VIEWPOINT
U.S. HOTELS

Hotel Industry Update

A Slower Recovery Ahead


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EXECUTIVE SUMMARY:

- The U.S. hotel industry has seen 10 consecutive weeks of occupancy gains, but a recent uptick in COVID-19 cases threatens to derail the progress.
- Demand has outpaced near-term expectations for six weeks but only pulled forward the recovery by a month and doesn't change our long-term outlook for a full recovery in hotel occupancy.
- Our forecasts show that RevPAR will decline 52% this year, and occupancies will average just 41% - well below last year's record of 66%.
- Given the expected quick rebound in economic growth and historic resiliency of travel demand, we forecast a strong hotel revenue recovery in 2021 and 2022, and that RevPAR could recover to pre-recession levels by mid-2023.

An unexpectedly positive jobs report for May and June and 10 consecutive weeks of positive occupancy gains have the U.S. hotel industry in a better position than we had forecast six weeks earlier. However, a recent uptick in COVID-19 cases in the south and southwest threaten to derail those gains.

For the week ending June 27, U.S. hotels reached 46.2% occupancy according to STR, up significantly from its low point of 22% in mid-April as strict local lockdown measures brought travel to a standstill. Occupancy levels doubled as Americans have hit the road as the country has re-opened to domestic travel. Occupancy gains were stronger than expected and reflect an earlier-than-expected easing of lockdown measures and strong pent-up demand for hotel rooms in leisure destinations that can support drive-to travelers.

According to STR, hotels in resort hotel locations like Myrtle Beach, Daytona Beach, and Lake Tahoe were hardest hit in April, with RevPAR (revenue per available room) declines of more than 90% on a year-over-year basis. As consumers return to those destinations, resort areas are now only down 50% versus the same period last year, a significant improvement in performance. Urban areas have not seen the same improvement. RevPAR is still down almost 80% and in many large gateway cities like Boston, Chicago, and San Francisco, hotels – if they are open – are generating RevPAR levels today at just 15-20% of what they were earning last year.

ECONOMIC OUTLOOK

While recent economic metrics, like the June jobs report, have generally been better than expected and support our relatively bullish recovery pace for the U.S. economy, the health crisis continues to pose a risk to the economic recovery.

Many states that began lifting restrictions have seen an increase in the number of COVID-19 cases. As case numbers accelerate in some areas of the U.S., states have begun to pause their reopening plans and have reinstated lockdown measures in some cases. Even without additional lockdown measures, a resurgence in cases is expected to curtail lodging demand in these areas as the risk of infection causes travelers to avoid these locations. As was the case at the start of the pandemic, consumers and employers cut back on travel well before social distancing and lockdown measures are put in place to reduce their own risk of getting the disease and spreading it to others.

As Q2 2020 has ended, CBRE expects GDP growth will decline by 36.2% annualized during the quarter. The real test of the recovery will take place in Q3 when we expect a strong rebound of 29% annualized GDP growth. Several variables contribute to this rebound, including the reopening of businesses, pent-up demand, and an unprecedented level of government support, according to the June jobs report.

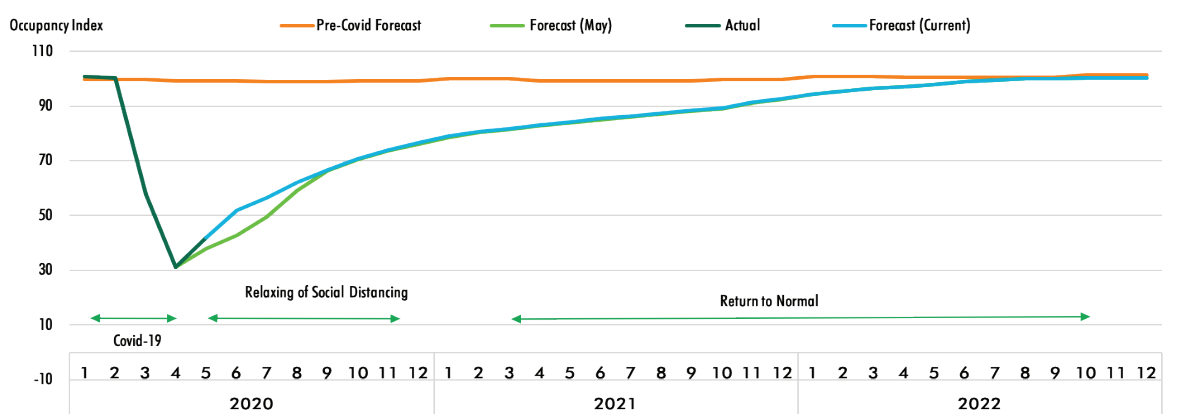
Signs of the recovery are already beginning to emerge; payroll employments were up by 2.5 million jobs in May and 4.8 million in June and retail sales increased 17.7% from April. We expect, after a challenging Q2, that unemployment will drop to 8-10% by the end of 2020 and trend slowly downward in 2021, although it will not bounce back to its precrisis level of below 4% in the near term. We forecast 6.1% GDP growth for the U.S. economy in 2021. For now – assuming the economomy does not face a widespread re-lockdown or a retreat from globalization – we see a V-shaped economic recovery and a "Nike swoosh"-shaped recovery for hotels.

