RobertDouglas MARKET INTELLIGENCE. CAPITAL SOLUTIONS

ROBERTDOUGLAS MARKET PULSE
MAY 7, 2020

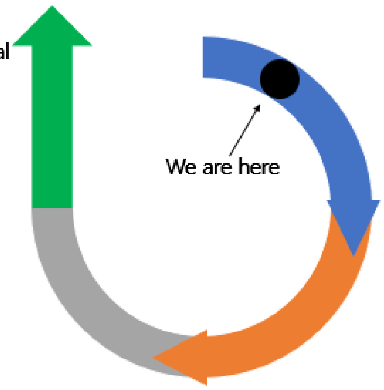
"**Where are we in The Investment Cycle?**" is the classic question asked at every real estate industry event, and very few people expected the answer to be "we are in the phase where ninety percent of the demand for hotels, restaurants and casinos disappears **almost overnight."** In our fourth Market Pulse, we address the same question but with a focus on our expectations for how the capital markets and asset management challenges facing the industry **will play out over the next 12-18 months.**

The critical elements that we see are **phases two and three of the Cycle** when lenders and borrowers are **forced to work together** (cooperatively, reluctantly or combatively) to develop longer-term business plans for assets. This will be the time when we believe that the distressed debt, rescue capital and distressed sales markets will begin to heat up. We also anticipate that the glide path toward **recovery will be bumpy** and that a **resurgence of the virus is not unlikely**, thus making the challenge of Surviving the Winter even greater.

Investment Cycle – COVID-19 Version

March 2021 and Beyond
THE NEW NORMAL

- Viral treatments improving / vaccine timeline more clear
- Business activity reflects the new normal
- Growing efficiency in capital markets
- Normalized investment sale market
- Distressed debt market is active
- Strategic and portfolio sale activity begins to re-occur



March 2020 to July 2020
"KICKING THE CAN"

- 90-120 day forbearance
- Heavy focus on asset management initiatives
- Whole loan sales focused on performing loans
- Investment sales limited to strategic sales with clear use of proceeds
- Illiquid / choppy debt capital markets

August 2020 to October 2020
"COME TO JESUS"

- Markets begin to re-open
- Valuation metrics become more clear
- Complex loan restructuring begins
- Emergence of rescue capital
- Refinancing market becomes more active
- Investment sales of most distressed assets
- Increasing loan sale activity

November 2020 to February 2021
SURVIVE THE WINTER

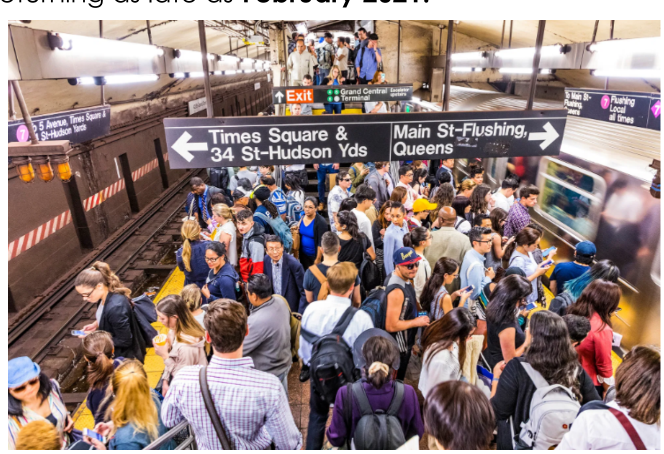
- Potential for virus resurgence
- Seasonality challenges for travel
- Growing pressure on owners
- Increased investment sales
- Increased distressed debt
- Active rescue capital market
- Debt markets begin to normalize
- Increased M&A Activity

What Will the Workplace Look Like When We Return?

We had the opportunity to hear, off the record, some of what the **top HR professionals** in the country are thinking about. When you listen to these folks getting into the weeds about the **legal, logistical, financial and health safety challenges** they're facing it is **genuinely sobering**. It also drives home the fact that our hospitality industry will not truly recover until corporate America returns to some sense of normalcy.

