Horwath HTL
Hotel, Tourism and Leisure

MARKET REPORT

USA:
Hospitality Update & COVID-19 Impact

JUNE 2020

Covid-19's Impact on the Economy

The principal resources used for the update on the U.S. economy include Barron's, the Congressional Budget Office (CBO), CBS, CNBC, Federal Reserve Bank of Atlanta, Federal Reserve Bank of St. Louis, Goldman Sachs, STAT News, Trading Economics and the U.S. Bureau of Economic Analysis (BEA).

Pre-Covid-19, the U.S. economy had expanded and remained in record-setting territory for 31½ quarters. The annual rate of real GDP growth had slowed from 3.1% in 1Q19 to 2.1% in 3Q and 4Q19, though it remained positive and consistent with the potential rate of growth estimated by most economists at 1.75% to 2%.

For the last three quarters of 2019, increased tariffs and slow global growth were negatively impacting manufacturing, non-manufacturing and farming alike as they had led, respectively, to higher costs, lower profit margins and reduced exports.

In 2Q19, the domestic manufacturing sector began curtailing fixed capital expenditures, which in turn led to fewer orders and a slowing of business activity at the nation's factories.

That said, real GDP growth remained positive throughout 2019 due to high levels of consumer spending. Strong personal consumption expenditures (PCEs) were buoyed by favorable labor market conditions—a 50-year low unemployment rate—steady increases in home prices and double-digit gains in equity prices.

Taken together, the state of these two pillars of the economy—business capital expenditures and consumer spending—led to a pre-Covid-19 outlook for GDP growth to remain positive but decelerate from 2.3%—its 2019 average—to 1.8% in 2020.

Currently, the Covid-19 pandemic is upending this 10-plus-year trajectory of the U.S. economy.

- Q1 saw real GDP actually decrease -4.8 percent after 126 successive months of increases.
- 2Q20 to-date has seen:
  - 36.5 million new unemployment claims for the 8-week period ended May 9,
  - the U.S. unemployment rate jump from 3.5% in February to 14.7% in April,
  - the number of unemployed persons rise by 15.9 million to 23.1 million, and
  - the number of employed persons decline by 22.4 million to 133.4 million, a labor force participation rate decrease of 2.5 percentage points to 60.2%, the lowest rate since January 1973.

Deficit spending and the passage of debt-heavy stimulus bills have added significantly to the U.S. economy's already heavy debt load and created new pressures on a growing number of companies and small businesses with anemic balance sheets. Even as social and economic activity have begun to resume, albeit slowly and owing more to fiat than victory over the virus, and even though the current target for the Fed Funds Rate is 0.00-0.25%, states, municipalities and companies of all sizes are beset by tight liquidity conditions and uncertainty about a second Covid-19 outbreak during the fall flu and above-average-activity hurricane season.

The Covid-19-influenced outlook is for annualized 2Q20 GDP to shrink by -42%, the worst decline ever, and for unemployment to peak at 25%, the worst since the Great Depression peak of 24.9%. However, unlike the Great Depression of the 1930s or the Great Recession of 2007-2009, the cause of this sharp downturn is not an asset bubble or another more fundamental socio-economic reason, it is a self-induced economic freeze brought on by a random event—the Covid-19 pandemic—and is expected to be of shorter duration than the aforementioned contractions.

According to the Fed and Goldman Sachs, the economic outlook for Q3 growth is positive. Upon learning that most states had relaxed lockdown orders and begun to reopen, Goldman upgraded its GDP forecasts to predict a more V-shaped recovery based on an expected annualized growth rate of 29% in the third quarter, up from 19% previously.

Even without a cataclysmic reopening-induced second wave due to social distancing guidelines not being followed, a full recovery is expected only once a vaccine is found. Regarding this caveat, on May 18 it was announced that a biotech company's candidate vaccine for Covid-19, which had been developed in conjunction the National Institute of Allergy and Infectious Diseases (NIAID), successfully completed its interim Phase I trial involving humans.

