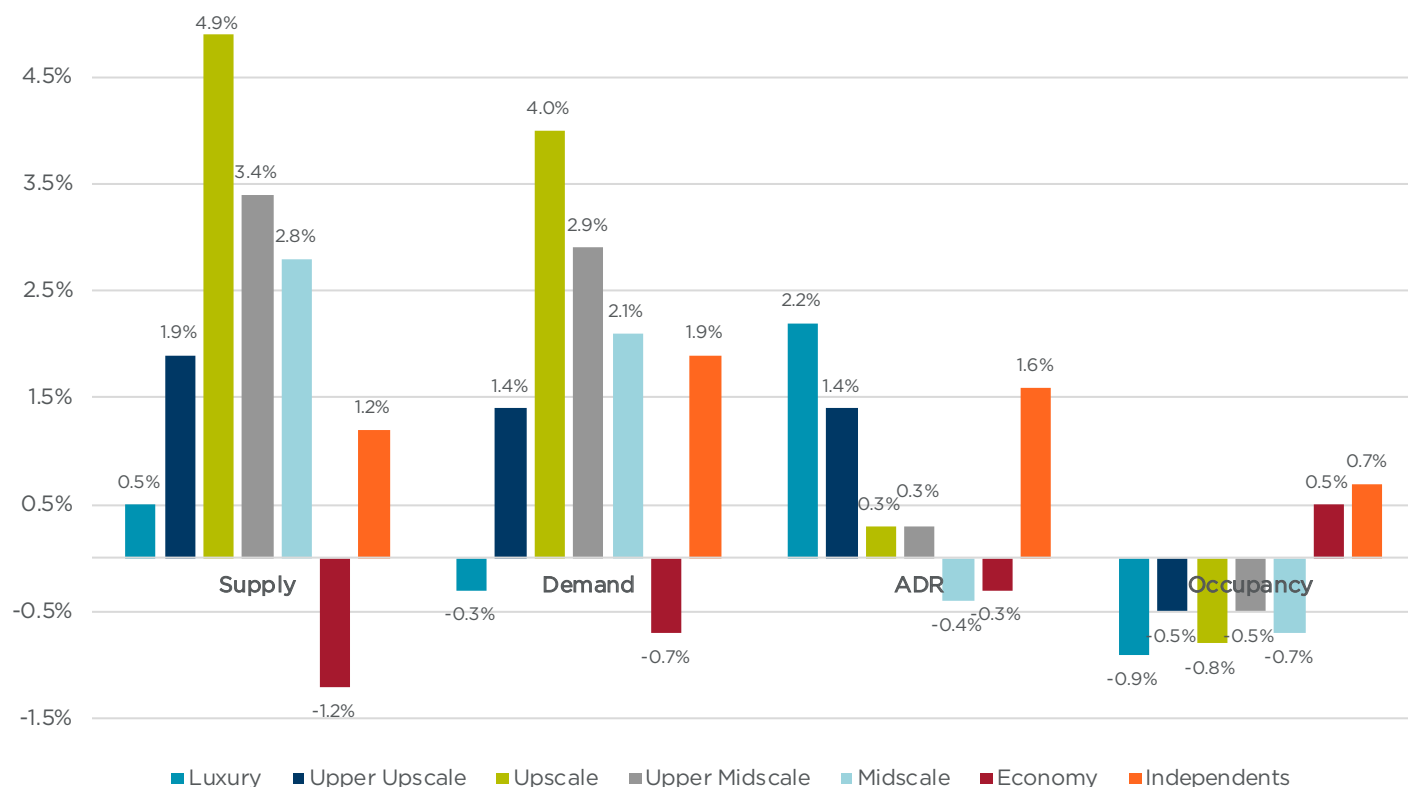
The unique attributes of each of the 25 markets shows the diverse performance and fragmented nature of the U.S. lodging market and the parochial dynamics influencing supply and demand from area to area.



SEGMENTATION ANALYSIS

Equally as important to consider as geography is the performance by segment, identified in the STR Chain Scale as indicated in the following chart for year end 2019.

Segmentation Data by STR Chain Scales



Source: STR / Cushman & Wakefield
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As has been expected, supply growth in 2019 surged, particularly in the Midscale through Upscale categories. With the additional capacity in these segments, demand also increased, although not yet to the same levels of supply, resulting in declines in occupancy and only modest average rate growth.