Bearing in mind that many of these executives are planning for **urban locations,** which have different challenges than those being faced in our manufacturing sectors or in non-urban locations, here are a few of the takeaways:

"Three phase" return - everybody is talking about a phased return with as few as **25% of employees** returning in **August/September**, another 25-50% returning in the **fourth quarter of 2020** and the balance returning as late as **February 2021.**



Getting there - this is the big "ugh" for cities that rely on buses, trains or subways. More than **8.6M New Yorkers ride the subway** on a typical weekday, with another **900,000 commuting to work** on commuter trains. Chicago, D.C., Philly, Boston, Atlanta, and San Francisco rely on subway and trains, with ridership ranging from 150,000 - 750,000 per day. Relying on other riders to obey safety precautions on p ublic transportation or forcing employees into **app-based car services** may not be a reasonable expectation so employers are considering private shuttling, car allowances or leasing office space closer to their talent base.

Elevators - landlords expect to limit ridership to **3-4 people per car**, so corporations are thinking about staggering staff arrival times: think "Fast Pass" for your office.

Distancing in Offices - the modern bullpen office layout is efficient, provides for strong teamwork opportunities, and is **completely inappropriate in a COVID world.** Lot's of changes required here, including plexi sneeze guards everywhere. **Don't even ask about trading floors.**

Corporate Cafeterias - nope, not happening.

Mail - remember the anthrax scares after 9/11? Office mail is going to be like that for a while.

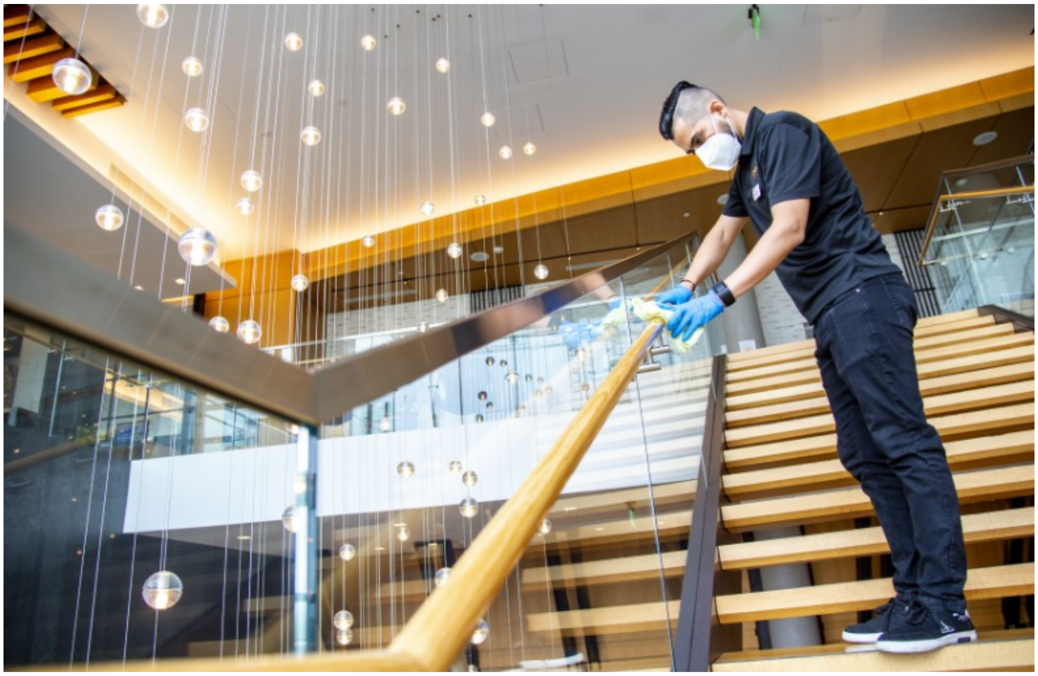
PPE Supplies - expect companies to provide/require masks for all employees.

