Forward

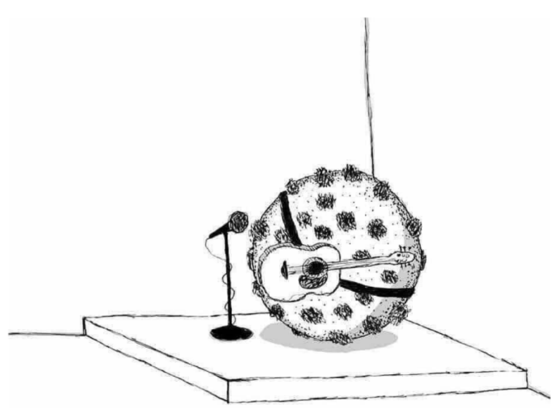
RobertDouglas

MARKET INTELLIGENCE. CAPITAL SOLUTIONS

ROBERTDOUGLAS MARKETPULSE
August 2020

"Everybody Has a Plan Until They Get Punched in the Mouth"

That Mike Tyson quote is uncomfortably appropriate as the U.S. stumbled into the ropes in response to the COVID resurgence sweeping through much of the country. In our last MarketPulse we spoke hopefully about some of the "green shoots" we were seeing as the travel and leisure industry began to re-open. Six weeks have gone by since then and those green shoots are wilting. A dog's breakfast of pandemic strategies including lockdowns, quarantines, mandatory closures, face mask regulations, online schooling and curfews - phrases that we had hoped we were putting behind us - have been hastily reintroduced from Florida to California in the past few weeks. It still remains difficult to reliably assess the impact on the tourism industry, but in our conversations with hotel owners we are hearing a new tone of weary soberness.



"This one's dedicated to all the people that didn't believe in me when I was getting started."

In this edition of MarketPulse we want to explore several broad themes that we see taking shape in the hospitality and tourism markets, as well as in the capital markets that underpin those markets.

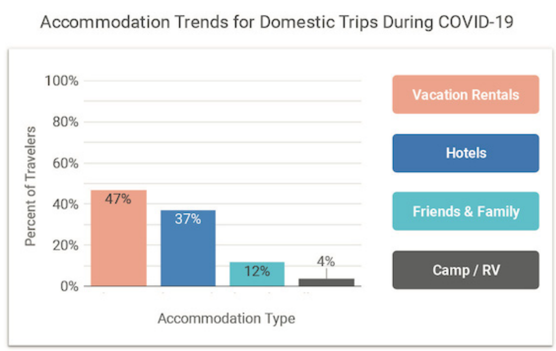
Toto, We're Not in Kansas Anymore

Initially, COVID-19 was viewed by most people as an **inconvenient obstacle** that we would navigate around and that we would eventually return to our original path. The debates over whether this recovery would be a "V" vs. "U" vs. "W" vs. "swoosh" were symptomatic of that mindset. However, like Dorothy in the Wizard of Oz, who found herself in a world that was both familiar and profoundly different, we believe that the **hospitality world coming out of COVID will be powerfully changed**. That change is being driven by several phenomenon which are, together, taking us into unfamiliar territory.

First, the pandemic is an accelerant, hastening trends that were already beginning to impact the hospitality market. Across broad swaths of the industry, we are seeing what might have been five or ten years of gradual change compressed into 12-24 months.

- **Outdoor and experiential hospitality** offerings are showing strong growth as travelers seek both a safe and also a less stressful environment. Many of these properties are achieving record occupancy and ADR.

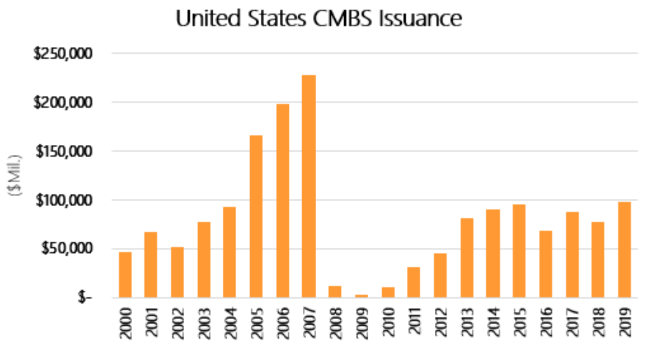
- **The luxury sector, and ultra-luxury** in particular, are performing surprisingly well. High-end resorts from Napa to the Florida Keys to the Grand Canyon reported positive EBITDA in the month of June, an extraordinary statistic given the weakness of the overall market. IHG is committed to expanding their 51%-owned Regent brand, as ultra-luxury still remains a durable sector to invest in despite the pandemic's impact on hospitality.



