

VALUATION & ADVISORY
HOSPITALITY & GAMING
U.S. LODGING
INDUSTRY OVERVIEW
H1 2020

H1 2020 – A CYCLICAL YET RESILIENT INDUSTRY MEETS A PANDEMIC

The hotel market has been significantly challenged since the expansion of the COVID-19 pandemic began in March 2020. As the virus spread across the U.S., actual hotel performance and the expectations about future hotel performance fluctuated with changes in local, state, and national government responses, as well as responses from corporations and with general sentiment about travel. The impact and the reaction of the hotel industry continue to change rapidly.

The following chart shows the historical national U.S. hotel market statistics annually, as well as quarterly trends for 2019 and 2020, along with monthly details for 2020.

U.S. HISTORICAL OPERATING STATISTICS – 2017 through Q2 2020

Year	Occ	% Change	ADR	% Change	RevPAR	% Change
2017	66.0	0.7 %	\$126.69	2.3 %	\$83.57	3.0 %
2018	66.2	0.4	129.70	2.4	85.88	2.8
2019	66.2	(0.1)	131.21	1.2	86.79	1.1
Avg Annual % Change		0.1 %		2.9 %		3.0 %
1Q - 2019	61.8 %	---	\$129.02	---	\$79.68	---
1Q - 2020	51.8	(16.1) %	\$123.76	(4.1) %	\$64.14	(19.5) %
2Q - 2019	70.0 %	---	\$133.01	---	\$93.17	---
2Q - 2020	33.5	(52.2) %	\$83.59	(37.2) %	\$27.98	(70.0) %
YTD 2019	66.0 %	---	\$131.17	---	\$86.51	---
YTD 2020	43.1 %	(34.6) %	\$108.96	(16.9) %	\$46.98	(45.7) %

Source: STR and Cushman & Wakefield
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 Revised August 26, 2020

Travel sentiment surveys performed since the onset of the COVID-19 pandemic indicate that travelers are most comfortable getting to a destination via their car, as opposed to air travel. As a result, individual transient travel is dominated by short-term trips primarily within a two- to three-hour drive. In May and June 2020, as areas of the U.S. “reopened,” hotel use in many areas showed modest improvements and the occupancy levels, in drive-to leisure destinations, were ramping up. However, in the beginning of July 2020, COVID-19 cases and hospitalizations surged in many areas of the U.S., and in response, travel slowed down. Hotel occupancies in many markets that saw improvements in May and June 2020 ticked down in July.

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At this time, market participants remain uncertain about travel and hotel use through the remainder of 2020 and even into 2021. Hotel owners, operators, and investors agree that the pivotal event to significantly propel a hotel market recovery would be the widespread implementation of medical solutions, particularly a vaccine but also potentially therapeutics to diminish the health effects of the virus. The recovery of the hotel industry is being modeled to assume this occurs during the middle of 2021. Until then, the hotel market is anticipated to perform modestly and unevenly.

As states began “reopening,” hotels benefitted from local transient use. Extended-stay, economy, and highway hotels were the primary beneficiaries of guestroom use by essential workers, essential businesses, and displaced residents. As the weather warmed up, staycations at properties within a one- to three-hour drive also showed stronger occupancies, especially on weekends. In May and June, resorts along the east coasts experienced the highest weekend occupancies in the U.S.

While thousands of hotel rooms were closed in March, many have since reopened. According to STR, at the peak of closures, approximately 18.0 percent of the total U.S. inventory was affected. The closures were expected to be temporary, and have been for the most

part, but some areas are expecting a number of hotels to remain closed or be converted to other uses such as residential. New York City has been particularly affected. According to STR, 125 hotels, or 34,000 rooms, remained off-line (or more than 25.0 percent of total New York City hotel supply) through mid-July 2020. Industry experts believe that up to 20.0 percent of properties that have remained off-line may never reopen for hotel use. This suggests that approximately 6,800 hotel rooms in New York City could remain vacant and/or converted to an alternative use.

