COVID-19 Hotel Market Update

October 2020

Core Hospitality Advisors – Our View

2020 will be remembered as a historic year for the lodging industry, with a tumultuous end to a 10-year growth cycle. Current projections call for a 50%+ decline in RevPAR in 2020 for the US market, leaving many hotel owners in a distressed situation. The hotel industry has already begun to recover, but it will take years to reach pre-COVID 2019 levels. The impact on individual hotel performance varies widely by property type and market type, with some hotels impacted marginally and others severely.

The winner (relatively speaking) has been the economy segment and lower-tier extended-stay hotels, while convention/urban hotels have been the laggard. Leisure has done relatively well though the summer, driven by a combination of stimulus money and the desire to get out after quarantining. Significant uncertainty remains for the fall and winter months, which historically rely on more convention and corporate travel. White collar corporate travel remains very depressed, driven primarily by corporate travel restrictions and better ability to replace face-to-face communication with technology. Blue collar travel generally needs to be somewhere in person, which has helped drive the relative success of the economy segment. Big cities that rely on more air travel, particularly urban areas, are expected to a have a very slow recovery. Small towns and interstate markets should recover much faster.

Most national projections call for a full recovery to 2019 levels in 2023 or 2024, although many small towns and interstate markets can expect that to be late 2021 or early 2022. Convention demand will be the last to return, as people remain hesitant to gather in large groups and the booking window is often 12-24 months out. The return of corporate travel will depend on company restrictions, which likely follow the availability of a vaccine. It is unclear how many cuts to corporate travel will remain permanent or at least extended for cost savings purposes. Leisure travel appears to have the best future outlook. Work from home should remain a larger share than before, causing people to plan more trips to get out of the house.

The hotel industry is badly damaged, but remains resilient long-term. This shock will cause significant pain for some owners and will likely result in a notable spike in REO assets. Investors are currently sitting on the sidelines with unprecedented amounts of capital looking to buy distressed assets, which most believe will hit the market sometime next year. This will negatively impact asset values overall, but will also occur at a time when the market is entering the next growth phase.

Ask the Broker

In an attempt to provide more geographic specific market updates, we interviewed nine leading hospitality brokers from across the country to discuss their views of the hotel market. All of these brokers specialize in hotels as an asset class and have been active throughout the pandemic.

- Burton Brooks – Mumford Company – Southeast
- David Altman – Marcus & Millichap - Florida & Southeast
- Chris Gomes – Marcus & Millichap - Texas and Oklahoma
  - With Matt Omansky representing Oil and Gas Markets
- Damian Gordillo – Marquee Lodging Advisors - Southwest (Arizona and New Mexico)
- Alan Reay – Atlas Hospitality - California
- Bennett Webster – Paramount Lodging Advisors - Northeast
- Brent Clemens – Paramount Lodging Advisors - Midwest
- Joseph & Michelle Kennedy – Crystal investment Property – Pacific Northwest
- Ryan Bodine – NewGen Advisory – Change in Use

Burton Brooks
Principal
Mumford Company
770-831-5878 X 2
bbrooks@mumfordcompany.com
Analysis – Southeast

The past six months have changed all our lives as participants in the hotel industry. It has been a wild ride that has turned our business upside down, making it difficult to budget and plan for the future. Challenges our clients are seeing include shifts in demand patterns (primarily weekday business hotels becoming weekend leisure destinations), finding labor, and inconsistent requirements from local governments on containment efforts. Now our franchisors are asking us to spend additional money on upgraded cleaning requirements and installing "touchless" check-in systems. Hotel owners deserve some credit for paddling up a stream in the face of all of these challenges.

Southeast markets reflect much of what has been seen across the United States. Downtown convention locations and those surrounding major airports continue to be challenged. Suburban office markets close to residential areas such as Alpharetta, GA are doing extremely well attracting leisure business on weekend nights, compared with historically being mostly empty on the weekends. Our owners in the drive-to leisure markets (mountains and coastal areas) did well this summer but remain cautious as fall begins. Most owners are delaying any type of capital spending and sitting on cash to be able to make it through this. It is painfully clear that business plans and strategies from years past are no longer applicable in this new reality.

