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Hospitality Market Analysis

4th Quarter 2023

At a Glance

Revenue

Industry-wide revenue for Hotels/Motels grew at a CAGR of 7.7% to $341.7 billion over the past five years, including 17.9% growth in 2023.

Profit

Profit accounts for 23.6% of the hotel industries revenue in 2023, up from 17.7% in 2018.

Profit Margin

The profit margin varies depending on the size of the hotel. Large hotels and chains enjoy higher profit due to economies of scale.

Cap Rate

Capitalization rates are on the rise for the hotel sector, up 40 bps from a year earlier.

Sales Volume

Deal volume for limited-service segments of the market fell more than that for the full-service segments. Activity fell 62% from a year earlier for the limited-service segments versus only 44% for full-service hotels.

Occupancy

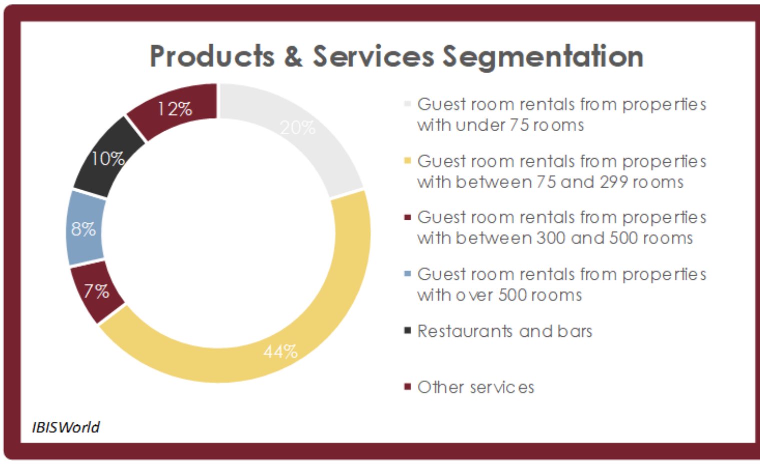
The Hotel industry has experienced higher occupancy post pandemic. Although occupancy rates are still slightly lower than in 2019, higher nightly rates have boosted hotel performance.

U.S Overview

The Hotels and Motels industry offers short-term lodging in hotels, motels and resorts. The need for hotels and motels relies heavily on domestic and international tourism levels, making them dependent on the overall economic environment.

Travel trends were impacted by the 2020 pandemic, as travel restrictions limited tourism in the United States, causing hotels and motels to be one of the hardest hit industries by the pandemic. Since 2020, travel spending, corporate profit and general consumer spending soared, causing a rise in domestic and international tourism. Industry-wide revenue grew at a CAGR of 7.7% to $341.7 billion over the past five years, including 17.9% growth in 2023. The growth of alternative accommodations, such as Airbnb and VRBO, is a threat to hotels and motels, forcing them to offer competitive nightly rates.

Because of the highly competitive market, hotels have turned to include new services to maintain their revenue streams, although not all operators have been able to do so. Increasing competition levels, alongside the pandemic's effects, will limit hotels' ability to reach higher profit.



3.6%

Of revenue growth over the next five years

As the economy continues to recover and tourism picks back up, hotels are expected to continue experiencing growth. Specialty hotels, including extended-stay hotels, boutique hotels, spas, health retreats and resorts, will experience higher growth as they offer unique features that differentiate them from the competition.

But large hotel chains are looking to expand to new foreign markets, lowering new investments within the United States and limiting revenue growth. This will result in a slower growth rate, with the industry growing at a CAGR of 3.6% to $407.1 billion over the years through 2028.