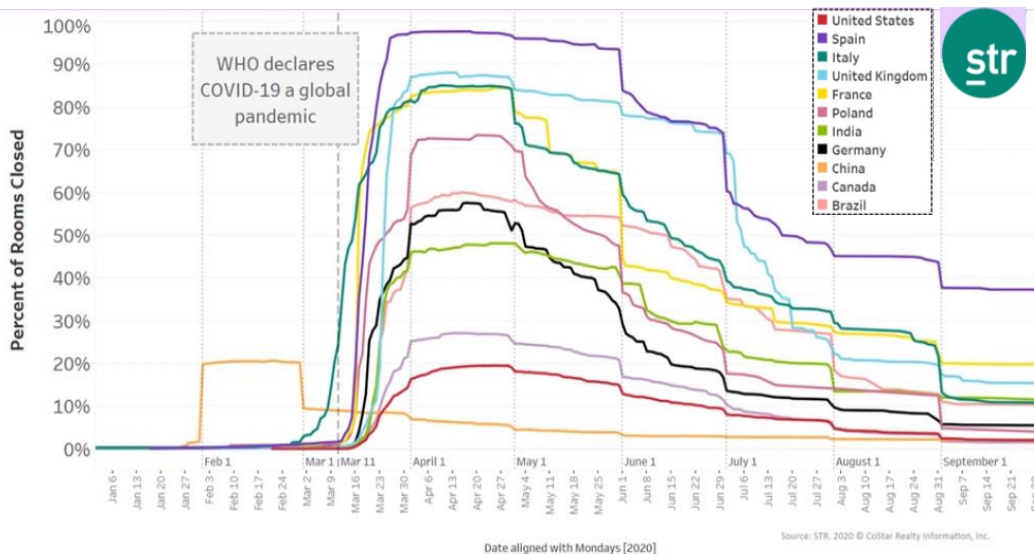
The following chart, courtesy of STR, shows the brief period of hotel closures for the U.S., relative to other countries. Represented by the red line, the reduction in hotel inventory in the U.S. was very modest and short-lived compared to other countries, and by September, very few hotels within the U.S. are expected to remain closed.

Despite these green shoots within the U.S. hotel industry, air travel and hotel stays remain depressed, particularly for destinations and hotels that rely on group events and business travel. Some hotels in urban areas have short term contracts in place for quarantine-related guests, first responders and medical personnel, and

other hotels have leased their rooms to cities, counties, and states for temporary short-term housing. The U.S. travel industry continues to be among the hardest hit sectors by COVID-19. The stay-at-home orders have been embraced by many businesses that are mandating work-from-home; some companies have extended this practice into at least the first quarter of 2021. Other businesses are still not allowed to open due to local and state mandates.

REPORTED HOTEL ROOM CLOSURES DUE TO COVID-19 OUTBREAK

Comparing Percent of Reporting Rooms Closed by Country by Date –Date as of 23 July 2020