Only one category showed a decline in supply, the Economy segment. As properties in this segment age, considerations of

highest and best use often result in changes in use for older lodging facilities. While some older product is being converted to residential or student housing, other obsolete hotels and motels are getting demolished for redevelopment. As a result, the reduction in Economy tier rooms led to decreased demand; some of which is expected to have been displaced to other segments or alternative lodging.

Demand also dropped for the Luxury segment for the first time in many years. The Luxury segment is expected to see the greatest ratio of new rooms opening in the next few years and investors are closely watching the metrics of this strata of the market.

Overall the drops in occupancy for five out of the seven Chain Scale segments is being carefully tracked by market participants, as new hotel rooms continue to open. While average rate growth remained positive for most property types in 2020, the challenges of absorbing additional inventory and the ever-looming consideration of an economic slowdown, are prominent investment considerations in the current environment. Occupancy contraction typically precedes average rate decline. Average rate growth on a national basis is anticipated to remain modestly positive, however, it is likely that more markets will see greater discounting and lower rates in 2020.


NEW HOTEL CONSTRUCTION

As discussed earlier, new hotel supply is top of mind for all hotel market participants from operators to lenders and investors. Hotel construction has recently accelerated, yet projects are taking longer to complete. By the end of 2019, STR was reporting 200,000 rooms in construction, a 4.4% increase from the 192,000 rooms being built at the end of 2018. The number of rooms in final planning has increased 29% from 189,000 in 2018 to 243,000 in 2019. Rooms in the planning stage have declined from 258,000 in 2018 to 208,000 in 2019, indicating a notable moderation to the pipeline. Upscale and Upper Midscale hotel rooms continue to dominate the new construction with over 60% of total new rooms under construction.

While the number of new hotel rooms is greatest in the Upscale and Upper Midscale chain segments, the Luxury segment is expected to see the greatest percentage increase in new rooms. Over the next two to three years, the Luxury rooms currently being built represent 12% of the existing supply. In contrast, the Upscale segment is expecting an increase of 8.0% while the Upper Midscale segment's growth is a more moderate 5.0%.

Despite the deteriorating performance of the national hotel market, developers continue to actively pursue new hotel projects as the potential of feasible construction is still considered possible location by location. Some markets with aging hotel stock and/or increasing commercial development are still presenting opportunities for different brands and new hotels. However,

construction costs continue to rise and while some lenders are becoming increasingly cautious about extending funds for new building, we are seeing more local banks and private debt for new hotels, particularly in second and third tier markets. Developers and hotel companies are aggressively pursuing options for enhancing feasibility including new construction technology and modular building methods. Hotel development in opportunity zones is also gaining traction for some projects in the pipeline.



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The slowdown in top-line revenue and rise in operating costs are also deterring some projects from moving forward. Yet even in this more challenging part of the hotel market cycle, hotel companies continue to roll out new brands and products. The majority of new rooms (83%) will be affiliated with the top six hotel companies, which has grown since the 59% in 2010. As of the end of 2019, company websites showed Marriott offers 32 brands, Hilton offers 18 brands, and IHG offers 16 brands. The range of more stratified product offerings that cater to specific psychographic guest profiles and also fit into particular types of locations, provide developers and operators a range of options and lets hotel companies increase distribution. Only time will validate the success and benefits of the expanding hotel brand landscape.

In this seemingly contradictory environment, where hotel performance is moderating, yet brands are proliferating and capital is available and affordable, hotel industry participants are cautious but not completely dissuaded from investing in new and existing product. The investment horizon is lengthening and the underwriting is more cautious, some potential contraction in the near term, but anticipating the investment and operational benefits that a recovery brings.