Domestic trips by US residents

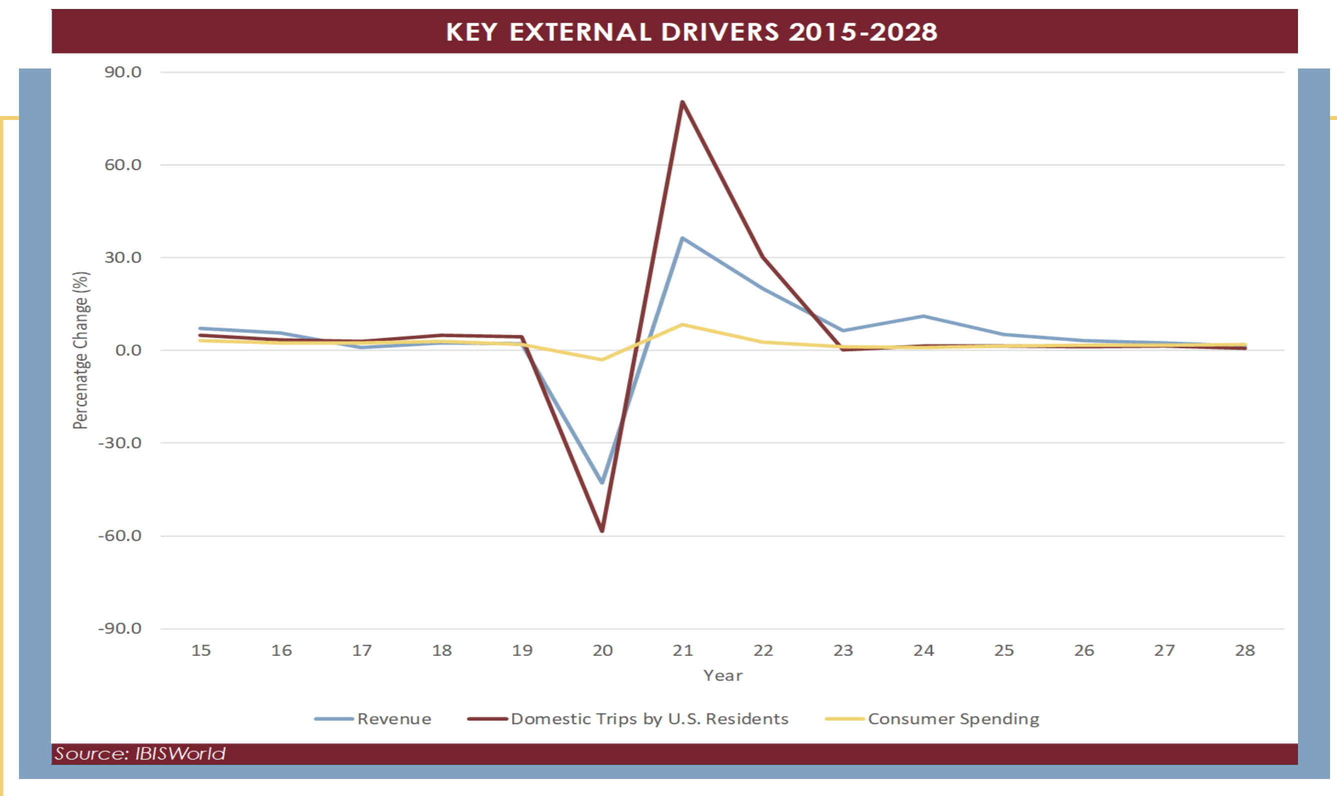
The total number of nights spent away from home affects demand for accommodation. When the number of domestic trips increases, demand for hotels and motels increases as well. The number of domestic trips by US residents is expected to increase in 2023, representing a potential opportunity for the industry.

Consumer spending

Consumer spending levels affect travel demand directly. When consumers spend more, they are more likely to spend on travel and accommodations. Conversely, as consumers reduce spending, they decrease excess spending on travel, reducing demand for hotels and motels. Consumer spending is expected to increase in 2023.

External competition for the Hotels & Motels Industry

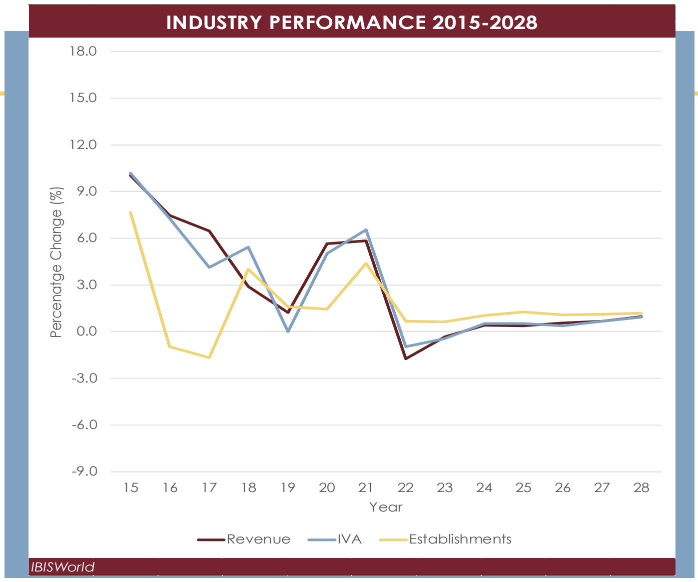
The Hotels and Motels industry experiences competition from lodging alternatives, such as RV parks, bed-and breakfast establishments, room rental services and hostels. Travelers are increasingly comparing prices across these alternatives when booking travel arrangements. External competition for the Hotels and Motels industry is expected to increase in 2023.