CURRENT STATE OF U.S. HOTELS

The lodging sector faces two headwinds: a contraction in overall economic activity and the need for social distancing. With our May 2020 forecast release, we assumed that U.S. travel would likely resume by mid-June, with some drive-to demand beginning earlier. Over the previous six weeks demand has outpaced near-term expectations but only pulled forward the recovery by a month and doesn't change our long-term outlook for a full recovery in hotel occupancy.

Figure 1 shows our current expectations for U.S. hotel occupancy, indexed to 2019 levels. We anticipate strong gains to demand in May and June 2020. The speed of recovery is expected to slow in July and August as demand returns to states that open back up for travel and pause or pull back in areas where case numbers begin increasing again.

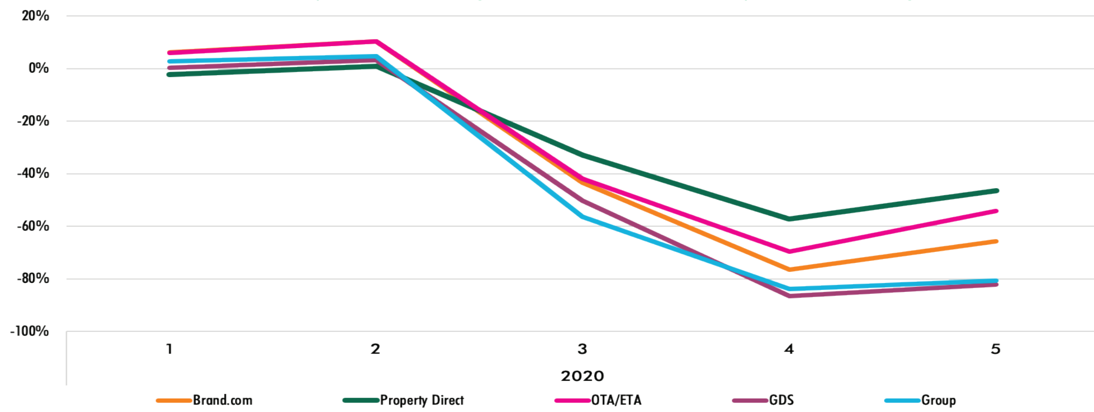
FIGURE 1: U.S. Hotel Occupancy Outlook



Source: CBRE Hotels Research, Oxford, STR, June 2020.

According to data from Kalibri Labs, of the five largest channels for hotel booking, most of the gains in demand have come through online travel agencies (OTA), Property Direct, and Brand.com channels, which have historically supported the bulk of transient leisure demand. Figure 2 shows monthly year-over-year change in hotel demand by channel. In May, global distribution systems (GDS) and group demand were still down over 80% versus the same time last year. OTA bookings, on the other hand, were only down 55% in May compared to -70% y-o-y in April.

FIGURE 2: 2020 U.S. Monthly Y-o-Y Change in Hotel Demand by Channel Segment

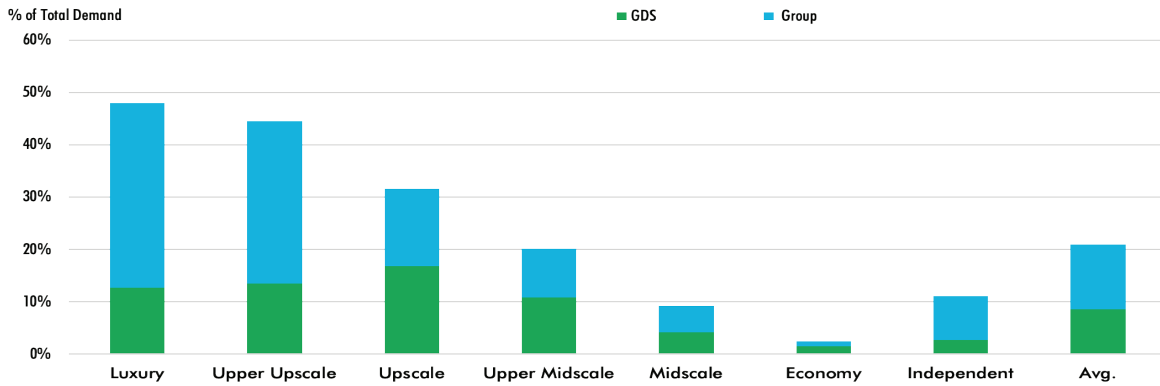


Source: CBRE Hotels Research, Kalibri Labs, June 2020.

In 2019, GDS and group bookings represented 21% of total U.S. occupied rooms. Until group and corporate travel begins to return in earnest, GDS and group bookings will act as a ceiling on the lodging recovery.