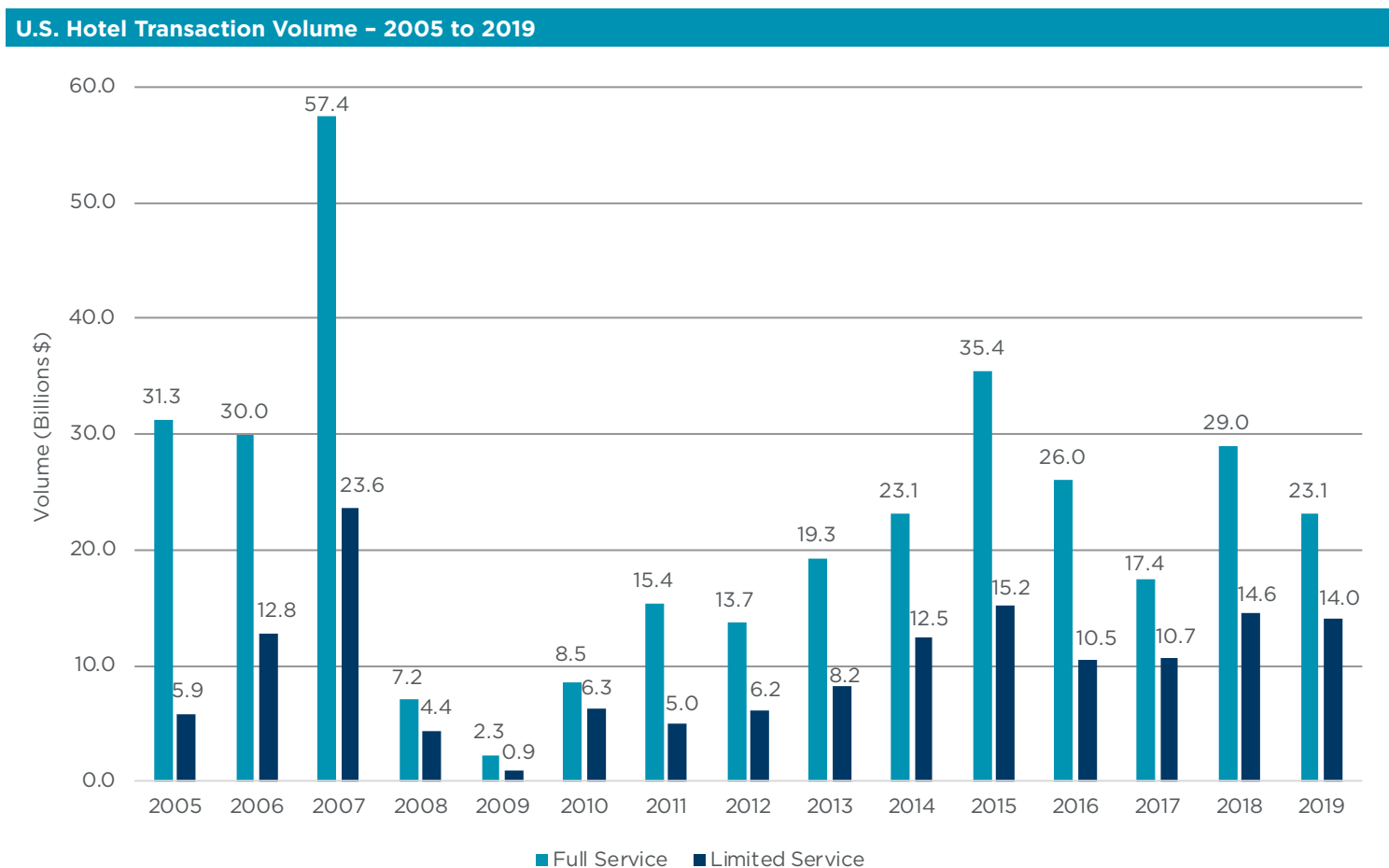
OPERATING FACTORS

On par with the concern regarding supply growth is the contemporaneous decline of property profitability. The impact of lower RevPAR growth and increasing expenses, particularly payroll and related costs, is reducing the net income of hotel operations throughout the U.S. Some areas, such as California, are more affected than others because of mandated wage increases. In addition, the state of natural disasters in recent years throughout the U.S., including fires, floods and hurricanes, is resulting in exponential increases in insurance premiums. In most of the top 25 markets, expense levels are anticipated to increase faster than RevPAR growth, directly hitting the bottom line. Operating forecasts for many hotels for the next few years are expected to show stagnant and/or declining income.



HOTEL TRANSACTION OVERVIEW

The following chart shows the historical volume of U.S. hotel sales since 2005.



Source: RCA / Cushman & Wakefield

The first half of 2019 was challenging for hotel buyers and sellers. The slowing of hotel performance fundamentals and anticipated increases in operating expenses dampened transaction activity. While the volume of transactions improved in the second half, the majority of the total sales amount was from full-service hotels while limited-service hotel sales were slightly higher than in the first half.