Industry Performance

Current Performance

Hotel revenue has grown at a CAGR of 7.7% to $341.7 billion over the past five years, including 17.9% in 2023 alone, when profit will reach 23.6%. The 2020 pandemic limited domestic and international travel activity, lowering the need for accommodation. The United States had significantly high rates of COVID-19, creating skepticism among international travelers and reducing tourism.



Businesses reduced work-related travel significantly as more alternatives became available for online meetings and events. Hotels surpass pre-pandemic daily rates Hotels experienced high occupancy rates towards the end of 2022, a trend that will spill over to 2023. Demand increases allow hotels to raise their nightly rates, increasing revenue and producing a higher average profit margin. According to PWC, the average daily rate (ADR) has increased 12.8% since 2019.

HISTORICAL PERFORMANCE

Year	Revenue ($m)	IVA ($m)	Establishments (Units)	Enterprises (Units)	Employment (Units)	Exports ($m)	Imports ($m)	Wages ($m)	Domestic Demand ($m)	Domestic Trips by U.S. Residents (Million)
2014	201,697	105,583	86,428	75,785	1,538,730	N/A	N/A	50,519	N/A	665
2015	215,915	111,227	89,725	78,945	1,578,039	N/A	N/A	53,362	N/A	698
2016	228,006	114,855	94,667	83,886	1,611,277	N/A	N/A	54,434	N/A	722
2017	229,967	115,949	99,779	88,705	1,655,893	N/A	N/A	56,617	N/A	744
2018	235,547	120,737	129,013	117,734	1,691,400	N/A	N/A	58,082	N/A	780
2019	240,498	123,020	131,787	120,456	1,724,941	N/A	N/A	60,021	N/A	814
2020	137,309	75,012	135,523	124,512	1,727,793	N/A	N/A	42,418	N/A	337
2021	187,395	98,690	148,176	136,034	1,833,348	N/A	N/A	47,350	N/A	608
2022	224,917	118,268	167,453	153,203	2,110,638	N/A	N/A	54,975	N/A	791
2023	239,211	125,866	181,404	166,272	2,244,618	N/A	N/A	58,466	N/A	793

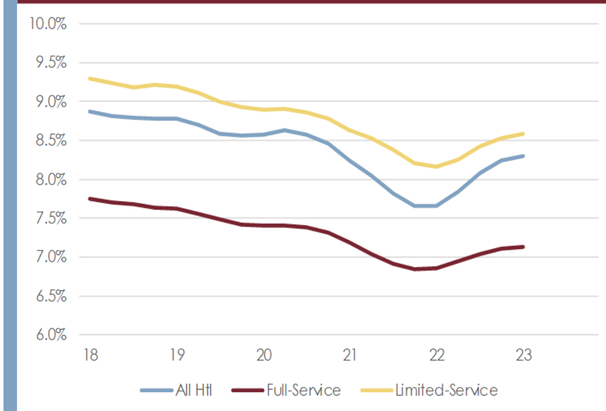
IBISWorld

Although occupancy rates are slightly lower than in 2019, higher nightly rates boost hotel performance. Positive economic conditions allow the industry to bounce back. High consumer spending and low unemployment create positive conditions for people to travel domestically. Tourism in the United States skyrocketed as the Centers for Disease Control and Prevention no longer requires proof of vaccination or a negative COVID-19 test. International travel will grow at a lower rate than domestic travel as increasing costs discourage large expenses. Business travel has increased since the pandemic but will not reach pre-pandemic levels.

