NATIONAL REPORT

Marcus & Millichap

HOSPITALITY

MIDYEAR 2022

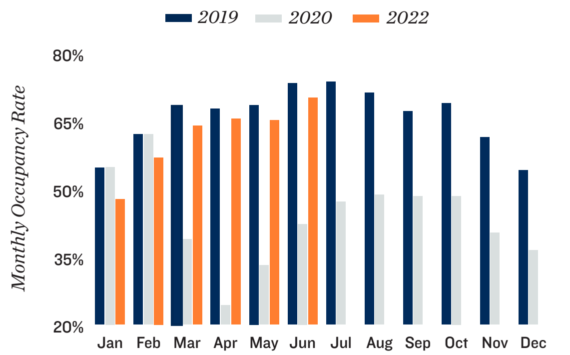
Hotel Sector Puts Most Pandemic Challenges in Rear View; Travel Demand Improving, Although Inflation Presents Headwinds

Demand for hotel rooms takes on more familiar patterns this year. After persevering through incredible challenges in 2020 and 2021, the hospitality sector in the first half of 2022 more closely resembles that of the pre-health crisis period. Room demand through the first six months of the year has been in line with bookings from the same windows in 2017 and 2018, only trailing the record 2019 span by about 3 percent. The greatest beneficiary of this returning demand has been room rates. The average daily rate for the 12-month period ended June was $140.59, up from the previous high set in February 2020 by about 7 percent. Occupancy, meanwhile, trailed the previous benchmark by 450 basis points at midyear, but continues to make steady improvement. Climbing occupancy, paired with record ADR, will lift the annual average revenue per available room above the pre-pandemic peak by the end of 2022.

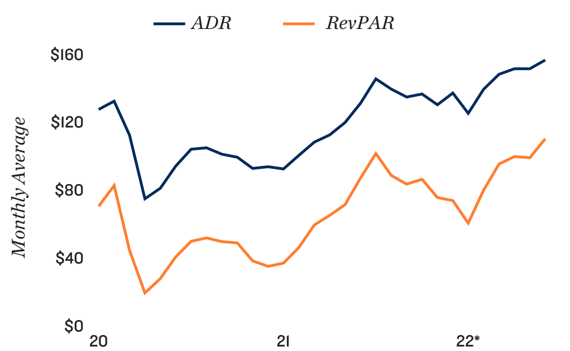
Robust summer travel season brightens outlook for rest of 2022. Free of most pandemic-related encumbrances, summer vacationing is back in force this year with travelers resuming typical habits. Visits to attractions and other entertainment venues are nearly on par with pre-pandemic totals, while airport checkpoint traffic is at 90 percent of 2019 levels. Occupancy surpassed 70 percent in June as a result, the highest monthly measure since the health crisis began. This positive dynamic is expected to continue through the rest of the season and into the fall, with most sporting events, music festivals and conventions resuming without capacity restrictions. Multiple Southeast and Southwest metros are reporting bookings in excess of 2019 levels, led by the vacation hot spots of Austin and Nashville at gains exceeding 10 percent. Travel into the U.S. no longer requires COVID-19 testing, which bodes well for the major gateway metros that have so far lagged in recovery.

Labor, inflation still challenges to be overcome. While travel appears to be returning to more traditional patterns and levels, the hospitality sector has not left all health crisis-related challenges behind. A shortage of labor continues to be an issue, although hotels are adapting. Hoteliers who have lacked the staff to fill capacity have instead maximized daily rates for the rooms they can service, while also extending hiring times. Most hotels began recruiting for this summer travel season three-to-four months ahead, earlier than normal, and are allowing for more flexible schedules and hours. Upward wage pressure is also apparent, which is contributing to another dilemma facing the sector — inflation. While hotels have been able to lift ADR rapidly over the past year to help keep pace with costs, consumers are also facing the same challenges. So far travel demand has been robust, aided by low unemployment, but a potential economic slowdown could adversely affect room demand if it materializes in the months ahead. Hotels may need to accommodate travelers' budgets in the near future, which could put a limit on ADR growth in the coming months.