Source: Squaremouth.com

- **"Less is More":** The pandemic has thrown a spotlight on the value of providing less: less F&B, less person-to-person check-in, less spa. Less of everything in fact, except housekeeping, where people want more. Select service hotels, the "ankle-biters" of the hotel industry, have been stealing market share from full-service hotels for years and we are now seeing that market share growth accelerate. Keep your eye on **new brands like Bode** and Sonder that are working to fill the growing need for short-term rentals that offer an economical, safe and "cool" option to the traditional extended-stay market.

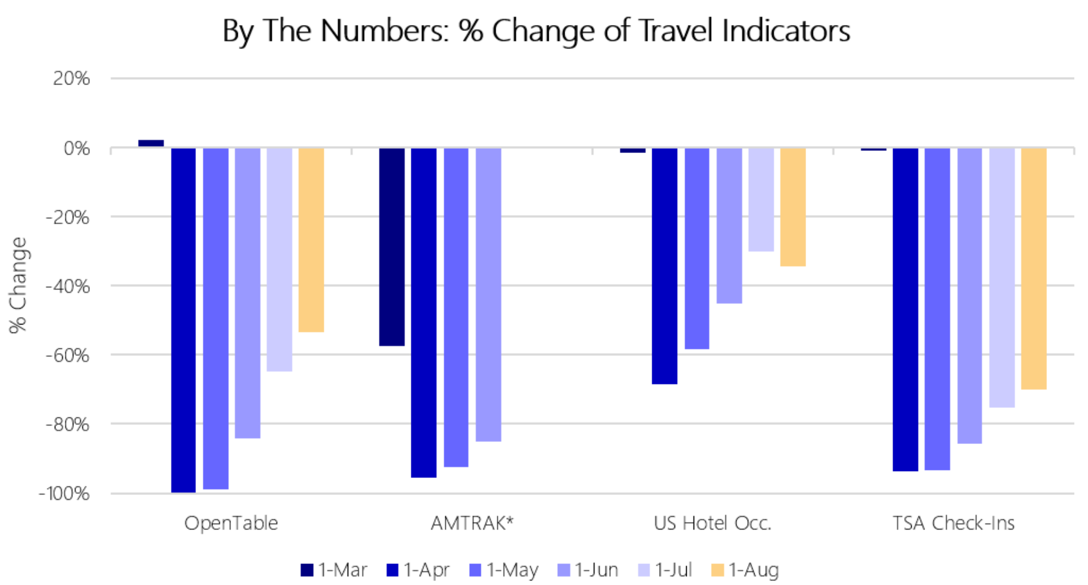
- **The use of technology** to make hotel operations more efficient and reduce headcount, as epitomized by Lifehouse and, more notoriously, Oyo, is continuing to accelerate.



Source: CMA

- **The CMBS market never truly recovered** after the great recession, losing significant share to balance sheet lenders including banks, life companies, pension funds and debt funds. Expect that decline to accelerate post-pandemic, driven by growing frustration with some servicers and with the built-in shortcomings of securitizations.

Second, **the value of being able to flex costs, especially labor costs, has never been more obvious and large, group-oriented, union hotels in urban markets are in the cross-hairs.** The challenge of managing large, full-service hotels, particularly group-focused hotels or urban hotels subject to CBA's with restrictive work-rules, was having a chilling effect on the value of those properties in markets like Chicago, New York and San Francisco even before COVID. Similarly, 3- and 4-star urban hotels that have rolled out **high-touch offerings** such as spas, fine dining, bars or communal areas to differentiate themselves will struggle in a low/no-touch environment. The **cash hemorrhage** occurring now in hospitality will influence lender and investor perceptions of our industry for a generation.



***July & August AMTRAK data unavailable**

- **Many hotels will close permanently.** Numerous hotels in markets such as New York, Washington, D.C., Boston, Chicago and San Francisco have already indicated they plan to close forever. Estimates are that the NYC market could lose 10-20% of its room inventory or upwards of 15,000+ guest rooms.