Cap Rates & Volume Trends

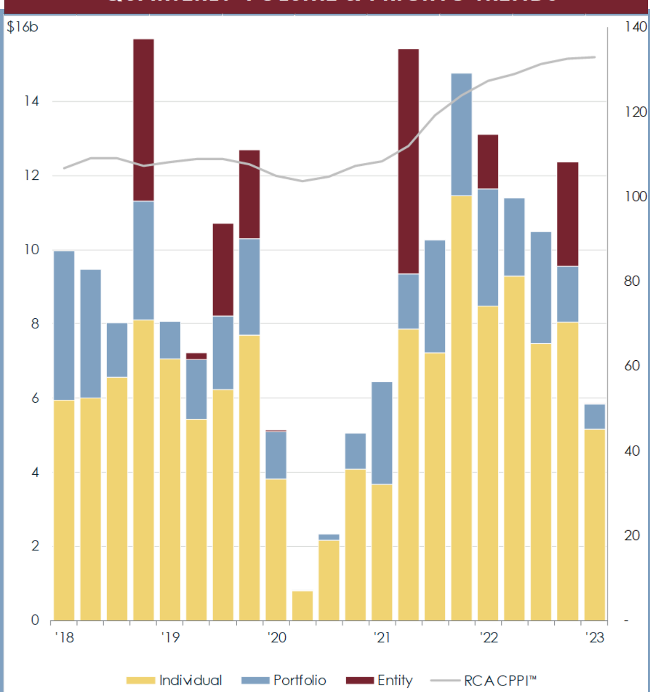
Cap rates were on the rise for the hotel sector in the first quarter. The RCA Hedonic Series cap rate measure for limited-service hotels stood at 8.6% for the quarter, up 40 bps from a year earlier. This measure was up only 30 bps from a year earlier for the full-service segments of the market. The 7.1% rate for the full-service segment is still lower than historical averages — from 2005 to 2019 it averaged 7.7%. Cap rates for the limited-service segments were likewise 60 bps lower than the long-run, pre-pandemic average.