The buyer community today is sitting on the sidelines waiting to move on expected bargain acquisition opportunities. We are fielding numerous calls daily from investors that are well capitalized and looking for acquisition targets in major metro markets, even if properties are not performing. Economy and mid-market extended-stay and limited-service properties in drive to markets will fetch the best pricing. Even in this unprecedented pandemic environment, we are a street corner business and each solution for profitability is different. Consult your trusted hotel advisor and come up with a plan of action that is right for each individual situation.

David Altman
Vice President Investments
Marcus & Millichap
954-245-3426
david.altman@marcusmillichap.com
Analysis – Florida and Southeast

2020 has been a difficult year for the hotel industry, but is not all doom and gloom like the media portrays. The national average for hotel occupancy hit its low on April 12th at 18.9%, but has since seen occupancy increase at an average of 3.6% each week, leaving us currently hovering around 48-50%.

Nationally, the hardest hit properties tend to be in the downtown, airport, and resort locations. For example, Downtown New Orleans still has many hotels closed while the small towns, interstate, and suburban locations tend to be faring better. That being said, geography has the biggest impact on property performance. Panama City Beach, FL and Orange Beach, AL had a quicker rebound due to their drive-to locations and high leisure component.

From a sales perspective, the number of transactions has slowed as many operators have decided to focus on their existing hotels, while many others are sidelined waiting for distressed hotels to come to the market. Thus far, servicers and lenders have demonstrated a willingness to work with their borrowers, which in turn has slowed many distressed hotels from coming to the market.

It remains to be seen what, if any discount there will be on hotel pricing, but our team has noticed that the buyers who are actively seeking properties want to see if the hotel has had a steady recovery since April.

Chris Gomes
Senior Managing Director
Marcus & Millichap
972-755-5302
chris.gomes@marcusmillichap.com
Analysis Covering – Black States
Coverage – Black and Grey States

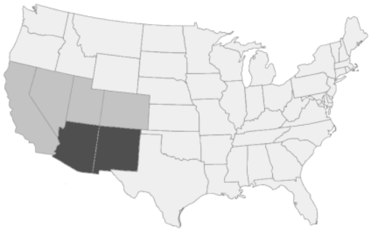
Since an almost total shutdown in March and April, the hotel industry has managed to slowly get out of the rut. Stimulus monies enabled increased leisure travel, benefiting assets along the major interstates in many secondary markets. Many non-MSA markets were relatively less impacted than major MSA downtown/urban core assets. Air and business travel remain stalled, impacting full-service/conference hotels the greatest, followed by high-end select service hotels. Extended stay hotels (especially economy) have outperformed their counterparts.

Owners remain focused on operating cost cutting, suspending amenities like breakfast, room service, social/happy hours, etc. Conversely, increased hygiene and sanitation procedures are placing additional expense burden on hotels. Temporary debt payment relief greatly helped the hotel owners sustain in the interim, while CMBS borrowers have faced more challenges.

Asset valuation has emerged to be a major challenge for the industry, driven by minimal post-Covid transactions and looming uncertainty over a recovery timeline. We have been working hard to apply some level of science to valuation - assisting buyers, sellers and lenders. The result is almost half a dozen hotel transactions in last two weeks and 19 since the beginning of the pandemic.

From Matt Omansky, matthew.omansky@marcusmillichap.com 512-338-7800 - oil and gas markets:

Texas, New Mexico and Oklahoma have a large exposure to oil and natural gas, which saw a sudden drop in demand from COVID that was only amplified by an OPEC price war that began in March. This resulted in the lowest crude oil price in a decade. They have bottomed and are slowly creeping up. New permits being pulled and other wells coming back online support a recovery, although a slow one.



Damian Gordillo
President
Marquee Lodging Advisors
480-566-0077
damian@marqueehotelgroup.com
Analysis – Southwest – AZ & NM

At this moment, there are less than five defaults/foreclosures within Arizona and New Mexico. Although all hotels have been impacted, most owners that we are speaking with remain optimistic about the future. Phoenix RevPAR is starting to stabilize as East coasters are starting to visit. Northern Arizona and Northern New Mexico are doing better as folks are now vacationing to drive to markets (Santa Fe, Las Vegas, Taos, Sedona, Flagstaff, and Page).