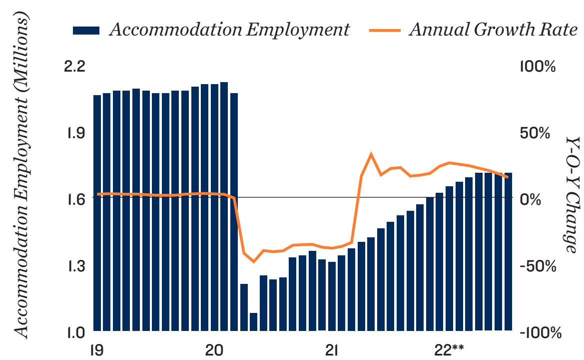
Occupancy is Recovering



Rising ADR Drives RevPar Growth



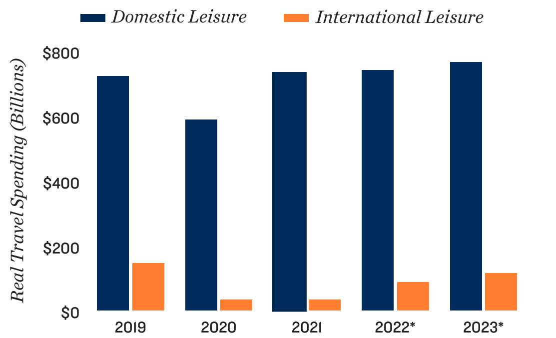
Hotel Labor Market Makes Gains



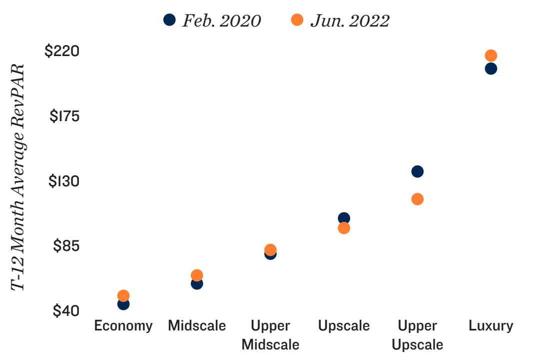
* Through June ** Through July

Sources: Bureau of Labor Statistics; CoStar Group, Inc.

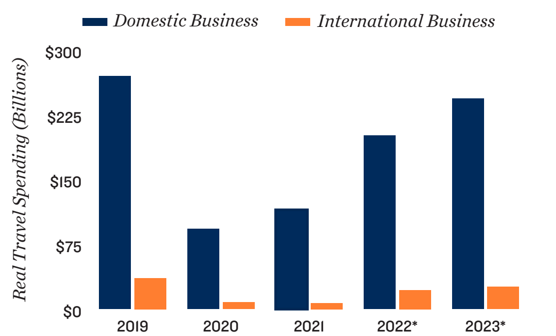
Domestic Leisure Travel Fully Recovers



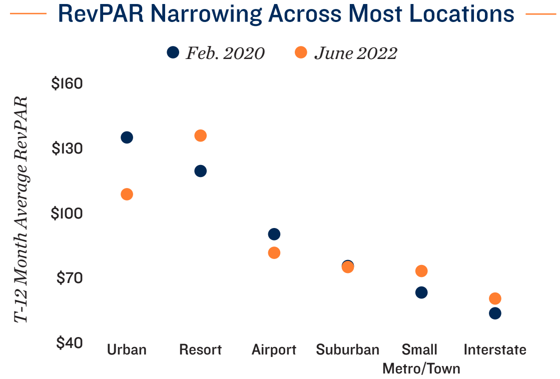
RevPAR Elevated at Low & Very High End Hotels



Domestic Business Travel Improving Faster



RevPAR Narrowing Across Most Locations



** Forecast*

Sources: CoStar Group, Inc.; Tourism Economics; U.S. Travel Association

LEISURE TRAVEL OUTLOOK

Domestic vacationing to surpass 2019 levels, benefiting a broader range of hotels. Domestic leisure travel is set to fully recover this year, building on strong momentum from 2021. For much of the health crisis, short-notice trips by individual households to regional destinations were more common, translating to demand for hotel rooms in smaller markets and scenic destinations reachable by road. Revenues per available room for hotels in both small towns and along interstates returned to their pre-pandemic 12-month averages by late last year. Moving into 2022, leisure travel has expanded to include more traditional vacations and family visits, as well as group events, including a pent-up wave of weddings. These vacations are benefiting hotels higher on the service scale, particularly upper midscale and luxury hotels, which posted annual RevPAR averages on par with pre-COVID-19 marks in May of this year.