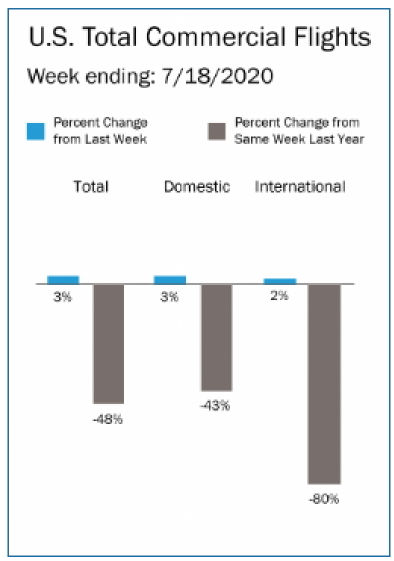
- **Convention hotels are under tremendous pressure.** The convention and large corporate group market operates on 6-12 month lead times and will not begin to show real signs of recovery until 2022. The impact on hotels in convention-heavy markets will force drastic cost cuts and recapitalizations.

- **Urban fine dining is in a vice-like squeeze** with low margins as the jaw on one side and the disappearance of high-margin corporate guests as the jaw on the other side. The industry will survive, but only because landlords have absolutely no alternative but to waive rent and hope their tenants will recover.

Finally, basic business and social behavior is going to change. The massive, unplanned experiment in remote working and online interaction that the world is engaged in will change the workplace and the hospitality industry for years to come. People in the airline, hotel and tourism industries all know that the last ten to twenty percent of demand creates eighty percent of their pricing power. It is easy to imagine that a shift to more remote working, more online meetings and less international travel could reduce business and leisure demand by ten percent or more:

- **Quality of life is being redefined and is becoming a priority**
    - More people will make the decision to move out of urban centers in search of better quality of life. This may drive need for serviced apartments or short stay rentals in urban centers. New concepts like Bode, PodShare, and LivINN are rushing to fill this space.

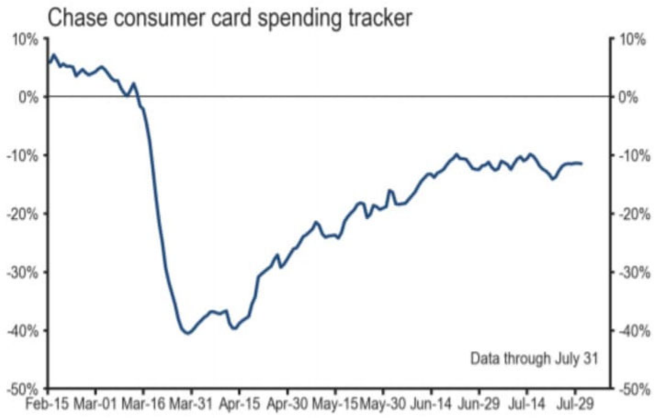
- **Even the disruptors are being disrupted**
    - Early in the pandemic, Airbnb made the controversial, but probably business-savvy, decision to allow all renters in its system to get 100% refunds regardless of the policies of individual hosts. The safety protocols being trumpeted by the major brands is something that individual online hosts cannot duplicate. Among other short-term rental operators, Lyric, with $180M of funding from Airbnb, shuttered its operations.



- **International corporate travel will decline for years**
    - Most of the major airlines have indicated on recent earnings calls that they are now projecting a long recovery period and are adjusting their schedules and equipment deliveries to reflect this more cautious outlook.