My prediction is that assets which were over leveraged and/or acquired in the past 36 months will have some serious challenges. However, assets that have been owned by the same ownership group for 3-6 years should be able to ride out this wave. Convention hotels and resorts will be impacted for at least another year or two, as business travel and conferences are still down significantly.

Hotels that can cater to a guest looking for a special experience (mountain bike tours, culinary, kayaking, glamping, etc.) will fare much better than traditional run of the mill hotels. Overall, I do believe that the tourism industry needs Government assistance in order to stay afloat

Alan Reay
President
Atlas Hospitality Group
949-622-3400
alan@atlashospitality.com
Analysis – California

As we are all now aware, the COVID pandemic has had a devastating impact on the hotel industry. In California, we have seen a record decline in RevPAR as well as hotel sales transactions. Since April 1st, 2020, hotel sales volume is down over 80% and RevPAR for the State is down 49.2% year-to-date (August 2020), as compared to the average decline of the U.S. at 46.6%.

The previous record for the decline in California RevPAR was during the great recession in 2009. To add some perspective to how bad 2020 is, the August YTD 2009 RevPAR decline was 21.5% (compared to this year's 49.2% decline). Within California, the cities that are suffering the steepest RevPAR decline are; San Jose (-59.1%), San Francisco (-57.5%) and Anaheim (-55.7%).

The larger full-service business/meeting oriented hotels have been hit the hardest, while the smaller independent hotels in drive-to-markets and coastal locations have seen less drastic revenue declines.

Most lenders on the conventional side continue to work with their borrowers on deferring or forbearing loan payments. As a result, we are not seeing an increase in hotel foreclosures. On the CMBS side, the picture is completely different. We are currently tracking over 250 hotels in California with CMBS loans that are now delinquent on loan payments and in special servicing.

From a valuation standpoint, we are seeing declines in value from 2019 of between 30% - 60%. Two recent closings, one in San Francisco (124 rooms) the hotel appraised for $38 Million December 2018 and just closed escrow for $19 Million. A 28-room hotel in Hollywood that appraised for $13 Million in 2018, sold for $4,600,000.

Bennett Webster
Senior Managing Director
Paramount Lodging Advisors
312-239-0560
bwebster@paramountlodging.com
Analysis – Northeast

The U.S. Lodging Industry has experienced unprecedented challenges, although the recovery thus far has proven surprisingly resilient. Occupancy troughed in early April at 22%, but has seen steady improvements since peaking at 50.1% in mid-August. Performance early on was buoyed by the economy / midscale sectors, particular extended-stay. Resort/leisure markets, particularly in drive-to destinations, saw growth post-Memorial Day.

School openings and reduced post-Labor Day travel are now contributing to a pull back, increasing concerns relative to forward looking performance. Updated analyst projections call for year-end occupancy of 40%. By comparison, the industry's worst year on record was 2009 at 54.5%. This occupancy projection is below the threshold that many owners will need to generate positive NOI. Strains on cash flow are far greater than in 2009.

The ongoing operational headwinds and corresponding hindrance to profitability is evident in recent lender default rates and hotel closure stats. Of the $86 billion in outstanding CMBS hotel debt, approximately 26% is in special servicing and 23% more is delinquent in some form. As of mid-September, approximately 6% of U.S. inventory remained closed. This includes many high-profile assets in the historically strongest RevPAR markets (NYC and Washington DC). Without a return of corporate/group travel in any critical mass, hotels should trend below historic levels until there is a vaccine.

The shorter-term horizon will continue to present unique and unprecedented challenges. While long-term, we remain optimistic of a robust recovery. We do not view the current challenges as a permanent paradigm shift or existential threat to the hotel business.