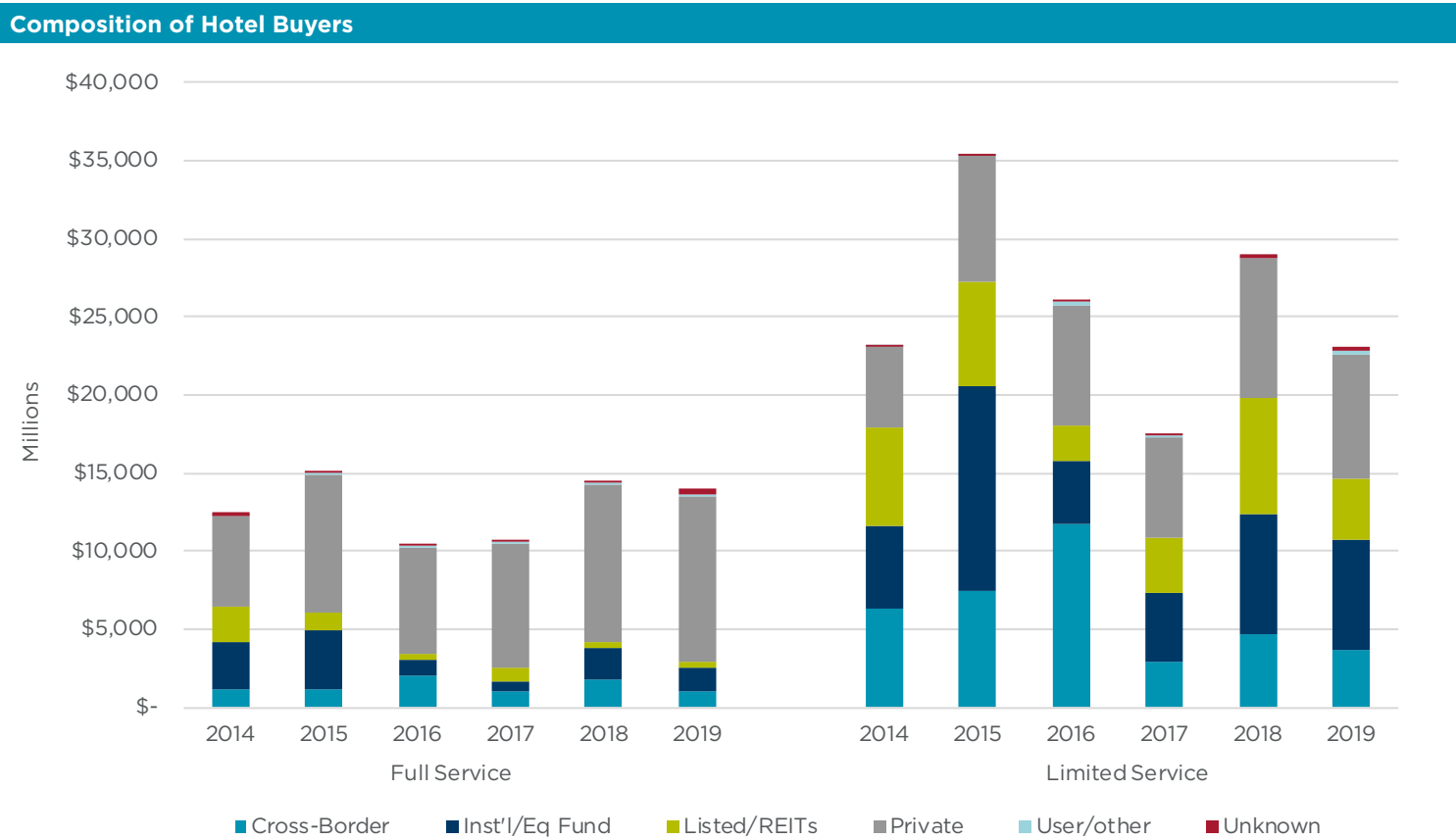
Transaction volume (Full-Service and Limited-Service hotels) in the most recent cycle peaked in 2015. While the volume surged again in 2018, the results for 2019 were even more disappointing than expected. A continued disconnect between buyers and sellers about pricing and the more attractive alternative of favorable lending rates has spurred many investors to refinance rather than dispose of assets.