Temperature Testing - a tough one because it is a both a logistical and a legal nightmare (HIPPA), but companies and landlords are considering the challenges of providing temperature checks. The **UK is already talking about temperature checks** and active tracking as a part of its return to work strategy.

"Revenge of the 'Urbs", (Exurbs and Suburbs that is) - p ublic transportation is less of an issue in these locations as most employees **drive to work**. Companies expect these offices to open months **before their urban counterparts**. Does this usher in a new era of people returning to the 'burbs or, imagine this, a second golden age of personal car ownership?

What Will Your First Hotel Stay Look Like?

Sorry DoubleTree lovers, you're probably not going to get your cookie. Until there is a vaccine for COVID, what are some of the other changes to expect?



Source: LA Times

- In the near-term, expect operators to keep **rooms out of circulation** for three days between guest changeovers (the "3-day rule");
- Maids may only **clean rooms** at **changeovers** and will, at the guest's request, drop clean linens at the room;
- Rooms will be **stripped of all non-essential items** (e.g., marketing collateral, coffee makers, extra pillows and blankets, ironing boards, etc.);
- **Room keys were on their way out.** COVID will accelerate that trend;
- Buffet breakfast will be another perk that disappears;
- Staffers will be **wearing masks** in almost all public spaces and you will see **plastic screens** separating staff and guests at check-in;
- Stickers on guest room doors **identifying guests who have COVID** so that staff know not to enter the room ("yes, people are checking into hotels knowing that they have COVID");
- What will replace the handshake greeting? We don't see American's bowing, maybe a **hand over the heart instead?**
- Automation has been coming slowly (very) to the hospitality industry. This will be the event that **accelerates that trend;**
- Changes to **room design and materials** to make rooms and surfaces easier to clean;
- **Temperature checks** upon entry and perhaps during your stay

Some of the bigger-picture changes we expect include:

- Brand and Manager consolidation
- Conversion of older, marginally obsolete, lodging inventory into **student, low income, workforce and senior housing.** We anticipate this trend everywhere, but expect it to have the greatest impact in **major cities with strong union contracts**
- Accelerated trends to more outdoor-focused travel (check out **AutoCamp, Collective Retreats, GetAway, Under Canvas**, if you haven't already)
- Greater emphasis on **regional travel** (national parks, local attractions, farm to table, etc.) - **41% of Americans** say their first trip will be via car and within 100 miles of their starting point

News That May Not Be Making the Headlines

CMBS is Desperately in Need of an Overhaul

The 90's brought us Britney Spears, "Friends", Blockbuster Video, the World Wide Web and **CMBS financing.** CMBS revolutionized real estate financing, bringing the efficiency of the **global markets** to your local Hampton Inn. However, we all knew that the weakest links in the chain of CMBS were always the restrictive **REMIC structure** and **special servicers.** Today, the responsiveness and **personal relationships** that underpin **balance sheet lending** (even the debt funds are proving to be much more responsive than the specials) are **straining those links**. Fitch reported that special servicers have received modification, default, or forbearance requests on almost **5,550 loans representing $120B of loans**. Will specials be able to stay ahead of this tidal wave or do they start to send out **wholesale foreclosure notices?** Absent a fundamental re-tooling of the CMBS servicing model, we expect that the debt funds will continue to gain market share.

Blackstone and KS Development Case Tests *Force Majeure*

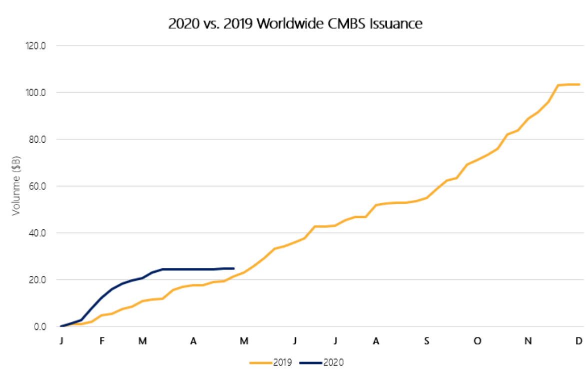
The **$250M suit filed by Blackstone** against **KS Development** for failing to close on the sale by Blackstone of **nine hotels across California** will be interesting to follow. This should have been a relatively straightforward contract law case, but it has ramifications across various industries from **property insurance** to **management contracts** to **lending**.