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STR TOP 25 MARKETS

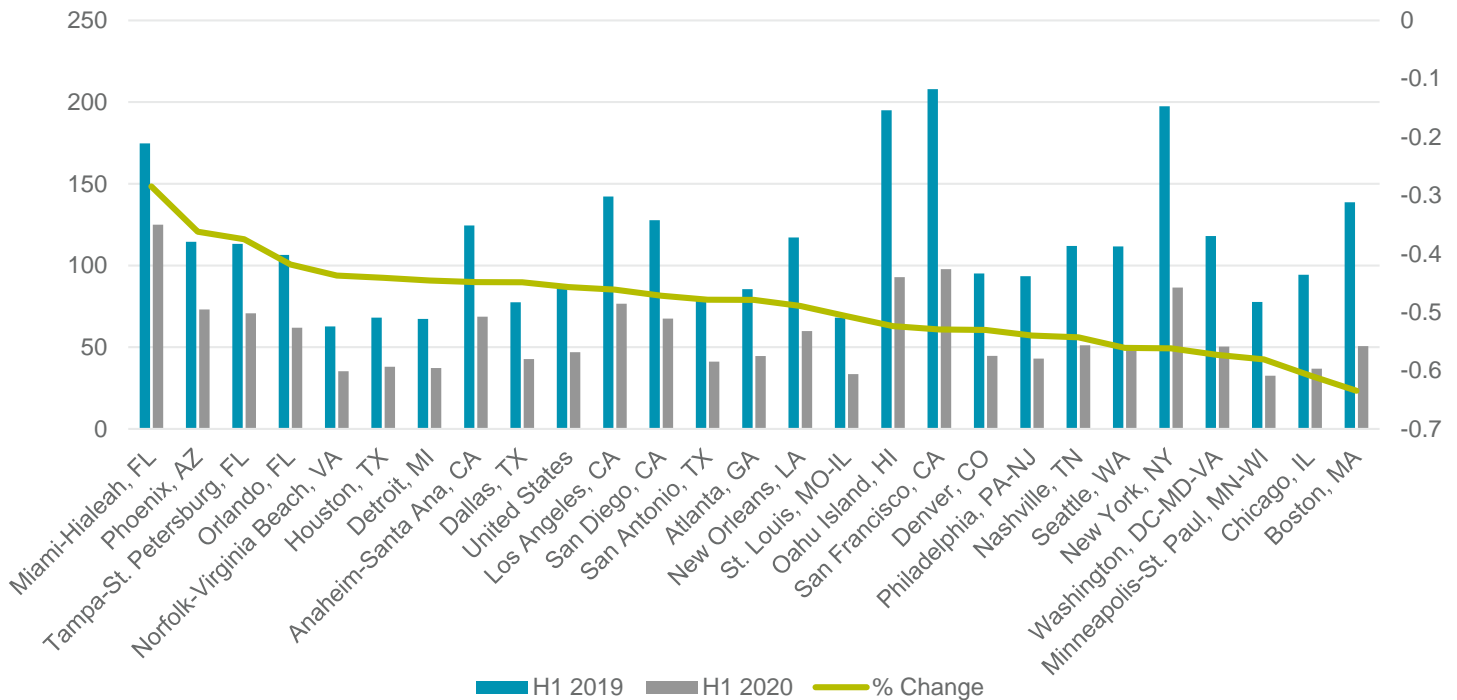
Consistent with the pre-COVID-19 results, national trends do not mirror the performance of the individual top 25 markets, but no market has been spared from the impact of the pandemic.

As reflected in the RevPAR rankings of the market shown in the following chart, the national RevPAR average was \$46.98 at the end of the H1 2020, which

was based on a range of the individual market RevPAR from \$32.56 in Minneapolis – St. Paul, which has its worst months in the winter, to \$124.96 in Miami-Hialeah, which peaks at the beginning of the year.

The following chart shows the magnitude of the impact of the pandemic on the top 25 markets from H1 2019 to H1 2020.

RevPAR CHANGE H1 2019 to H1 2020



Source: STR

For the most part, markets reliant on airlift and business travel, and supportive of strong convention/group demand were the most impacted. These include Oahu, San Francisco, Chicago, Boston, and New York. Other markets such as Anaheim and Orlando were impacted due to their reliance on major attractions, which were largely closed from mid-March.

All the top 25 markets experienced decline in both occupancy and average rates. These markets have been exceptionally affected by the lack of business and group travel. In suburban and urban markets, operators report extensive discounting to secure even modest occupancy as hotels of all caliber compete for the same few guests.

Below are the changes in the monthly occupancy, average rate, and RevPAR for the first six months of 2020 compared to the same period of 2019, sorted by changes in supply.

