Houlihan Lokey

HOSPITALITY MARKET UPDATE

The Impact of COVID-19

Market Update

After a nearly complete shutdown of the hospitality, lodging, and leisure sector, hotel owners and operators are beginning to see glimpses of recovery, but with uncertainty looming large. Operators ask, “Can properties sustain operations with depressed demand and increased operational (e.g., cleaning) costs? When will travel return to ‘normal’?” Investors contemplate, “What is the impact on my investment valuation? What should I think about if I need to sell, and is now a good time to buy?” These questions and more, together with a continued lack of price discovery, have caused increased uncertainty in the hotel market, with investors and operators waiting anxiously for a return to “normal.”

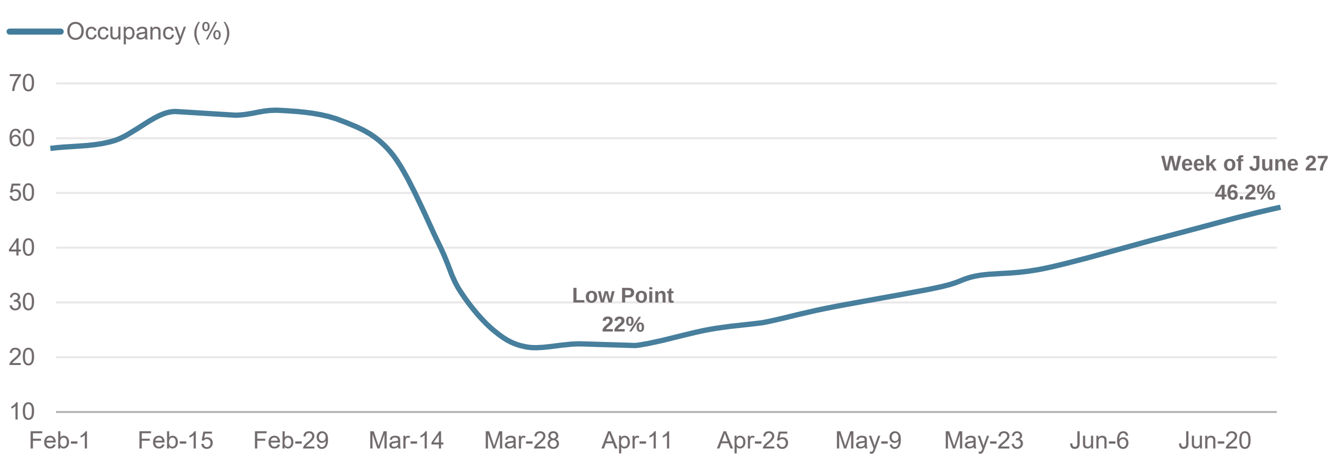
Asset and investment values are significantly lower

- While the public lodging sector has taken a hard hit (Nareit reported a negative 53.09% total return through July 20),(1) estimates of declines in hard asset values are somewhat more muted. Green Street Advisors estimates a 25% decline from pre-COVID-19 pricing and discussions with market participants indicate buyers are looking for 20%–30% discounts, with most sellers contemplating closer to 10%–20%.(2)

Operating metrics plummeted, but certain assets are seeing some recovery

- National RevPAR for June 2020 was $38.88, reflecting continued declines from the prior year (negative 60.6%) but improving from May’s RevPAR of $26.35.(3)
- Also, ADR was down 31.5% for June year over year, similarly showing some recovery (increasing in June to $92.15 from $79.57 in May).(3)
- A similar story was displayed in the occupancy metrics, although even more pronounced with national occupancy hitting a low of 22% in mid-April, primarily due to forced closures and lack of nearly all business and leisure travel,(4) with the upper upscale hotels (e.g., Ritz Carlton, Marriott) experiencing a 90% decline in RevPAR year over year.(5)

U.S. Hotel Occupancy
Weeks ending with specified dates



- In early spring, some expected the beginnings of a recovery in 2021, with PwC’s hospitality projections estimating a 58.1% resurgence in occupancy rates.(6)
- However, subsequent projections are starting to indicate that the recovery may linger through 2023/2024. For example, Green Street Advisors projects the hotel sector’s EBITDA in 2024 to be 15% lower than the 2019 levels(5) and a recent McKinsey survey projects RevPAR in 2023 to be 20% lower than the 2019 reported rates.(7)

Market Update (cont.)