Covid-19's Impact on Hotel Industry

The principal resources used for the update on the U.S. hotel industry include CBRE Americas Research, Cleveland Research, CoStar News, Hotel News Now (HNN), Lodging Magazine, STR, Tourism Economics and the United Nations World Tourism Organization (UNWTO).

Covid-19's impact on hospitality, tourism and leisure has been profound. Q/Q real GDP growth, a reliable precursor of hotel demand, decelerated from 2.1 percent in 4Q19 to -4.8 percent in 1Q20. Following suit, hotel industry performance has been abysmal. For the five-weeks ended April 11, April 18, April 25, May 2 and May 9, the industry has experienced perilously low occupancy rates of 21.0%, 23.4%, 26.0%, 28.6% and 30.1%, respectively. Viewed charitably, hotel occupancy levels appear to have bottomed out at 21% (April 11) and embarked upon a slow but steadily increasing path to recovery.

Comparing the week ended May 9, 2020 with the year-ago week ended May 11, 2019, the industry recorded:

- a 55.9% decline in Occupancy to 30.1%,
- a 42.1% decline in ADR to $76.35, and
- a 74.4% decline in RevPAR to $22.95.

[1] *Source: STR, as reported in Lodging Magazine May 13, 2020*

While the above numbers are well below those for the same week in 2019, they represent the industry's fifth straight week of upward-trending occupancy since bottoming out at 21.0% the week ended April 11. The 30.1% occupancy rate for the week ended May 9 is an improvement of more than nine percentage points over the bottom.

Our survey of market participants reveals hotel industry recovery will be leisure-driven, deliberate and US-centric.

Other observations:

- Demand is down due to an external shock and concerns about personal safety, so hold price. Don't sacrifice rate to drive occupancy.
- International tourism, already down 22% in 1Q20, could decline 60-80% over the whole year.
- Per STR, suburban, small-town and interstate hotels will experience more demand than hotels in urban or resort destinations.
- Domestic demand drives 95% of all U.S. rooms sold. Leisure transient will lead the recovery commencing 2H20.
- Corporate demand will lag leisure transient as companies adopt and employees adapt to new liability-limiting travel policies.
- Group demand, corporate/association, will be the last segment to recover due to longer booking time horizons and participant reluctance to meet in large settings.
- With most states at least partially reopening, job losses began coming back mid-2Q20 and will continue at an accelerated pace in 2H20, though year-end unemployment will remain high at ±10%. Jobs lost in 2020 will be almost fully regained in 2021.
- Key Performance Indicator (KPI) Forecasts[1]
  - Occupancy will end 2020 at 35.8%, down -45.8% from 2019, and improve in 2021 to 52.1%.
  - ADR will end 2020 at $102.83, down -21.6% from 2019, and improve in 2021 to $104.58.
  - RevPAR will end 2020 at $36.84, down -57.5% from 2019, and improve in 2021 to $54.53.

[1] *Source: STR and Tourism Economics, as reported in Lodging Magazine May 18, 2020*

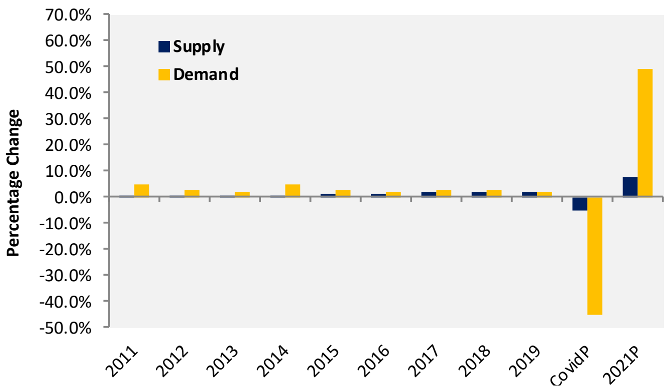
Covid-19 Views from the Top:

- **Choice**: Occupancy is climbing, led by extended-stay hotels reporting 60% occupancy in April. Most midscale and economy class hotel owners can break even at 30% occupancy.
- **Hilton**: The second quarter is going to be very bad. With travel at a virtual standstill, April RevPAR declined approximately 90%. The industry will start to see a recovery heading into the third and fourth quarters.
- **IHG**: When travel resumes, guests are going to want to stay in the biggest branded hotels. Weaker brands and independents will convert over to the big brands. Strong domestic business and a lack of exposure to meetings and events (group) make it easier to navigate the current crisis. Breakeven occupancy for the mainstream portfolio is around 30%. April occupancy was in the mid 20%s.
- **Marriott**: April defined the bottom. The trend line is towards more hotels opening than closing. Dropping rate to chase demand that is not there accomplishes nothing. Interest in soft brands is increasing. Occupancy has been clicking up a point a week over the past few weeks. As Covid-19 restrictions abate, early travelers will be going to drive-to locations, first leisure then corporate.

Room Supply and Demand Forecast

STR projects 2020 room supply and demand declines of -5.2% and -45%, respectively. Post-Covid-19, STR expects 2021 increases of 7.7% in supply and 49.1% in demand—positive disequilibrium.

Lodging Industry Supply and Demand Growth

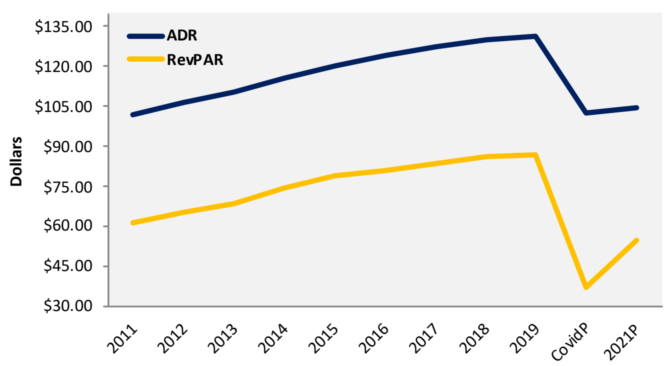


Source: STR

ADR and RevPAR Forecast

STR projects Covid-influenced 2020 ADRs and RevPARs to decrease by -21.6% and -57.5% from $131.11 to $102.83 ADR and from $86.66 to $36.84 RevPAR, respectively. For 2021, STR projects a 1.7% ADR increase to $104.58 and a 48% occupancy-driven RevPAR increase to $54.53.

National ADR and RevPAR

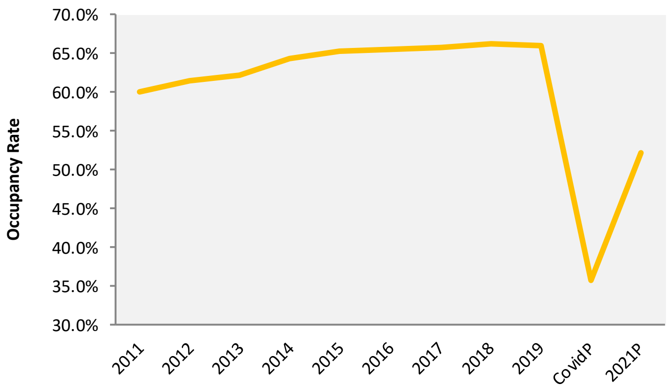


Source: STR

Occupancy Forecast

Covid-influenced occupancy levels are expected to decline -45.8% from 66.1% in 2019 to 35.8% in 2020. Prospectively, STR expects a 45.5% increase in occupancy to 52.1% in 2021.

National Occupancy Rates



Source: STR

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Horwath HTL

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Our clients choose us because we have earned a reputation for impartial advice that will often mean the difference between failure and success. Each project we help is different, so we need all of the experience we have gained over our 100-year history.

We are a global Brand with 47 offices, who have successfully carried out over 30,000 assignments for private and public clients. We are part of Crowe Global, a top 10 accounting and financial services network. We are the number one choice for companies and financial institutions looking to invest and develop in the industry.

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