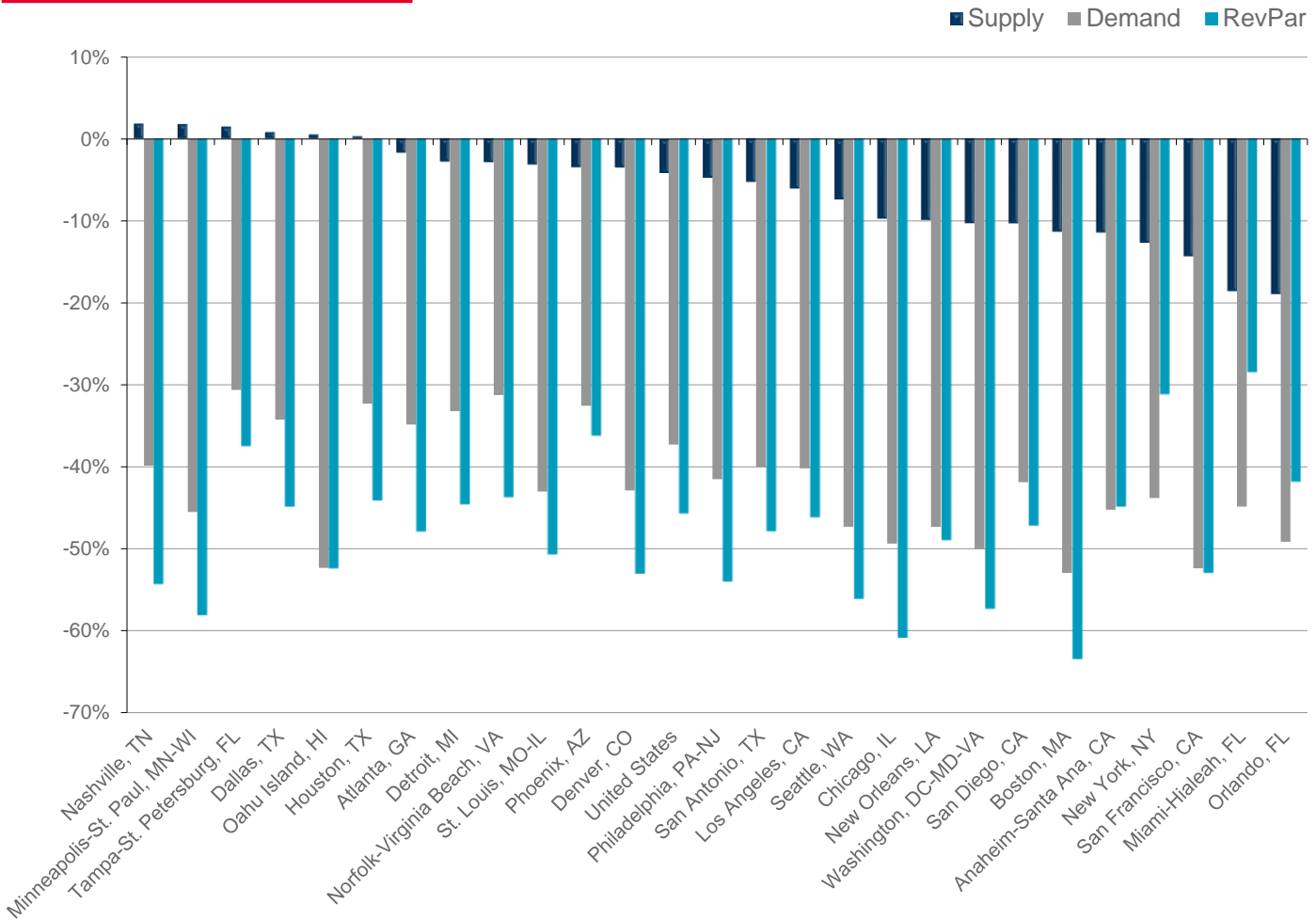
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TOP SUPPLY TO DEMAND H1 2020



Source: STR & Cushman & Wakefield; Compiled by Cushman & Wakefield V&A

Modestly priced economy hotels are showing the greatest resilience in the current downturn. Lower-rated transient hotel guests, including displaced residents, essential workers, infrastructure workers, construction workers, and transportation workers, remain regular users of these properties. Operators anticipate upticks in trainings and relocations and some limited business travelers as travel and hotel use improves.

Luxury hotels and large group/convention properties are still bearing the brunt of the current downturn, as constraints on business travel and group gatherings

have a direct impact on larger properties that rely on these hotel demand drivers. The performance of these types of hotel are expected to have the longest recovery contingent on governmental and corporate policies on corporate travel and group gatherings. Maintaining rate integrity and providing appropriate service levels with new safety procedures in the context of unprecedented competition for limited demand, are daily challenges for operators.