Sun Belt markets continue to lead the pack, but stalwarts gaining ground. Stateside vacating from international visitors is growing, but continues to fall short of the 2019 mark. Those travelers who are coming to the U.S. for leisure are, like their domestic counterparts, favoring locations with warmer climates and outdoor activities. In 2021, 45 percent of all international visitors touched down in Florida, surpassing the previous record of 34 percent set in 2011 by New York. Florida hotels are benefiting from this. RevPAR for the year ended June 2022 was more than 10 percent above the average from the 12-month span concluded June 2019 in Miami, Fort Lauderdale, Tampa-St. Petersburg and Jacksonville, as well as across several smaller cities in the state. International visitation should be more dispersed this year though, as most states have rescinded COVID-19 health precautions. Metros that posted year-over-year RevPAR growth exceeding 100 percent in June included Chicago, Boston and San Francisco, traditionally popular destinations for overseas visitors. Some of the markets that gained popularity during the pandemic are also continuing to advance by similar paces however, including Denver, Nashville and Austin.

BUSINESS TRAVEL OUTLOOK

Full restoration of business travel still out on the horizon. Hotels continue to see less demand from business travelers than before the pandemic. Domestic business travel spending last year only achieved 41 percent of 2019 levels, as health concerns and a higher prevalence of remote/hybrid work postponed or canceled many meetings and events. More gatherings are taking place in 2022 however, as domestic business travel spending is projected to hit 74 percent of the 2019 mark this year, even after adjusting for inflation. Many organizations continue to meet in person to complete critical objectives, while larger gatherings offer an efficient way to interact with multiple clients or colleagues at the same time. Small and medium sized businesses seem to value such practices more as Marriott reported a complete return to bookings from such companies in the first quarter, ahead of larger firms.

No one strategy or destination for resuming work trips. Business travel volumes are varying greatly by geography. Las Vegas, which reported the highest average occupancy rate of any major market at midyear, is on track to record a nearly 20 percent increase in business travel spending this year compared to 2019. More events are scheduled to take place in the metro this year than in 2019 as well, although attendance at each event is lower. Knoxville and San Bernardino are also projected to see more business travel spending this year than in 2019, due in part to the appeal of regionally lower room rates amid high inflation. Climate is also a factor. Business travel spending in Miami and St. Petersburg this year are both close to pre-pandemic levels. In stark contrast to these gains are the country's largest gateway markets and the traditional hosts for large corporate and commercial gatherings. Hotels in New York, San Francisco and Washington, D.C. will see about half the 2019 level of bookings from business travelers this year. Prospects are looking up for hotels in urban centers, though. The average annual occupancy rate for downtown hotels across all markets passed the rate for small town hotels in May, a dynamic that has not existed since the pandemic began.

Rapid Improvement Brings Investors Back to the Table

2022 Forecast

U.S. SUPPLY

2.1% increase Y-O-Y

- The delivery of 103,900 rooms this year will increase the number of available room nights nationally by 2.1 percent. Last year the room night supply rose 5 percent, undoing the 4 percent drop recorded in 2020, due to a series of temporary and permanent closures.

U.S. OCCUPANCY

510 basis point increase Y-O-Y

- The national occupancy rate is on track to average 62.7 percent for the full year 2022. This measure is up 2,150 basis points from the pandemic nadir, but still 320 basis points under the pre-pandemic mark, which was near a record high. The long-term average rate is 62.5 percent.

U.S. ADR

11.9% increase Y-O-Y

- ADR is improving more readily than occupancy as fewer rooms are booked at higher rates compared to before 2020. Passing pre-pandemic levels in March, the average annual ADR will be $139.75 at year-end, 6.4 percent above the comparable metric from February 2020.