Securitization Lenders Would Like to Crack Open the Market

Stripping **hotel and retail out of their loan pools**, investment banks may soon test the securitization market if only to **clear some paper** from their inventory. However, even with some new issuance, Bank of America revised its projection for issuance over the balance of the year from **$17B to $7B**.

TALF Pumps Much Needed Stability into Debt Markets

Industry lobbyists are thankful the Fed included AAA-rated CMBS in TALF. As a result of that support, secondary trading has stabilized significantly and spreads for **super-senior paper are back to 150bp over swaps**. Unfortunately, **"cuspy" investment-grade** bonds continue to trade at 1,150bp spreads, nearly 800bp higher than their February levels.



Source: CMA

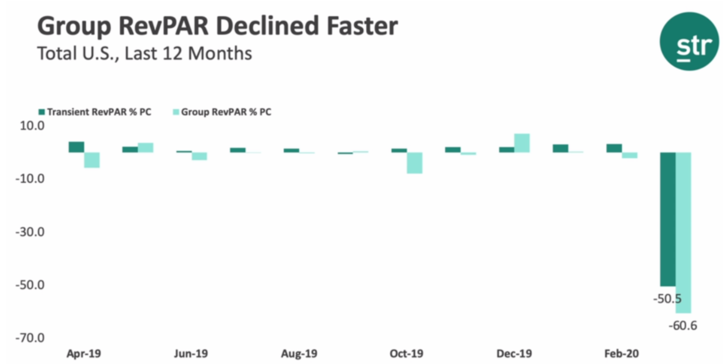
Public Hotel Companies Return PPP Loans

After racing to get PPP applications into their banks two weeks ago, publicly-owned hotel and restaurant **companies raced last week to disavow the PPP** loans granted by the SBA. One hotel REIT, which was approved for more than $100M of PPP funding, became the poster child for big, bad, hotel companies hoarding government funds, but this was really just a textbook case of the confusion that invariably occurs when complex financial legislation is drafted and enacted before public policy has been established.

<u>Simon Property Group Reopened 49 Malls this Past Weekend</u>

Simon Property Group, the country's largest shopping mall owner, **opened 4 9 malls in states that have loosened their coronavirus-related restrictions**. We applaud their enthusiasm and would agree with the hypothesis that malls will simply disappear if they don't start to win some business back from the online world. Whether consumers will care is a different question.

<u>The Theory of Convention Hotels Inducing Demand Comes into Question</u>



Convention hotels have been hard hit by the coronavirus, with most convention business **literally evaporating in the last 45 days**. Regarded by civic leaders as a necessary part of any healthy downtown, many municipalities across the nation have provided tax **subsidies** and **financing guarantees** to **large-scale projects**. With revenues gone and municipal credit ratings under pressure, the rating agencies will have no choice but to downgrade loans that fit into this category, including bonds associated with the $367M, 800-key Loews Kansas City, $240M 600-room Hyatt Regency at the Portland Oregon Convention Center, and the $152M in bonds sold to finance the expansion of the Hilton Columbus Downtown expected to be completed in 2022.

And For the Grand Finale - The State of Hospitality

The stats coming out of STR and the industry **continue to be mind-numbing**. Tucked away in the data however are **some nuggets** worth pointing out.

The **extended-stay segment** of the select service market is holding up remarkably well. We continue to hear owners praising the operating efficiency, value proposition, brand strength and resilience of their **Residence Inn, Homewood, Hyatt House, Fairfield, Home2** and similarly-positioned hotels. Interestingly, certain strong, premium select service brands that cater primarily to transient corporate guests, Courtyard for example, are struggling relative to their extended-stay brethren.