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OPERATING AND OWNERSHIP FACTORS

The hotel industry remains very fragmented, and every market and hotel will have a particular recovery experience. Some of the major influencing factors include:

- **Demand Mix** – The local area hotel market/property reliance on particular segments. Group demand and business travel are expected to take longer to recover than leisure travel.
- **Reliance on Group** – Group events are not anticipated to recover until a medical solution is implemented on a widespread basis. Governmental constraints on group sizes and personal sentiment will also impact event sizes. The universal adoption of online group meetings on web platforms by businesses may also effect budgets and attendance post-pandemic.
- **Cleanliness Standards** – In reaction to safety concerns for employees and guests, the hotel industry rallied around cleaning protocols. Hotel brands, operating groups, and industry associations developed and published detailed cleaning protocols for every area of the hotel. As knowledge about the transmission of the COVID-19 virus grows, cleaning procedures are changing. However, most hotels continue to provide housekeeping only for checked out rooms and not during a guest's stay of fewer than five days.
- **Social Distancing Requirements** – In recent weeks, several of the major hotels have started mandating mask wearing for all guests entering hotels. This requirement may be at odds with local requirements and sentiment but are expected to remain in place until a medical solution is available on a mass scale. Social distancing practices also limit the capacity of hotel facilities, particularly food and beverage outlets, and meeting space configurations.
- **Changes to Supply** – The status of hotel supply included expanded scheduling and/or postponement of hotel construction projects. The reopening of currently closed hotels, and delayed renovations will influence market performance. Some developers of under-construction projects are trying to keep those developments going, while others are seeking to delay opening until adequate demand returns. Proposed hotel projects that have not started construction are likely to be delayed or cancelled.
- **Flexible Room Rentals** – Some hotels in suburban and urban markets are offering a wider range of room rental options. A number of hotels, and at least one brand, are marketing day use for guests seeking a place to work rather than work from home.
- **Non-Rooms Revenues Sources** – The availability of food and beverage and other amenities at hotels. Some operators report the lack of restaurant and lounge services is a deterrent for some guests as is the closure of pools and fitness facilities. The duration of the lack of these amenities remains unknown for many properties that seek greater occupancy levels to justify the cost of the operations.
- **Operating Efficiencies** – The ability to generate positive operating profit. Many hotels are operating with margin profit or at a loss. The cash reserve of any particular owner will influence the performance of the hotel. With the current reduced staffing, operators are finding lower break-even thresholds. Some operators express hope of a long-term maintenance of the unexpected reduction in costs even as occupancy recovers to prior levels.
- **Capital Expenditures** – The postponement of PIPs for existing owners and deferred maintenance. Owners that are managing cash will continue to try to put off upgrades. Hotel companies are reportedly still requiring brand mandated PIPs for acquisitions.
- **Break-even Occupancy** – While hotels were initially closed in an effort to save money, many operators are finding that reopening the properties, even with low occupancy, results in lower losses. Managers and owners report that the number of employees is relatively the same, whether the hotel is closed or running 20.0 to 30.0 percent occupancy. Effective break-even occupancy levels are reportedly between 40.0 and 50.0 percent for limited- and select-service hotels and with the current reduction in food and beverage, some full-service hotels are breaking even at 50.0 percent.

Since March 2020, preserving ownership of a hotel has been the major focus of investors. In the first two months of the pandemic, effort was spent on furloughing employees, implementing new operating protocols, working with lenders, securing government assistance,.

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and controlling expenses of all kinds. The initial expectations in March were for a shorter downturn, with a rebound in demand by the end of the third quarter 2020. As the pandemic has expanded, the timeline for the beginning of a sustained recovery is now estimated to be rolling into 2021.