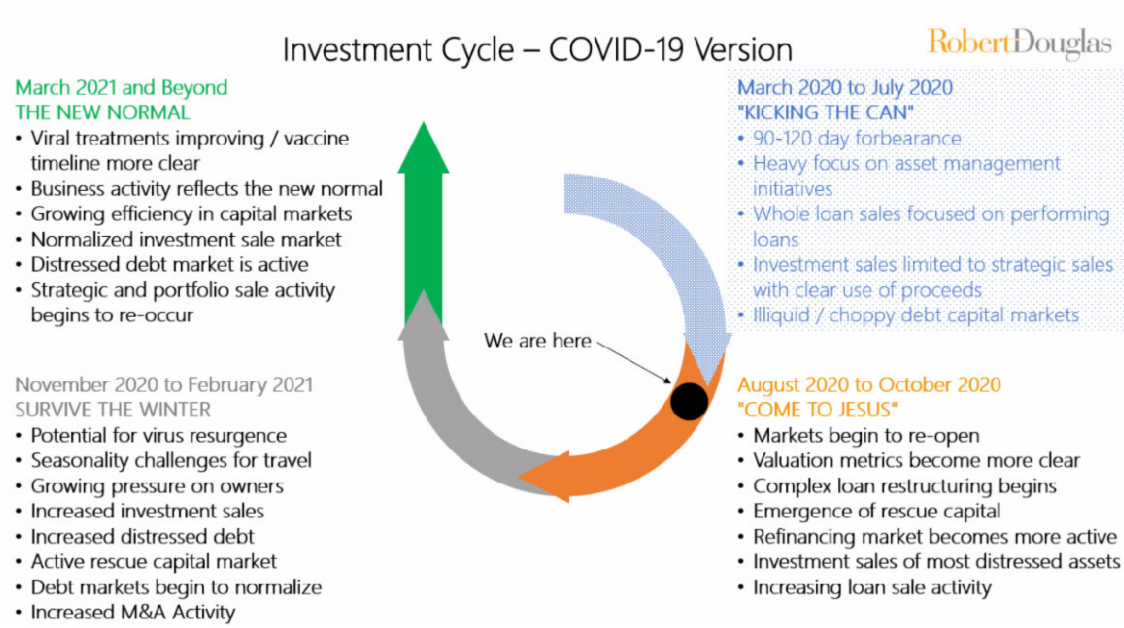
- **Middle-class balance sheets are shrinking**
    - Expect these consumers to stay closer to home, fly less frequently, visit more national parks and generally spend less. Expect domestic travel to surge and for Radical Localization to become a new phenomenon.

- Spending by JPMorgan Chase's credit & debit card holders has been approximately 10% or more below 2019 levels for over a month after rising from its late-March and early April low point.



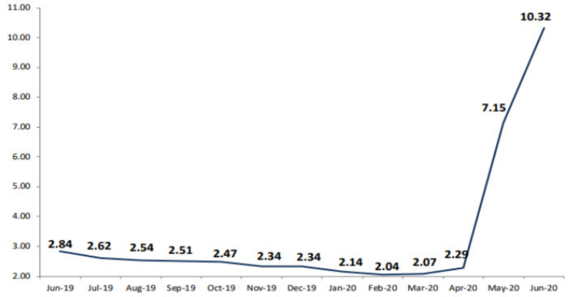
Source: J.P. Morgan. % change over year-ago in 7-day average of total in nonrecurring categories.

It's that Time; Welcome to "Come to Jesus"



Logic tells us that every hotel loan in the United States is in, at the very least, **technical default**. As a result, we are entering a new and more painful phase of restructuring and recapitalization. The good news is that many owners began the process of seeking and structuring that capital months ago. Today, there are a wide array of equity investors and subordinate lenders interested in providing capital to owners albeit at rates that may seem high to owners that are still struggling to cover their fixed costs.

GRAPH 1: PERCENTAGE OF CMBS MARKED AS 30+ DAYS DELINQUENT



Source: Trepp

How bad is it? The all-time record for CMBS delinquencies is 10.34% and that occurred in July 2012. However, delinquencies reached 10.32% in June 2020 and Trepp expects July and August to be worse. To put this number in perspective, pre-COVID, roughly 2.0% of CMBS loans were delinquent. In June 2020, 24.30% of Hotel loans were at least 30+ days delinquent followed by Retail at 18.07%.

Special servicers are overwhelmed. Fitch reported that $20B+ in CMBS loans have been transferred to special servicing, or 8.3% of all loans, since April. By comparison, approximately $9B across 674 loans were transferred to special servicing in all of 2019. Servicers are obligated to make protective advances where assets are failing to meet their basic obligations, but we expect them to work as quickly as possible to foreclose on and sell those assets in order to limit those advances which could lead to a deluge of sales in Q4 of this year.

The silver lining: Trepp reports we are approaching terminal delinquency - meaning by now, all borrowers have requested debt relief, so numbers may get worse, but the 5x jumps of the past are likely to be behind us.