Construction growth further exacerbates recovery

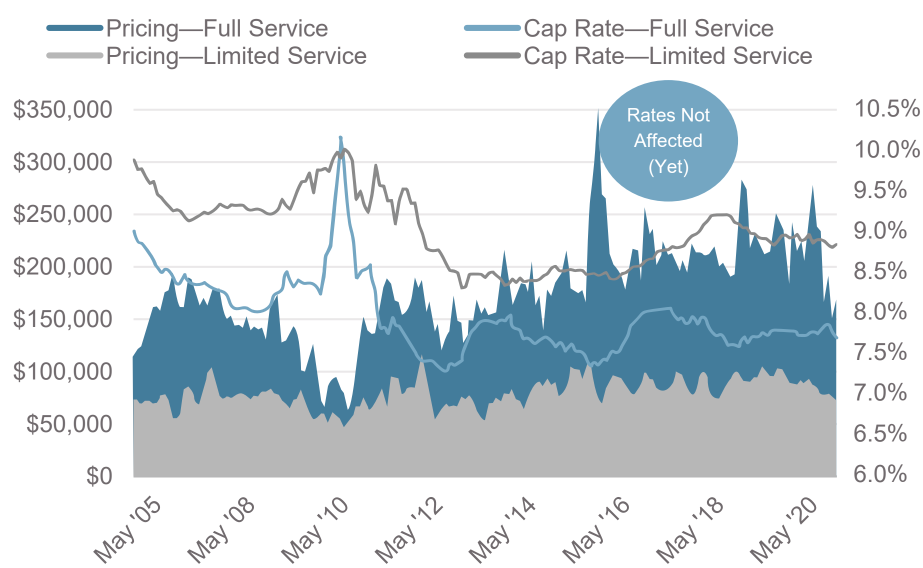
- Despite the recent shock, construction starts to remain healthy as STR reports that 215,000 rooms were under construction in March and grew to 220,000 in April. This increase in new supply is expected to prolong the sector's recovery.[8]

Transaction volume is slim, price discovery remains a challenge, and occupancy drivers remain unpredictable

Pricing Takeaways

- RCA reported a decline in transaction volume from April 1 to June 30 of 82% from the same period in 2019, the effect of which was further emphasized by a reported 98% decline in total dollar volume of transactions.[9][10]
- Not surprisingly, there remains a lack of clarity on market capitalization rates due to the lack of transaction activity. However, for those transactions that did report such information, no change in the 8.6% national average was reflected in April's at 8.6%.[10] Similarly, at a segment level, select-service capitalization rates remained flat near 9% and full-service capitalization rates remained steady at 7.6%[11]