In more good news, **bets made in the hospitality and travel industry** by some of the world's **largest investment groups** further support the thesis that today's bad times are just temporary:

Blackstone and **Starwood Capital** purchased a 4.9% and 8.5% equity stake, respectively, in **Extended Stay America** for well in excess of $200M.

Carnival Cruise Lines raised $6B in stock and debt at the end of March from high profile investors including an 8.2% equity stake from the **Kingdom of Saudi Arabia.**

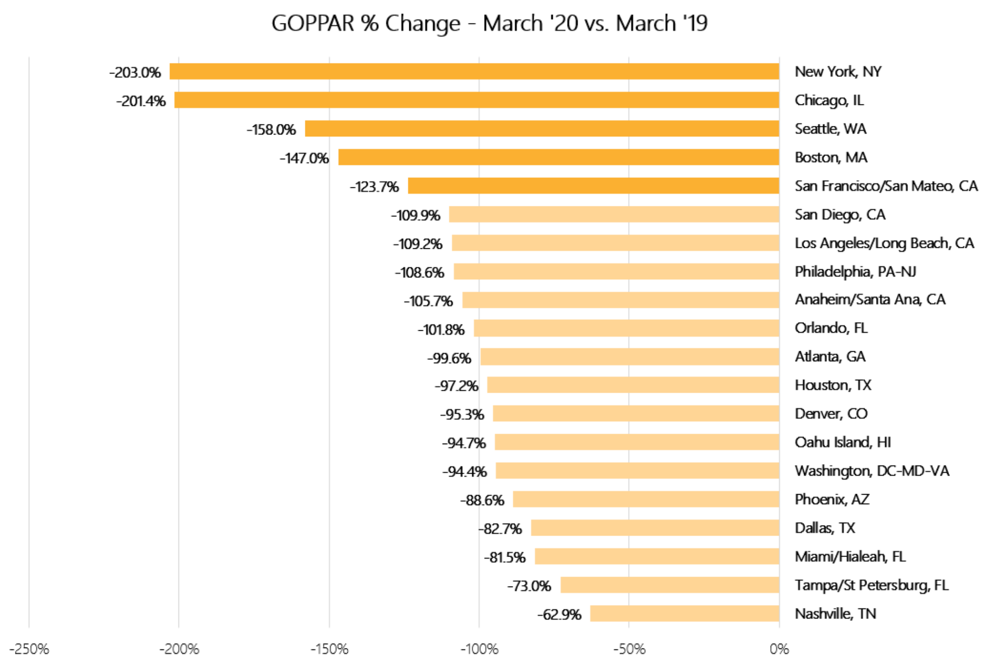
Sonder is on the brink of completing a **$150M+** funding round led by **Fidelity and WestCap**

Group.

Online-travel company **Expedia** announced a **$1.2B PIPE deal** with **Apollo Global Management** and **Silver Lake,** who will both take board seats at the company and advise on business strategy.

Source: WSJ

An analysis of the GOP decline in the **top-25 markets** in the country makes clear the **pain being felt** by owners, but it also highlights the exceptional pain being felt in a handful of **gateway markets** such as New York, Chicago, Boston and San Francisco. These markets, with their higher fixed costs and inflexible union work rule agreements, are showing profitability declines **25-100% higher than other markets**. Ironically, in the world of COVID, restrictive work rules put in place to protect unionized labor do not allow the flexibility to operate with greatly reduced and redesigned job roles and are forcing owners to close such hotels first. You can anticipate that those hotels encumbered by less flexible work rules in this crisis will also be the last to re-open, **assuming they even re-open as hotels**.