U.S. REVPAR

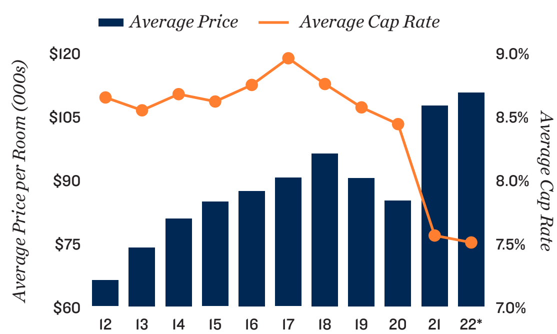
21.9% increase Y-O-Y

- The combination of record ADR and climbing occupancy will push the average RevPAR for 2022 to $87.62. The measure is just over the pre-health crisis high of $86.60. In the preceding 30 years, RevPAR has improved by 3.2 percent per year on average.

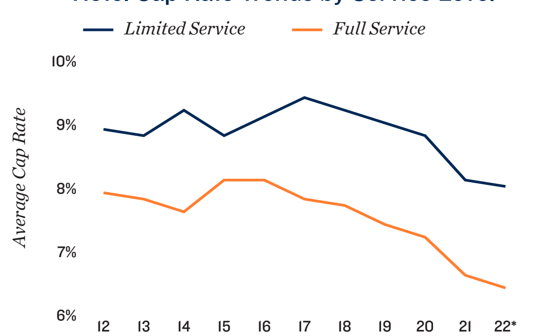
2022 INVESTMENT OUTLOOK

- **Sales activity back to familiar levels, prices climbing.** As hotel property performance has improved since 2020 lows, so has transaction activity. Trades completed in the 12 months ended June were up over 40 percent from the previous yearlong span. After pent-up buyer demand was released in the second half of last year, the pace of sales activity through the first six months of 2022 has returned to levels seen pre-pandemic. Improving RevPAR has restored investor confidence in the sector, lifting sales prices. The average sale price over the past four quarters was $110,400 per room, a new high, while the mean cap rate dipped to 7.5 percent. Despite this contraction, hotels continue to offer some of the highest cap rates on average of any asset class.
- **Sales up across classes, more so for higher tiers.** While just over half of all hotel trades made in the yearlong span ended June 2021 were economy class, in the following 12 months buyer activity was more dispersed. Recovering fundamentals and a more typical travel outlook are drawing investment to higher service level assets. Geographical preferences may have shifted, however. Sales activity advanced the fastest in Southern states, such as Arkansas, South Carolina and Kentucky. Trading has also improved notably in parts of the Midwest and Northeast, although the most liquid markets are still in California, Florida and Texas.
- **Issues of distress and delinquency are diminishing.** Improving revenues are helping more hotels avoid a distress-motivated sale. A shrinking share of properties becoming distressed comprise hotels, with fewer than 10 percent of recent transactions motivated from such pressures. CMBS loan delinquency is also improving, falling to a pandemic-era low of 8.48 percent in May. Higher interest rates could however add complications for CMBS loans that are about to mature.

Investment Sales Trends



Hotel Cap Rate Trends by Service Level



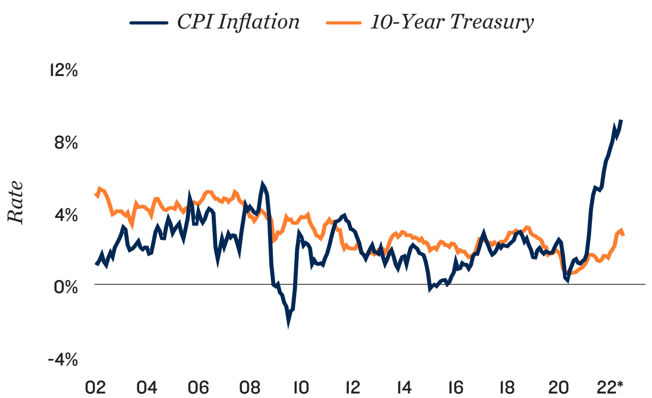
*Note: Sales $2.5 million and greater * Through 2Q*
Sources: CoStar Group, Inc.; Real Capital Analytics Hedonic Series