Figure 3 shows the percent of total demand that GDS and group booking accounted for in 2019 for each chain scale. Luxury and Upper Upscale chain scales rely on 45-50% of their bookings to come through these channels and will continue to underperform until that demand returns. We anticipate that much of this demand will not return to precrisis levels until there is widespread availability of a vaccine or treatment which isn't anticipated until mid-2021 at the earliest.

FIGURE 3: 2019 % of Total Demand for GDS and Group Bookings by Chain Scale



Source: CBRE Hotels Research, Kalibri Labs, June 2020.

Other measures of industry health are showing signs of recovery but still have some way to go. TSA check-ins are increasing about 20% week-over-week but are still about 80% below their 2019 levels. Some hotels have started to re-open after temporarily closing in March and April. As of the end of June, 10% of hotel rooms in the U.S. were closed, compared to 15% at the peak in mid-April, according to Kalibri Labs and Hotel Compete, and should continue to decrease as occupancies continue to increase throughout the summer.

U.S. HOTEL OUTLOOK

No areas of lodging have been spared from the pandemic. Our forecasts show that RevPAR will decline 52% this year, and occupancies will average just 41% - well south of last year's record of 66%. But, given the expected quick rebound in economic growth and historic resiliency of travel demand, we forecast a strong hotel revenue recovery in 2021 and 2022, and that RevPAR could recover to pre-recession levels by mid-2023.

Our Baseline scenario expects a two-year recovery for employment, and roughly the same for lodging demand. ADRs will take another year, on average, but longer in markets that feel prolonged impacts of the recession. Supply growth will halt after an initial wave of deliveries this year, and some temporary closures will become permanent in 2021 as hotels convert to condos or apartments. In New York alone, we expect a reduction of 17,000 rooms as hotels struggle to regain profitability.

FIGURE 4: Baseline Hotel Performance Forecast

Year	Occ	ΔOcc	ADR	ΔADR	RevPAR	ΔRevPAR	ΔSupply	ΔDemand
2018	66.1%	0.4%	$129.91	2.4%	$85.90	2.9%	2.0%	2.4%
2019	66.1%	-0.1%	$131.11	0.9%	$86.64	0.9%	2.0%	2.0%
2020	41.0%	-38.0%	$101.67	-22.5%	$41.67	-51.9%	1.5%	-37.0%
2021	55.9%	36.3%	$110.69	8.9%	$61.83	48.4%	-1.1%	34.8%
2022	65.0%	16.4%	$122.93	11.1%	$79.95	29.3%	0.0%	16.4%
2023	66.6%	2.4%	$130.47	6.1%	$86.92	8.7%	0.5%	3.0%
2024	66.5%	-0.2%	$135.63	4.0%	$90.18	3.7%	0.9%	0.7%

Source: CBRE Hotels Research, STR, June 2020.

Recovery timing will vary by market, depending on the market's business mix and ability to attract new leisure demand. Occupancy levels at lower chain scale hotels were higher than upper-priced properties during March, April and May, and we expect this trend to continue throughout the year. Luxury hotels will experience the lowest forecasted 2020 annual occupancy, at 33.4%. Conversely, economy hotels are projected to achieve the highest annual occupancy level, at 46.4%.

The combination of low occupancy levels and closures within the upper-priced segments will result in a disproportionate percentage of total U.S. demand accommodated at the lower-priced segments in 2020. On the other hand, in 2021, upper-priced properties will influence the turnaround in ADR. With their dependence on corporate, group and inbound international demand, higher priced chain scale hotels will lag in recovery timing and it may be four or five years before their RevPAR levels return to precrisis peaks.

HOTEL INVESTMENT OUTLOOK

In response to plummeting revenues and increased uncertainty, hotel trading came to an abrupt halt in Q2, with year-over-year activity down 98% in April, according to RCA. The additional risk of hotel investment demands compensation for the prospective hotel buyer, and this has driven a wedge between bid and ask prices. Liquidity constraints will intensify as many hotels continue to operate unprofitably, and hotel cap rates will rise toward the end of the year as limited trading resumes. Cap rates will peak in early-to-mid 2021 at around 9.5% nationally, up about 90 basis points (bps) from the pre-COVID-19 rate of about 8.6%.

This spike in cap rates is less than the spike subsequent the Great Financial Crisis (GFC). Furthermore, cap rates are expected to drop much more quickly as uncertainty becomes resolved and the worst periods of low revenues pass. Pent-up stocks of properties may lead to a short period of slightly lower-than-pre-COVID-19 cap rates at the end of 2022, followed by a return to cap rates around 8.5-8.6%. Net operating income is expected to return to 2019 levels about a year after revenues, so values should have recovered by 2024.

CONCLUSION

While hotel performance during May and June has surprised to the upside, downside risks remain elevated. COVID-19 case numbers continue to rise at an alarming rate and will more than likely slow or reverse the reopening of many states in the U.S. We anticipate slower growth ahead throughout July and August and if case numbers begin to decline again, as expected, many small groups and some corporate travel may begin heading into fall.

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