Markets with the largest transaction volume in 2019 included Manhattan, Miami/Dade County, Orange County California, Phoenix, and San Francisco. Other cities with strong hotel transaction volume increases in 2019, such as Palm Beach, Nashville, and New Orleans, saw strong growth that reflected individual sales of particularly high value properties. Included in the 2019 statistics is the Park Hotels purchase of Chesapeake Lodging; a \$2.5 billion purchase of a reported 20 hotels with 6,288 rooms.

The slowdown in transaction activity was felt for individual assets and particularly for portfolio deals. Earlier in the year, some portfolios of hotels that were brought to market were subsequently reconfigured into smaller packs or individual transactions. As was evidenced in the beginning of 2019, the moderating hotel markets were deterring investors. In addition to lower income expectations, buyers were discouraged by the additional expenses of Property Improvement Plans (PIPs) for branded hotels, without the anticipation of commensurate revenue increase. All these factors point to a spread in the continued gap between buyers' and sellers' transaction negotiations. The availability of well-priced debt often provided owners with a more compelling case to refinance rather than sell assets.

Because of the slowdown in hotel market performance, the universe of hotel buyers has also lessened. Off-shore entities, particularly from Asia, and institutional investors are not as active in hotel acquisitions as in previous years. Many of the REITs are still limited by their stock market positions. Private equity funds remain the largest group of hotel buyers.

The following table outlines the current investor profiles for the past six years.



Source: RCA/Cushman & Wakefield

Large hotel portfolio transactions from mid-2015 through the current period have been muted due to the same concerns that have been in play since 2016, including a deceleration of hotel fundamentals and increasing new supply. Hotel owners are holding on to assets for longer than many originally expected, seeking options such as refinancing or renovating and rebranding to extend their returns. Consistent with hotel investment sentiment of the last 6 to 12 months, many owners continue to hold on to hotel properties that are still generating cash flow, rather than selling the assets and having to redeploy new capital in assets that may not produce the same yields. While we continue to see a range of hotel property sales in the current environment, not all transactions are resulting in price appreciation. As with all markets, the timing of acquisition and disposition is as material to the success of a hotel investment as for the performance.

Hotel asset pricing is as distinct as the individual attributes of a property and the supply and demand of whatever inventory is available for sale at any given time; however, it still should be noted that the average price per room for hotels that sold in 2019 was modestly lower than in the prior year.

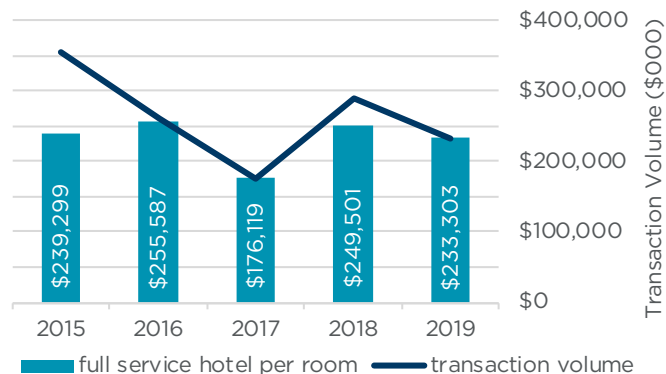


For both full-service and limited-service hotels, the price per room generally correlates with the overall volume of transactions, a function of supply and demand of hotel product and buyers.

In 2019, RCA reported overall capitalization rates for all hotels averaged 8.3%, surprisingly a modest decline from the 8.6% reported for 2018. This decline was driven by the overall capitalization rates from both full-service and limited-service hotels. Full-service hotel transactions averaged 7.1%, down from 7.3% at year end 2018. Limited-service hotels averaged 8.9%, down from 9.1% in 2018. It is interesting to note that the spread between overall capitalization rates between the two hotel product types has continued to widen from the lowest point in post-recovery cycle as transactions have slowed. In the post-Great Recession recovery, select-service transactions increased as the asset class became more attractive for private equity and fund buyers. The sale of large select-service portfolios supported lower capitalization rates for this segment. With the recent lessening of select-service portfolio sales and few high-prices of individual select service hotel transactions, the spread in capitalization rates between the two product types has returned to prior levels.

As seen in the following chart, with the exception of 2017, full-service hotel prices per room have been within a relatively narrow range.