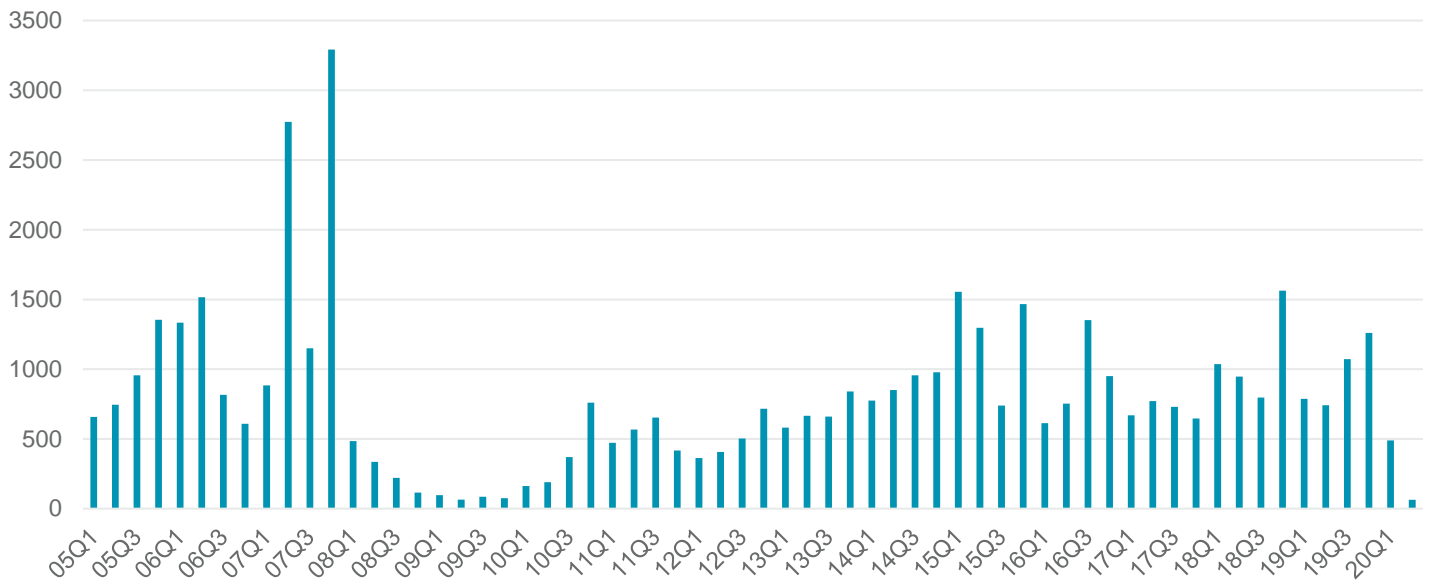
HOTEL TRANSACTION OVERVIEW

According to Real Capital Analytics (RCA), hotel transaction volume in 2019 was on a declining trend relative to 2018, particularly for full-service assets but in 2020, the transaction market froze with the expansion of the virus.

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

Hotel sales volume for Q1 2020, as reported by RCA, was \$4.89 billion, a decline of 38.0 percent over the volume for Q1 2019. Transactions in Q2 2020 were sparse with a reported \$643 hundred million in sales. Compared to the first half of 2019, when 905 hotels sold, only 474 hotels were sold in the first half of 2020. Most of these deals were put together at the end of 2019 and closed in the beginning of 2020. Only 71 hotels transferred in the second quarter of 2020. RCA reports the Pricing per key decreased by 11.0 percent from Q1 2020 to Q2, and 36.0 percent compared to 2019. However, market participants report signs of increasing momentum and thawing of the capital markets; the number of transactions for hotels nearly doubled from May to June, but still totaled just 68 transactions, the lowest quarter in over 15 years.

QUARTERLY HOTEL SALES VALUE SINCE 2005



Source: Real Capital Analytics; Compiled by Cushman & Wakefield

Transaction volume since the recovery from the financial crisis in 2010 had been inconsistent. Higher volumes in some quarters were influenced by portfolio sales and company and REIT mergers. In the four quarters ending in March 2020, portfolio transactions accounted for 36.0 percent of total volume. All the transactions in Q2 2020 have been single assets.