U.S. Hotel Pricing per Key vs. Cap Rates

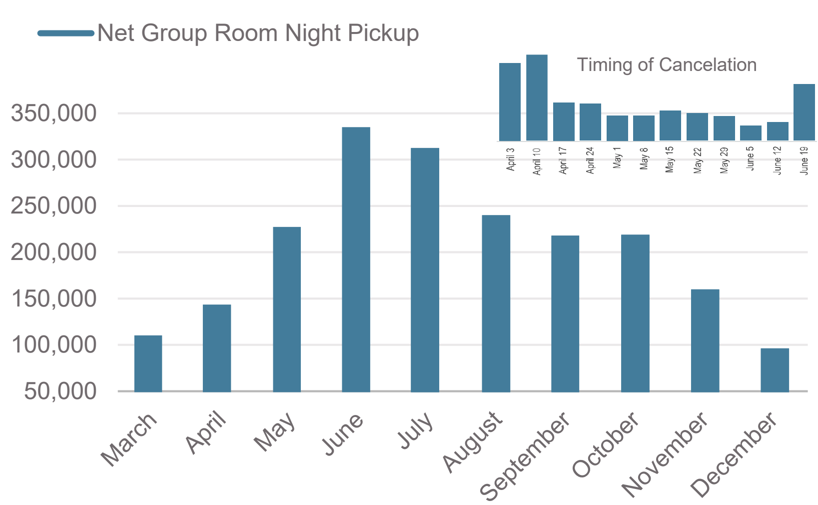


Source: RCA.

Continued Uncertainty Looms

- A recent study suggests that the increase in recent surges of COVID-19 may lead to an uptick in event cancelations, thus further troubling the industry,[11] as shown by the increase in bookings for summer 2020 as the crisis waned in spring 2020 and then a spike in cancelations as COVID-19 cases picked back up more recently.
- The **uncertainty of future consumer demand**, the **lack of activity in the capital markets**, and the **potential for future government action** during a second wave emphasize the shock this crisis has on the hotel, lodging, and leisure industry.
- Those that are **well capitalized**, **opportunistic**, and **flexible** will likely weather the storm. Others may suffer.

Would-Be Events Canceled in 2020

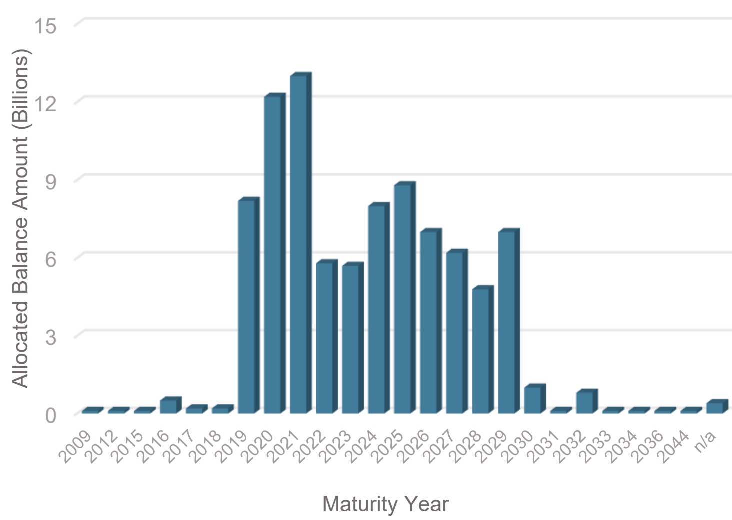


Source: Kalibrii Labs.

Market Update (cont.)

Borrowers are struggling to pay off debt and the CMBS market may be in trouble

- During the first few months of the crisis, CMBS markets were effectively frozen, with restructurings and negotiations largely taking place where owners and lenders had direct relationships.
- While relationship and balance sheet lending continued, anecdotally, lenders are talking about rates 200bps–300bps above pre-COVID-19 levels.
- The takeaway: While CMBS markets have seen increasing default rates and trouble, given the impending wave of maturities in 2020/2021, it is expected to only get worse before it gets better.



Source: TREPP.