CHART 2: DELINQUENCY RATE BY PROPERTYTYPE (% 30 DAYS +)

	JUN-20	MAY-20	APR-20	3 MO.	6 MO.	12 MO.
Industrial	1.57	1.82	1.36	1.35	1.57	1.94
Lodging	24.30	19.13	2.71	1.53	1.48	2.41
Multifamily	3.29	3.25	1.92	1.63	2.02	2.11
Office	2.66	2.40	1.92	1.86	1.87	3.02
Retail	18.07	10.14	3.67	3.89	3.76	4.44

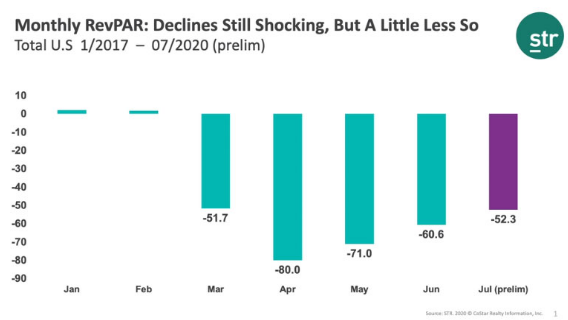
Source: Trepp

In our discussions with hotel owners, we are hearing concerns that leisure demand will naturally decline after August and that corporate FIT will not begin to recover until the first or second quarter of 2021. What does that mean for the tourism industry? Well, we have consistently counseled our clients that they should plan for at least 12 months of profoundly reduced demand, but we are starting to hear many owners talk about their 18- to 24-month "survival" plans and the painful decisions they face around furloughs, recapitalization, WARN Act notices, pension liabilities, shuttering F&B operations, deferred capital investment, and conversion opportunities. On a recent call, we even heard Sam Zell's prophetic **"stay alive 'til 95" updated to "stay alive until '25."**

The State of Hospitality - STR Statistics for the Week Ending August 1st

- **STR and Tourism Economics** adjusted their 2020 and 2021 Forecasts. 2020 RevPAR is expected to fall -50.5% followed by a 40.6% gain in 2021. The May forecast called for a **-57.5% RevPAR decline in 2020 followed by a 48.0% gain in 2021**. STR predicts it may take until 2023 or 2024 to recover to peak demand levels.

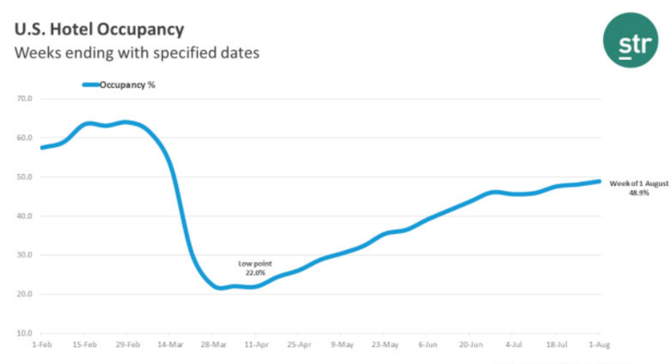
- **National RevPAR for the month of July decreased -52.3%** compared to July 2019. This marks the 3rd straight month of less significant RevPAR decline and a strong improvement from April's -80% decline.



- **National RevPAR fell -51.1%** to $48.96, a low figure, but a significant improvement compared to early April's $16.50.

- **National occupancy** was just shy of 50% at 48.9%, a massive improvement from the mid-April depths of 22.0%.

- **National Weekend Occupancy** reached 57.4% further evidencing travelers are comfortable traveling for leisure, but not yet on business.

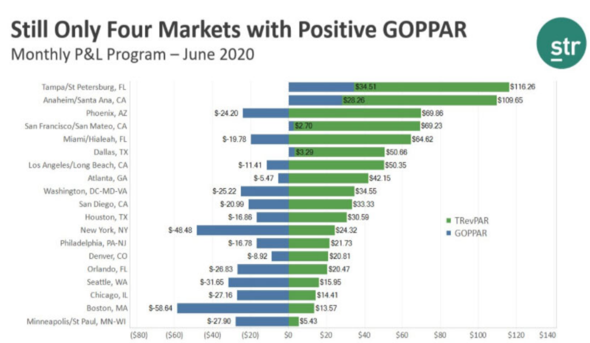


- **Upper Upscale Class properties overtook Luxury Class** properties as the biggest loser in terms of Occupancy posting 32.4% compared to Economy's 56.6%.

- **Simply having "Resort" in the Hotel** name allowed operators to charge almost a $70 premium compared to hotels without "Resort" in their titles.