The financing market is likely to remain muted until there is an obvious revenue recovery trend and current debt pricing is expensive. As of early August, debt pricing was being offered at 500 to 700 bps spread over LIBOR. Acceptable loan to value ratios were declining from pre-COVID-19 levels of 60.0 to 65.0 percent to 50.0 to 55.0 percent. And the lower loan-to-value ratios also considered

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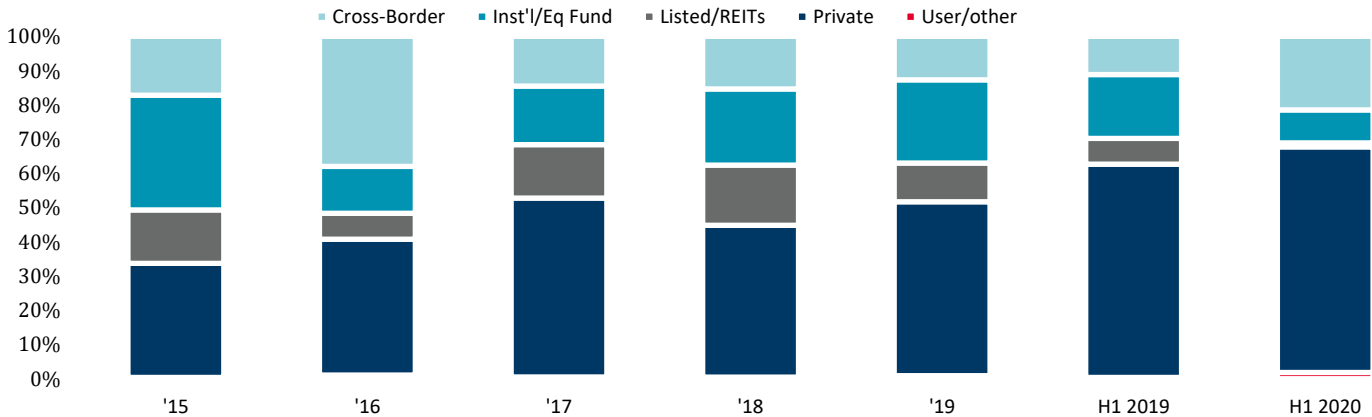
property values resulting from the pandemic. Assumable debt put in place before the COVID-19 pandemic is providing greater marketability to those properties that are offered for sale while some buyers may commit to all cash transactions with the anticipation of securing debt when financing is less expensive.

Because of the slowdown in hotel market performance, the universe of hotel buyers has also been diminished, and the impact has been global. Off-shore entities (particularly from Asia) and institutional investors were already retreating from the hotel investment market in 2019. However, recent reports of some family offices, sovereigns and international equity funds seeking acquisitions are bringing overseas buyers back to the market. Many of the REITs are sidelined by their stock market positions. Private equity funds dominated the buyer profile in H1 2020 as the chart shows below.

hotel sales have closed. Industry participants report these represent discounts of approximately 20.0 to 25.0 percent to 2019 values. Input from brokers and investors indicates that current valuation parameters (capitalization and discount rates) are generally consistent with 2019 levels. Most participants are considering the risk and negative impact of the COVID-19 pandemic on hotels to be primarily established in the forecast of revenue and expense.

As some owners evaluate their investment plans, brokers are bringing select hotel assets to market. The bid/ask spreads are still considered too great and many assets are not expected to be openly marketed for sale until a sustained recovery trail is evidenced. Hotel brokers are expecting a more sustained transaction market starting in the fourth quarter of 2020.

HOTEL BUYER PROFILES



Source: Real Capital Analytics

All categories of buyers are focused on value acquisitions in the current environment hoping for deals on distressed assets, however, the magnitude of the impact of COVID-19 on hotel values will depend on the individual property and market and the motivation of the seller. Since the onset of the pandemic, only a handful of

Traditional hotel debt remains expensive and elusive for most hotel owners. Efforts to work out debt issues rather than surrender assets are still the goal of most workouts, though the strain of a continued poor hotel market and eroding equity positions, are changing the expectation of some owners and lenders.

About Cushman & Wakefield

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ELAINE SAHLINS

Executive Director, MAI, CRE
Valuation & Advisory
Hospitality & Gaming Group
+1 415 773 3531
elaine.sahlins@cushwake.com