Defaults are rising and will continue, but there may be hope

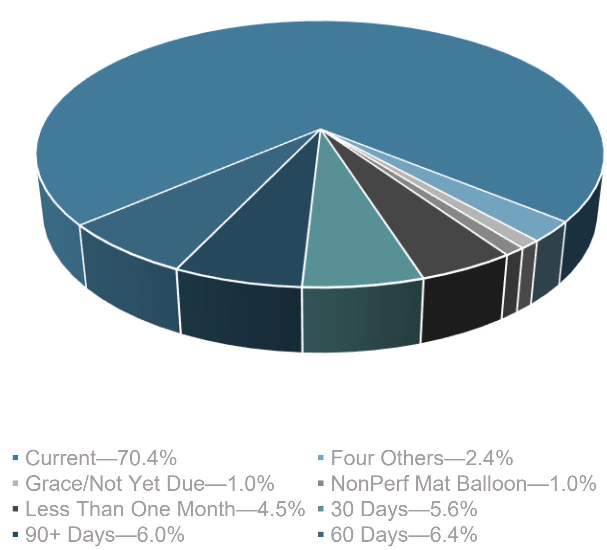
- As shown below, nearly 30% of the CMBS market is in some level of delinquency.(12)
- While the pain is felt across the country, there are certain markets being hit worse; Houston, Portland/Vancouver, and Pittsburg are reporting 50% or more of the loans in those market being delinquent.(12)
- This will lead to asset sales, lender auctions, and more, giving those with dry powder and a strong balance sheet the opportunity to grow and take advantage of depressed prices.

Delinquency Status Stratification

Delinquency Status	Loan Count		Allocated Balance	
	#	%	Amount	%
Current	2,030	64.0	63,452,342,979	70.4
Grace/Not yet due	50	1.6	924,371,615	1.0
< 1 Month	227	7.2	4,014,865,687	4.5
Perf Mat Balloon	5	0.2	870,012,725	1.0
30 Days	249	7.8	5,024,914,991	5.6
60 Days	253	8.0	5,741,029,946	6.4
90+ Days	219	6.9	5,435,635,997	6.0
Foreclosure	49	1.5	764,399,197	0.8
REO	31	1.0	517,118,864	0.6
NonPerf Mat Balloon	35	1.1	3,312,922,916	3.7
n/a	24	0.8	108,456,289	0.1
Total	3,172	100.0	90,166,071,205	100.0

Source: TREPP.

Opportunities will arise; the smart money is patiently waiting and working with their advisors to identify good buys and rescue financing opportunities.



Action Items

Houlihan Lokey is ready to assist hotel owners, operators, and lenders in assessing their real estate or debt portfolios and provide guidance on opportunities during this difficult time.

Revisit **underwriting assumptions**, consider engaging **transaction advisory specialists** to provide another perspective.

Consider **opportunistic purchases** and **distressed asset purchases**, as debt defaults will result in assets coming to market.

Have an **assessment** done on your property values to understand the potential impact of COVID-19 on your assets and **consider pursuing tax appeals**.

Discuss capital options with lenders and equity providers in order to shore up capital and ensure you have enough cash on hand.

Work with **third-party providers** to enhance your **acquisition and financing diligence**, given the heightened operating and financing risks going forward.

CONTACT US

Houlihan Lokey has a successful track record in assisting its real estate investors and owners through times of extreme volatility and exogenous events.

Please reach out to one of our team members for more information.

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Sources:
(1) Nareit, "U.S. Real Estate Index Series Daily Returns" (July 20, 2020).
(2) Green Street Advisors sector snapshot—lodging (June 2020).
(3) STR, U.S. hotel performance for May 2020, June 2020 (two press releases published on June 19, 2020 and July 21, 2020, respectively).
(4) STR, U.S. hotel results for week ending July 11 (July 16, 2020).
(5) Green Street Advisors lodging sector update (May 29, 2020).
(6) PwC U.S. Hospitality Directions (May 2020).
(7) McKinsey & Company, "Hospitality and COVID-19: How Long Until 'No Vacancy' for U.S. Hotels?" (June 2020).
(8) Skift, "Development Pipeline for New Hotels Throttles Ahead Remarkably to Record Highs—for Now" (May 26, 2020).
(9) Real Capital Analytics—transactions.
(10) Real Capital Analytics—capital trends U.S. hotel (April 2020).
(11) Newmark Knight Frank—National Trends Dashboard—Hospitality, Gaming & Leisure (June 24, 2020).
(12) TREPP (July 22, 2020).

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