CAP RATES



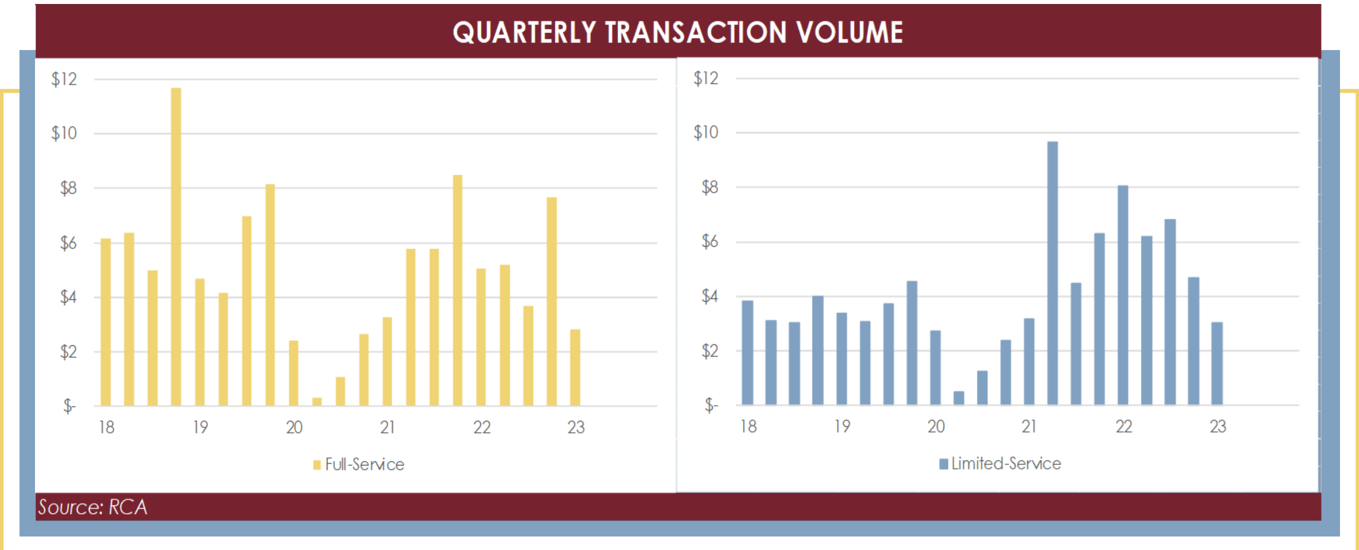
RCA

QUARTERLY VOLUME & PRICING TRENDS

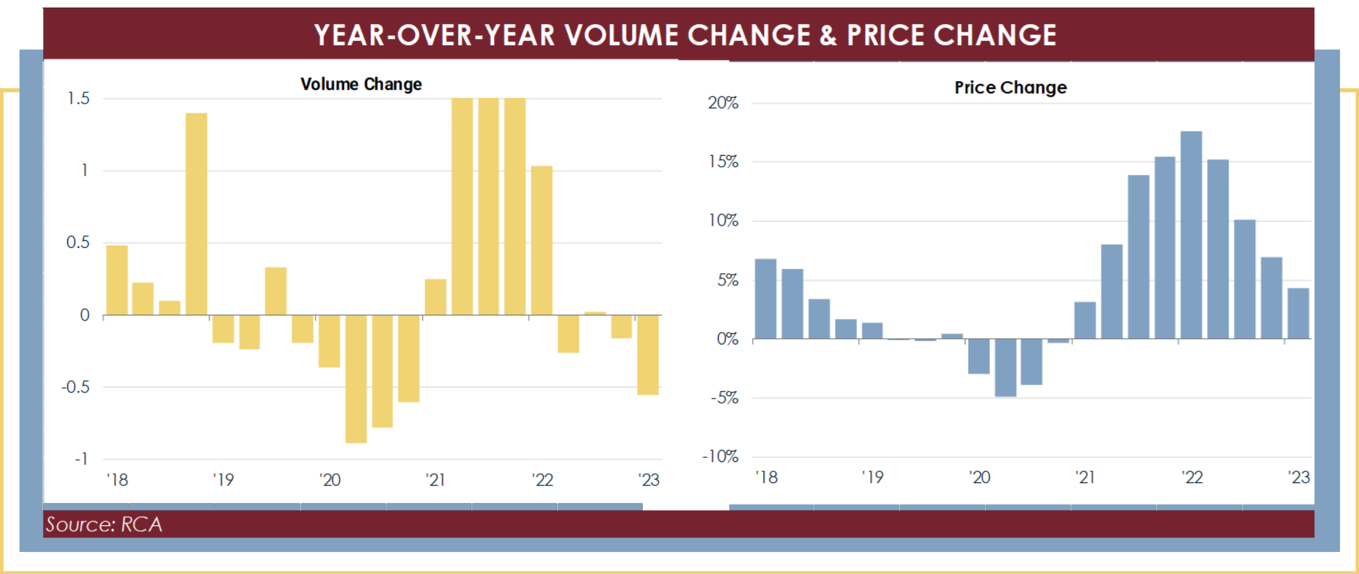


Source: RCA

Deal volume for the limited-service segments of the market fell more than that for the full-service segments in the first quarter, but again, portfolio and entity-level activity skewed the true signal. Activity fell 62% from a year earlier for the limited-service segments versus only 44% for full-service hotels. Looking at individual assets sales, however, the declines were 40% and 39% respectively — effectively the same magnitude. Deal volume for the full-service segment of the market is still off from the pre-pandemic averages. Individual asset sales stood at $2.7b for the first quarter, but this measure averaged $3.4b for each first quarter from 2005 to 2019. With individual asset sales closing at $2.4b for the first quarter, the limited-service segments were roughly twice that of the pre-pandemic average. The cost of financing hotel properties has become challenging over the last year, but the fear element that suppressed deal activity in 2020 has largely vanished. Deal volume retreated, but only to long-term averages so far.



From 2005 to 2019 deal volume in each first quarter period averaged $6.9b. Yes, the market was $1.1b off that mark in the first quarter of 2023, but weakness for portfolio and entity-level sales pushed down this average. The sale of individual assets is often the bedrock of the market as investors underwrite acquisitions one building at a time without the benefit of portfolio effects to paper over mistakes. Deal volume for such deals closed at $5.2b for the first quarter. This pace was nearly $0.5b higher than the average pace of individual asset sales across first quarter periods from 2005 to 2019, a range that suggests normal deal volume for the quarter.