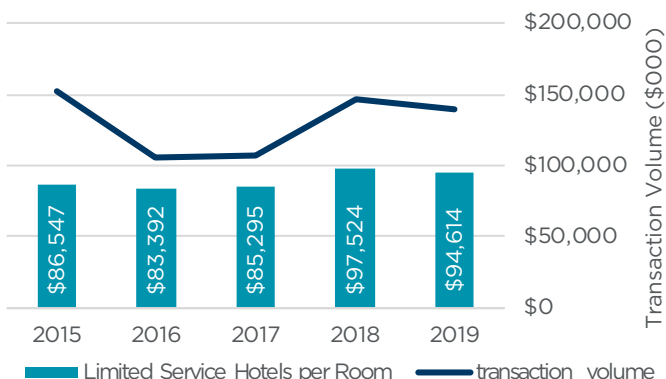
Full Service Hotels Price Per Room Trends



Source: RCA / Cushman & Wakefield

As shown in the following chart, limited service hotel prices per room notably increased in 2018 and were relatively stable in 2019.

Limited Service Hotels Price Per Room Trends

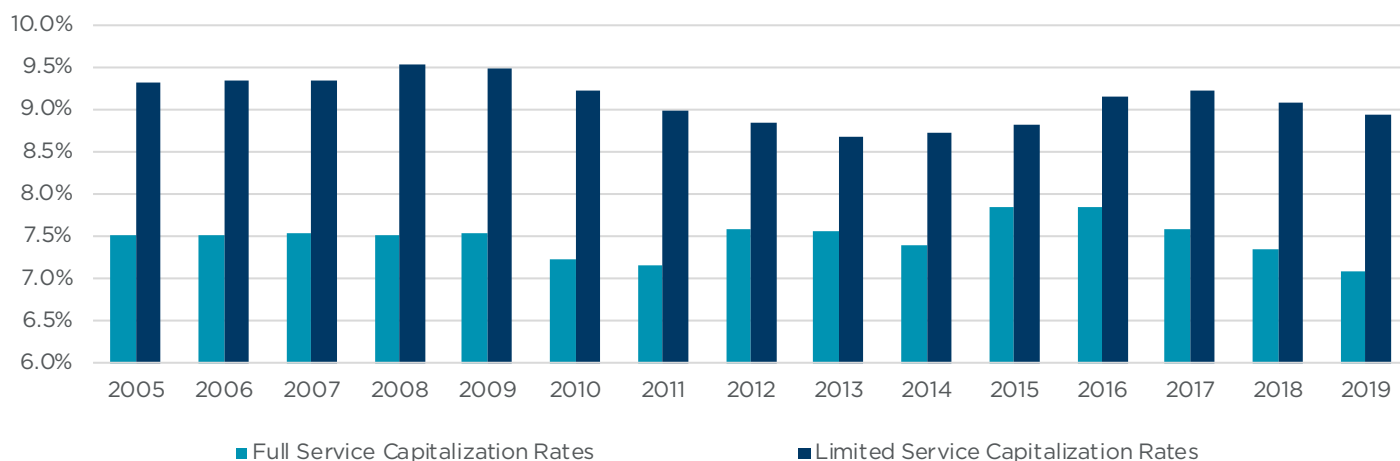


Source: RCA / Cushman & Wakefield



The basis point spread between the overall capitalization rates for limited-service and full-service hotels is shown below.

Overall Capitalization Rate Spread



Source: RCA / Cushman & Wakefield

While capital for hotel transactions remains largely available for debt and equity, the level of caution in the market increased in the later parts of 2019. The hotel investment market is currently full of uncertainty with fewer hotel assets actually transacting and a horizon of lower hotel performance trends.



CONCLUSION AND OUTLOOK

On a national basis, market participants are now seeing the long-anticipated deceleration in net operating income. In the current period, when this overview was being prepared, the Coronavirus was starting to spread internationally, and the impact was just beginning to be seen from decreases in Asian outbound travel and supply chain interruptions. We are also in the dawn of a national election year, which adds to the uncertainty that can affect travel and hotel use.

While the suppression of hotel revenue and profitability has been anticipated for some time, the continued availability of low-cost financing has mitigated some of the risk for hotel investors. The current environment is at a point where there are likely to be additional economic, political, and societal challenges from the upcoming events that will be manifested in the U.S. hotel industry performance. The hotel sector is a highly reactive marketplace because each room has to be re-rented every night. Nevertheless, market participants remain engaged in the industry with the acknowledgment that this is a historically cyclical business. In a longer-term perspective, expectations endure that a downturn can be managed through and a subsequent upside will once again bear financial fruit.



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