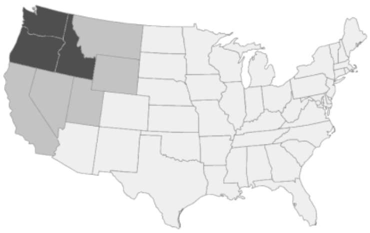
Brent Clemens
Senior Managing Director
Paramount Lodging Advisors
312-402-2959
bclemens@paramountlodging.com
Analysis – Midwest & Northeast

The hospitality industry recorded its 9th consecutive year of growth in 2019 and was firing on all cylinders. However, the cyclical nature of real estate and length of the cycle warranted conversation about what future performance would look like. Despite the traditional warning signs that brought an end to previous cycles - new supply, the creation of new brands, and a deceleration of RevPAR - many experts forecasted nominal growth in 2020 for much of the Midwest.

The first few months of 2020 were as predicted. National RevPAR increased 2.2% and 1.7% in January and February respectively. And then, during the second week of March, it all came to a screeching halt. Seemingly overnight, the pandemic contributed to multiple hotel closures (some permanently), suspended corporate and leisure travel for the foreseeable future, and over 600,000 lodging jobs were lost per *AHLA*.

The Midwest has experienced a measured recovery, with demand pick up in late summer, but it still remains well behind previous years. *Hotel Horizons* is forecasting a nearly -59% RevPAR decline for the Midwest's top five largest MSAs in 2020. The cities of Cincinnati, Detroit and St. Louis are anticipated to be in line with STR's national RevPAR projections of a roughly -52%, while the two most extreme outliers are Chicago and Minneapolis, are forecasted to fall by -73% and -65% respectively. Both cities have faced significant political unrest this past summer and have more exposure in the upscale segment, contributing to this decline.

So, what can we expect in 2021? The last 7 months brought a paradigm shift relative to demand. Less is more. Suburban locales are favored over their urban counterparts. Hotel guests prefer in-room kitchenettes to room service and self-parking to valet. Extended stay and midscale properties located on interstates or 'drive to' leisure destination markets are the preference over full-service hotels. Absent a vaccine and the return of large corporate and leisure travel, we anticipate a continuation of this trend.



Joseph and Michelle Kennedy
Principals
Crystal Investment Property
503-530-1316
michelle@crystalip.com

Analysis – Pacific Northwest

This past year has brought unexpected changes to every aspect of our lives, our businesses, and our sense of community. We close out 2020 with an expectation in all areas outside the airport and city center markets, of moderately to slightly lower year-over-year performance metrics. As we see conditions start to ease a bit and travel gradually resumes, the Pacific Northwest is experiencing a rebound of vacation and, to a lesser degree, business travelers. We are headed into a new normal until there is sufficient distribution of an effective vaccine and international travel restrictions are removed.

The Crystal Investment Property takeaway? The hotel market continues to offer opportunities for savvy investors who understand market trends and can appropriately respond in their operating models. There are solid opportunities for Buyers seeking to move into markets that have previously been much more restricted. With interest rates at record lows, Sellers and Buyers have much greater parity in pricing.

Distressed assets will constitute a major game-changer in the market in the coming months. Owners prepared with cash on hand and financing options will have unexpected opportunities. Auction platforms, carefully curated and attended by Broker representatives, will offer a strong, guaranteed platform to effectuate sales.

Despite the current economic market, we are seeing steady interest, in both cash-flowing and distressed properties, located in the Pacific Northwest region. The hotel investment market as a whole has seen an increase in activity recently. Despite the loss of revenue recently, this continues to be an attractive market for forward-looking hoteliers. We are encouraged by the number of high-quality Buyers who have reached out to us, as well as the diversity of property types and locations that they are considering.

Ryan Bodine
Senior Vice President
NewGen Advisory
602-483-4956
ryan.bodine@newgenadv.com

Analysis – Change in Use

Repurposing struggling hotels to apartments is by far the largest opportunity that individuals and private equity groups are actively pursuing. There are three types of buildings that make suitable conversions, summarized below. Their analysis is straight forward – number of units permitted, the market rent and cost to convert. Ideally, the zoning permits residential use. Adequate power and fire safety precautions are significant factors.