Still, the paucity of entity-level deals does highlight the financing challenges in the market. Traditionally the CMBS market was a primary source of financing for such megadeals and with that market moribund, it is harder to make such deals work. Prices are climbing, but at a muted rate. The RCA CPPI for hotels was up 4.3% in the first quarter from a year earlier. Much of that growth was backloaded, however, with the annualized rate of change from the fourth quarter of last year at 1.3%.

Economic Outlook

17%

Increase in the average daily rate

Despite worries of recession, bank failures, and a liquidity crisis affecting the macroeconomy, US hotels continue to outperform expectations. In Q1 2023, US hotels exceeded Q1 2019 RevPAR levels by 13%, based on data from STR. Room rates continue to be the primary driver in this performance recovery. While occupancy in Q1 2023 was still down 2.1 points from the same period in 2019, ADR increased 17%. Leisure travel continues to be strong, even though growth levels are slowing, and individual business travel and group business has slowly re-emerged, contributing more significantly to future growth expectations.

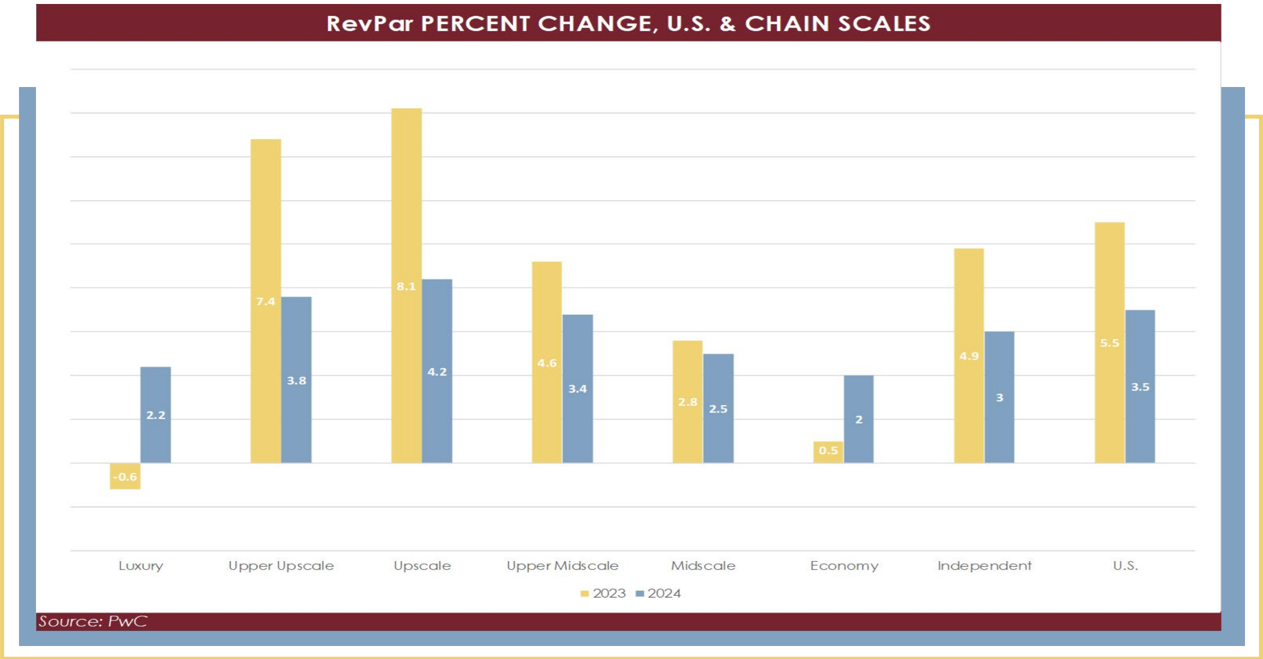
The Fed's continued increases in its policy rate, the failure of three banks, and a liquidity crisis, has caused greater uncertainty in the public markets, which is expected to have a downstream impact on hotel demand for the remainder of this year and into next. We now expect annual occupancy for US hotels this year to increase slightly less than in our November 2022 outlook, increasing to 63.4%. With slowing growth in occupancies for the balance of this year, we now expect average daily room rates to increase 4.1%for the year, with resultant RevPAR up 5.5% - approximately 114% of pre-pandemic levels, on a nominal dollar basis.