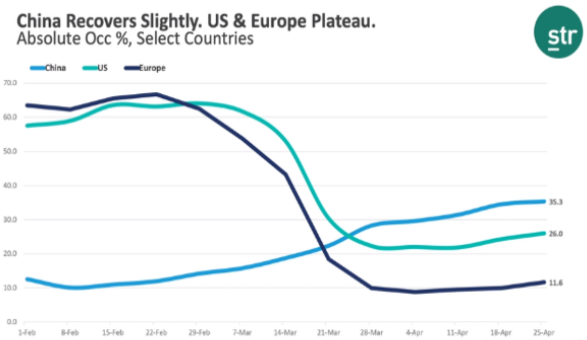
Source: STR

STR United States year-over-year stats for the week ending April 25th, 2020

The Good News

- **1.4 million additional room nights** were sold the last two weeks, as some states reduce social distancing guidelines - the increase in demand is largely concentrated in California, Florida, Georgia, New York and Texas
- **Class Performance Occupancy:** Luxury and Upper Upscale Class properties have climbed back into the double digits, and Economy Class properties reported Occupancy of 38.2%

- **New York, NY Occupancy** fell -53.2% to 41.0%, but that's an Occupancy level more than double the recent figures and is due to an influx of first responders, doctors, nurses and essential travelers



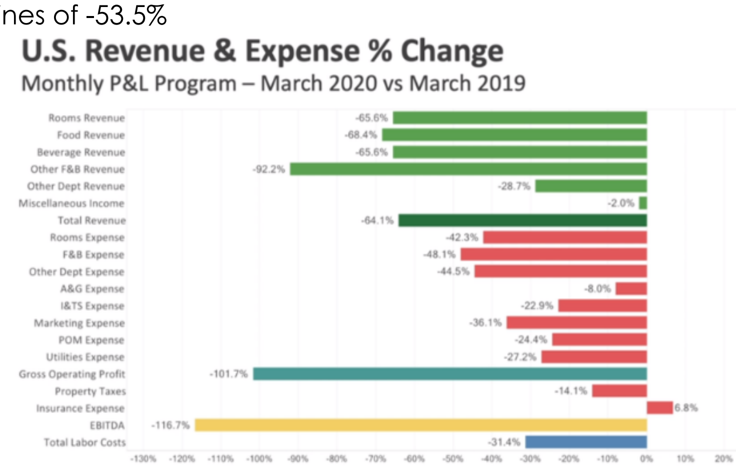
- **European Occupancy** climbs to 11.6% from its depth of 7%, and China reports Occupancy of 35.3% up from just below 10% eleven weeks ago

- China reports the **largest Occupancy gains** in the Economy and Midscale segments, up to 50% from 25% in just the past 45 days

The Reality (or the not so good news)

- **RevPAR fell -78.4% to $19.13** - this decline is less than previous weeks due to comparing this past week with the week of Easter/Passover in 2019

- **Class Performance RevPAR:** Luxury and Upper Upscale properties have experienced the steepest RevPAR declines of -92.2% and -90.7% respectively. Economy Class hotels reported lower RevPAR declines of -53.5%



Source: STR

- **For the 6th straight week, 100% of STR's 645 submarket's** experienced year-over-year RevPAR declines

- **Oahu Island, HI** experienced the largest Occupancy drop of -87.5% to 9.8% as well as the most severe RevPAR decrease of -92.1% to $13.95

- **15% of hotels are closed in the United States** , or 800,000 rooms out of the 5.4 million total

- **Baird Hotel Stock Index: YTD -43.3%**

Source: HNN

We will continue to share our insights with you and hope this correspondence finds you safe and healthy.

Sincerely,

RobertDouglas

If you have any questions about the RobertDouglas Market Pulse or would like to be added to our distribution list, please contact Alexander Bauman at abauman@robert-douglas.com.

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RobertDouglas is a real estate investment banking firm with offices in New York, Los Angeles and San Francisco that specializes in the sale, financing and equity capitalization of hotel, resort and gaming properties throughout North America. Founded in January 2013 and currently led by its four partners, Rob Stiles, Doug Hercher, Stephen O'Connor and Evan Hurd, RobertDouglas offers access to exceptional domestic and international institutional investor and lender relationships as it combines the capital markets sophistication of top-tier investment banks with diligent hotel underwriting and proven asset management experience.