- **Only 4 Top 25 Markets** reported positive GOPPAR: Tampa/St. Petersburg, Anaheim/Santa Ana, San Francisco/San Mateo, Dallas.

- **All Top 25 Markets except for Boston and Minneapolis** reported positive GOPPAR change from May to June.

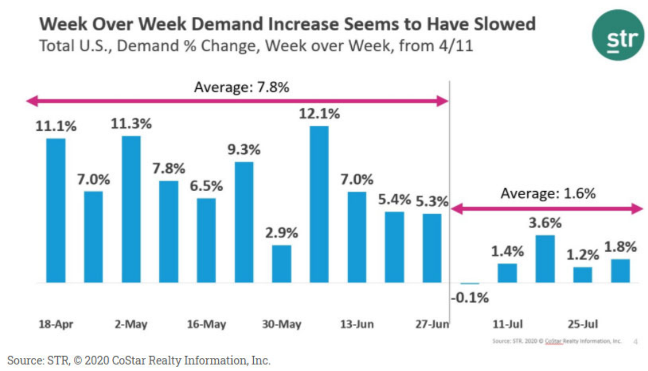


Source: STR, © 2020 CoStar Realty Information, Inc.

- **220,000 were under construction** in April 2020, falling to 214,000 in June.

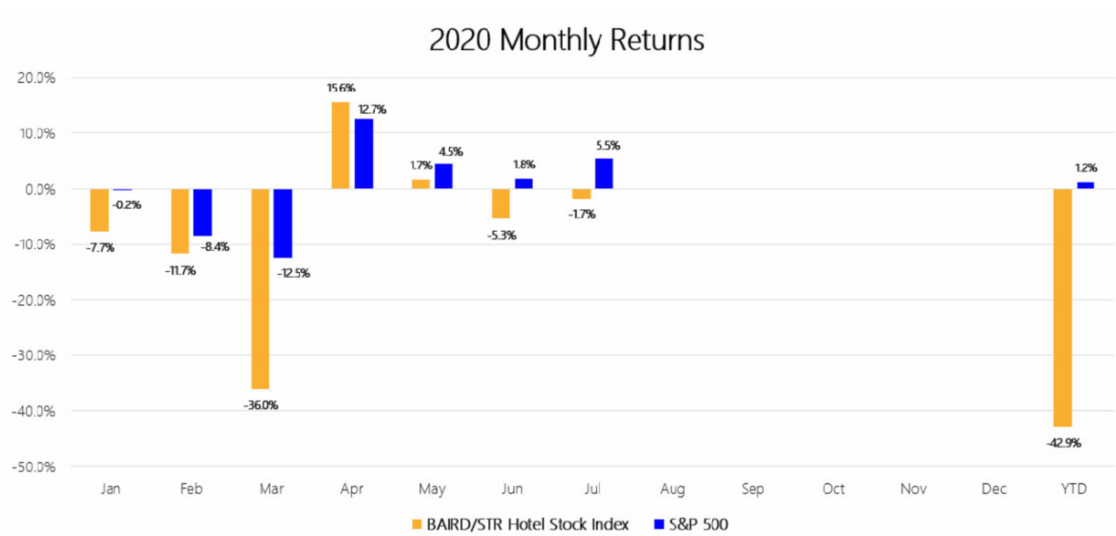
- **15,400 luxury hotel rooms** are currently under construction - one third in Las Vegas and the next highest number is Nashville.

- **Colorado Springs, CO** achieved weekend Occupancy of 81.7% during the week ending July 11th.



- **Norfolk/Virginia Beach** reached 64.1% occupancy, the highest in the country. Lowest markets included Oahu Island and New Orleans with 21.4% and 29.7% occupancy respectively.

- **July Year-to-Date, the BAIRD/STR Hotel Stock Index** is down -42.9% while the S&P 500 is up 1.2%.



Source: HotelNewsNow

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.

To discuss your capital market needs please contact:

Robert Stiles
Principal & Managing Director
(415) 578-9247
rstiles@robert-douglas.com

Douglas Hercher
Principal & Managing Director
(212) 993-7424
dhercher@robert-douglas.com

Stephen O'Connor
Principal & Managing Director
(310) 402-2820
soconnor@robert-douglas.com

Evan Hurd
Principal & Managing Director
(212) 993-7425
ehurd@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.

RobertDouglas, 350 Fifth Avenue Suite 4200, New York, NY 10118

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