1 - Gen 1 Residence Inn type make easiest buildings to convert. Conversion costs are minimal because rooms are oversized and have kitchenettes. With proper zoning, Buyers are willing to pay from $60K-$75k/key depending on rents and deferred maintenance.

2 - Concrete construction with oversized rooms in dense, walkable markets are being converted to target a younger tenant. Room sizes range from 350-450 SF, floor to ceiling windows with restaurants on premise. Former restaurants are being repurposed to tenant amenities. Buyer's price is impacted by need for kitchenette, ranging from $40-$50k/room.

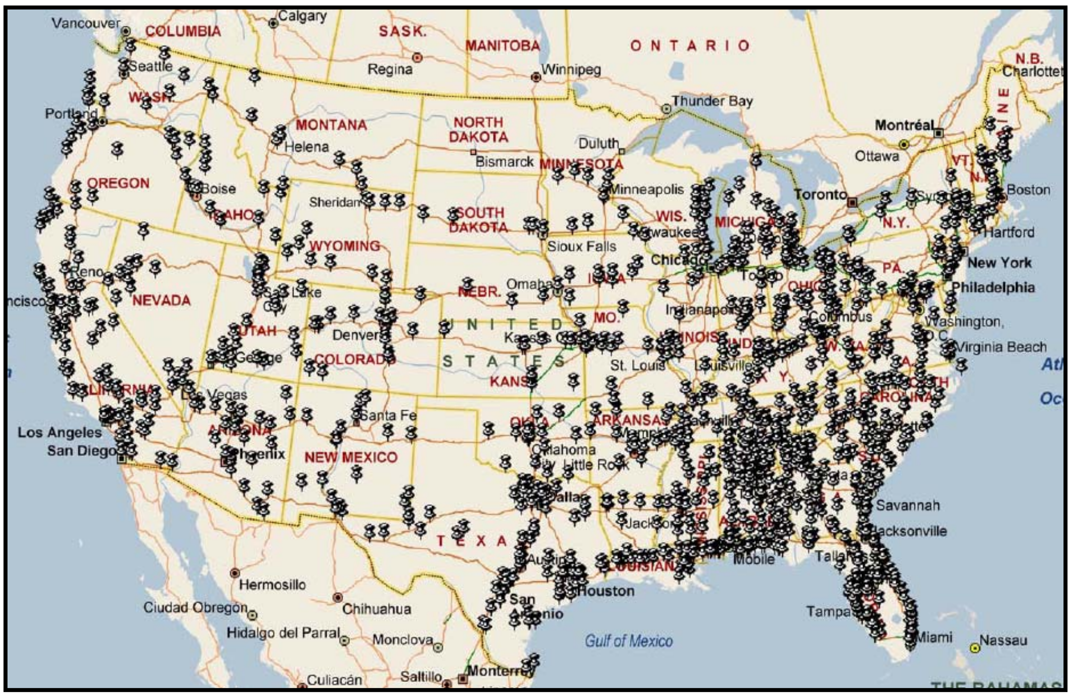
3 - 150+ rooms, 3+ story boxes. These rooms are small 250-280 SF and require a buyer to combine two rooms. Buyers factor in the cost to install more power and for kitchenettes and sprinklers. Approximate purchase price is about $35-$45k/room.

The most common challenge is a disconnect on price. Conversion buyers have a price ceiling, due to the reasons detailed above. 2021 will be a busy year for conversion buyers – seller's prices will soften, more properties will be in default, and cities will continue to be supportive in the rezoning efforts.

CORE
HOSPITALITY ADVISORS
www.CoreHA.com

A National Hotel Appraisal and Consulting Firm

We specialize in hotels as an asset class and in appraisals, feasibility studies and tax appeals. We have completed over 3,000 hotel assignments, spread across 48 states.



Adam Cowart, MAI

Principal
Birmingham, AL
adam@coreha.com
205-382-0616

John Ritger, MAI

Principal
Atlanta, GA
john@coreha.com
678-641-9768

Elaine Phares

Research / Business Development Mngr.
Boise, ID
elaine@coreha.com
205-563-4071