US OUTLOOK

	2019	2020	2021	2022	2023	2024
Demand Growth	1.5%	-36.2%	37.9%	10.9%	2.8%	1.7%
Supply Growth	1.8%	-4.3%	5.2%	1.8%	1.40%	1.5%
Occupancy	65.8%	43.9%	57.5%	62.6%	63.4%	63.5%
Occupancy % Change	-0.03%	-33.4%	31.1%	8.9%	1.3%	0.2%
Average Daily Rate	$131.36	$102.97	$124.29	$149.06	$155.21	$160.42
ADR % Change	1.0%	-21.6%	20.7%	19.9%	4.1%	3.4%
RevPar	$86.48	$45.16	$71.45	$93.30	$98.42	101.9%
RevPar % Change	0.7%	-47.8%	58.2%	30.6%	5.5%	3.5%
GDP, % Change	2.6%	-1.5%	5.7%	0.9%	0.5%	1.3%
Inflation, % Change	1.5%	1.1%	4.0%	6.2%	3.3%	2.3%

PwC Hospitality Directions US

Occupancy dipped in 2022 from 2021 across all regions and the nation as a whole. The highest rate since the November 2022 outlook, the Fed's monetary policy has resulted in continually elevated interest rates and an unexpected fallout of several large regional banks has occurred, both of which have contributed to a limited availability of debt. This tightening credit market has resulted in a steep slowing of construction starts for new hotels.



For the remainder of 2023 and into 2024, demand growth from individual business travel and groups is expected to offset a softening in leisure demand, with outbound international leisure travel outpacing inbound, given the relative strength of the dollar. With flattening occupancy levels in 2024, growth is expected to come almost entirely from ADR, with an expected year-over-year increase in RevPAR of 3.5% - approximately 118% of pre-pandemic levels. Significant risks to this outlook include the pace and magnitude of changes in the macroeconomic environment, continued high vacancy rates in office spaces nationwide, and increasing geopolitical tensions.

A liquidity crisis, elevated inflation levels, and three recent bank failures, are resulting in a worsening short-term outlook for the US economy. S&P Global expects a tightening of bank lending standards and has revised down its projections for GDP growth over the last three quarters of this year, including a contraction of (0.1%) in Q2. April unemployment for the accommodations sector increased significantly to 7.1% (from 4.2% in March), while the US overall rate decreased slightly to 3.4% (from 3.5% in March). S&P Global expects Q2 unemployment to remain near Q1 levels, then increasing for the remainder of our forecast period, and ending Q4 2024 at 4.5%.

With marginal GDP growth expected for the remainder of 2023, S&P Global expects the annual unemployment rate to remain flat at 3.6%, increasing to 4.3% by 2024. Consumer spending is expected to increase on an annualized basis by 1.6% in 2023 and 0.6% in 2024, with non-residential fixed investment spend expected to increase 1.6% in 2023 and then decline (0.3%) in 2024. Inflation remains stubborn and a cause for concern, but signs of stabilization may be finally starting to appear. S&P Global's PCE price index forecast for 2023 is 3.3%, declining to 2.3% in 2024.

Conclusion

The Hospitality industry is enduring uncertainty due to current economic conditions. As one of the hardest hit industries during the pandemic, the Hotel & Motel industry has bounced back nicely, experiencing significant revenue growth since 2021. Although alternatives have a decent share of the marketplace, the trend of Airbnbs and VRBOS seems to be dying down as cities place more restrictions on rentals and consumers flock to hotels that have recently become more convenient and cheaper. In general, regarding supply and demand, the condition of the hotel & motel market has slowed compared to five to ten years ago. Tourism, however, is picking back up post pandemic, and is forecasted to resume pre-pandemic levels by 2028. It is sensible to assume trends will continue to be dependent upon economic conditions.

At LPA we pride ourselves in providing our clients the most up to date and accurate market data, so they can make informed business decisions. If you would like further information about any of the data in this hospitality industry report or if you have additional commercial real estate valuation needs, please feel free to contact me using the information below.

Andrew Burns

Senior Associate Researcher

214.271.9170 (direct)

aburns@lowerypa.com

105 Decker Court Suite 1000, Irving TX 75062