Higher Interest Rates, Possible Recession Signals Complicate Outlook for the Fed and Investors

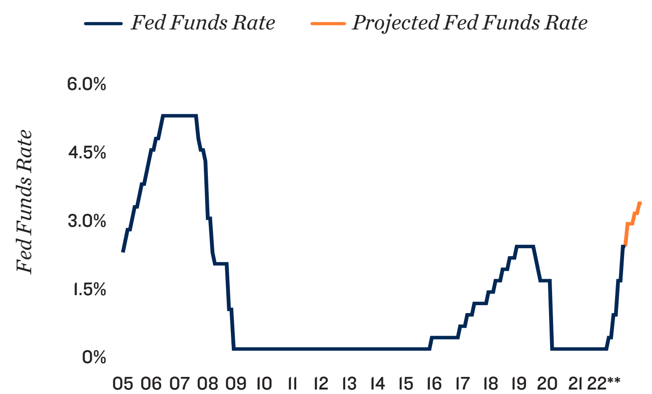
Fed continues rate hike plan as GDP posts second consecutive quarter of decline. The further acceleration in headline CPI inflation in June fortified the Federal Reserve's decision in July to raise the target on the benchmark overnight lending rate by 75 basis points to a range of 2.25 percent to 2.50 percent. Additional hikes in the Fed Funds Rate are anticipated through the rest of this year, as the Fed has previously made statements implying it intends to bring the target range into the 3 percent to 4 percent zone by early 2023. The Federal Open Market Committee gleans confidence in their strategy from the strong labor market. Employers created more than 360,000 jobs per month from March to July, despite an unemployment rate at or below 3.6 percent. Such robust hiring has never occurred when the unemployment rate is this low. As such, the FOMC believe they have sufficient margin to elevate borrowing costs without seriously eroding the labor market and economy at large. Their margin for error is shrinking, however. Gross domestic product for the U.S. declined in real terms on an annualized basis in both the first and second quarters of this year. While some consider two consecutive quarters of GDP decline to signal a recession, current employment growth trends do not align with a general economic decline. Disrupted global supply chains, which weighed down on net exports in the first quarter and limited what capital equipment businesses could invest in during the second, are disrupting the overall figure. Nevertheless, the growth outlook for the rest of the year is subdued.

Climbing lending rates amid ongoing property-level concerns add new hurdles to transaction process. Rapidly tightening monetary policy is prompting lenders to adjust quoted rates and widen spreads. The rapid change in benchmark interest rates has hindered new CMBS securitization, a challenge which is expected to continue in the second half of the year. Balance sheet lenders, such as banks, are more insulated but will still have to adjust lending criteria and objectives over time. While the travel outlook and current hospitality fundamentals are much improved from 2020 nadirs, capital availability for hotels is still highly dependent on asset-specific features. How a hotel performed during lockdown is highly important, as are its location and flag. Assets in large gateway markets, such as New York and San Francisco, will bear more consideration than properties in scenic drive-to destinations in warmer climates. The borrower's experience in the hospitality industry, as well as their relationship to the lender, are also factors. These conditions complicate the investment landscape as potential buyers face tightening margins against compressed cap rates. The rapid climb in ADR posted this year, however, illuminates potential upside for investors who may be able to improve returns in the next few years via room rate increases.

Inflation and Interest Rate Trends



Fed Funds Rate Over Time



** CPI through June; 10-Year Treasury through July 28 ** Forecast — assumes three further rate hikes in 2022 of 50 bps, 25 bps, and 25 bps, respectively.*
Sources: Marcus & Millichap Research Services; Bureau of Labor Statistics; Federal Reserve

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Sources: Marcus & Millichap Research Services; Bureau of Labor Statistics; CoStar Group, Inc.; Federal Reserve; Moody's Analytics; STR, Inc.; Real Capital Analytics; Tourism Economics; U.S. Travel Association; U.S. Census Bureau