An Updated 2020 Outlook

Expectations for the Year Ahead

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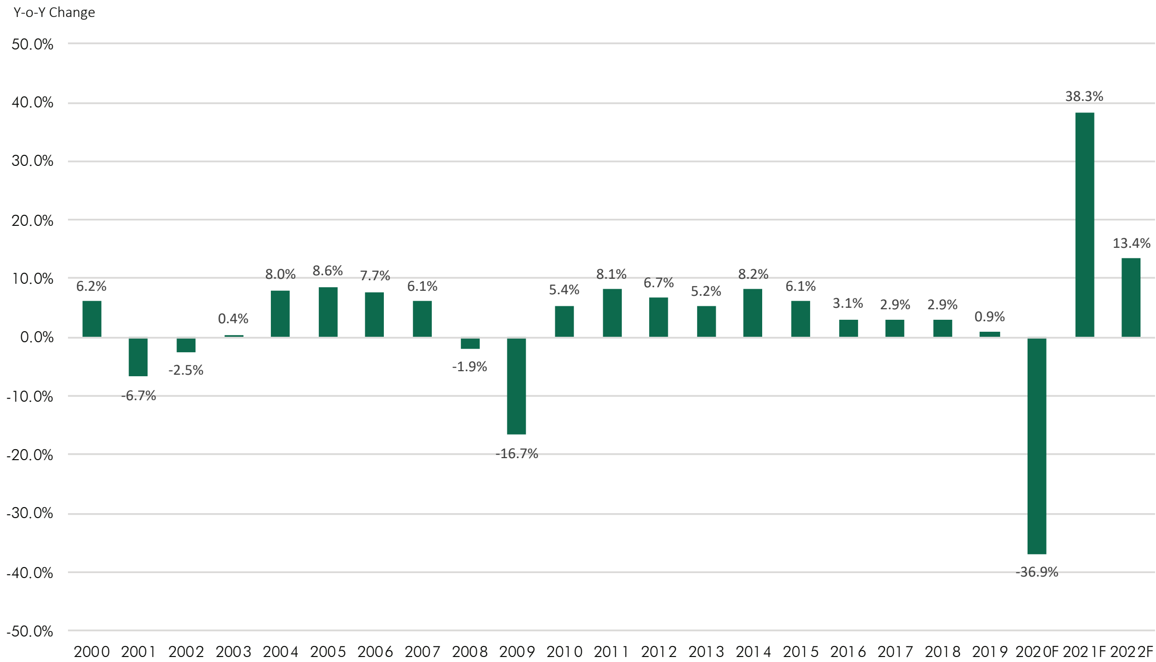
Economic conditions are deteriorating quickly and according to Oxford Economics, the U.S. economy is in recession. Oxford predicts that, "the coronavirus pandemic will lead to a profound, pervasive, and persistent, but not permanent reductions in activity, with widespread cuts in social spending, severe disruptions to supply chains, and major interruptions in travel and tourism activity."

CBRE expects GDP growth will slow to 0.4% in 2020, down from our previous estimate of 1.9%. The COVID-19 outbreak will cause a sharp drop in economic activity in Q2. As early as Q3 2020, activity will begin to stabilize and a recovery is expected to be underway by Q4. Employment is already contracting with service sector jobs disappearing as many cities restrict social interaction. Governments throughout the world are implementing monetary and fiscal stimulus to try to prevent a more long-term global recession. Our current expectations are that this stimulus, as well as pent up demand, will lead to a substantial rebound in economic activity in 2021.

The lodging sector will face two headwinds: a contraction in overall economic activity and the need for social distancing, which encourages staying at home or in settings with few other humans; and not traveling. This will cause a severe decline in lodging demand in the U.S., as it has in other countries. CBRE estimates that RevPAR will decline 37% in 2020, with a contraction of more than 60% in Q2. Prior to the spread of COVID-19 into the U.S., we had forecasted a 0.1% decline in RevPAR.

Figure 1: U.S. RevPAR Change



Source: CBRE Hotels Research, STR, March 2020

The expected declines in RevPAR will be worse than experienced in the 2001 and 2009 economic downturns combined. However, given the expected quick rebound in economic growth and historic resiliency of travel demand, we forecast a strong hotel revenue recovery in 2020 and 2021 and that RevPAR could recover to prerecession levels by 2022.

The Demand for Travel

Stays in hotels, short-term rentals, and on cruise ships are driven by leisure and the need for face-to-face business meetings. People avoid travel when they feel unsure about their future financial state (constraint #1) and when they feel afraid to make trips (constraint #2). In the wake of the 2008 financial crisis, for example, future cash flow and wealth uncertainties severely impacted travel.

Fear of travel is a broader and more complicated phenomena than financial insecurity. Following the tragic 9/11 events, for example, potential travelers avoided boarding airplanes for fear of being entangled in terrorist acts.

The most complex constraint impairing travel comes from the fear of contracting communicable diseases or infections. The world has recently experienced outbreaks of several forms of transmissible viruses such as SARS, Ebola, and H1N1 (Swine Flu). These illnesses took a large human toll, but while the effects on the paid accommodation industry were measurable, they were not devastating. COVID-19 virus is more dangerous, so the travel industry is braced for a huge reduction in business and leisure trips.

During the COVID-19 period, which the World Health Organization (WHO) has designated a pandemic, all markets are expected to be severely impacted as social distancing continues.

To get a sense of impact and recovery times, we have looked at previous demand shocks, namely the tech bubble, 9/11, SARS, and the Great Financial Crisis (GFC). The declines to demand during these shocks were severe, but relatively short lived with demand returning to pre-shock levels within 6 to 12 months. Even with the ranges of drops, the recovery period is relatively rapid across all events.

Figure 2: Hotel Demand Declines During Previous Shocks

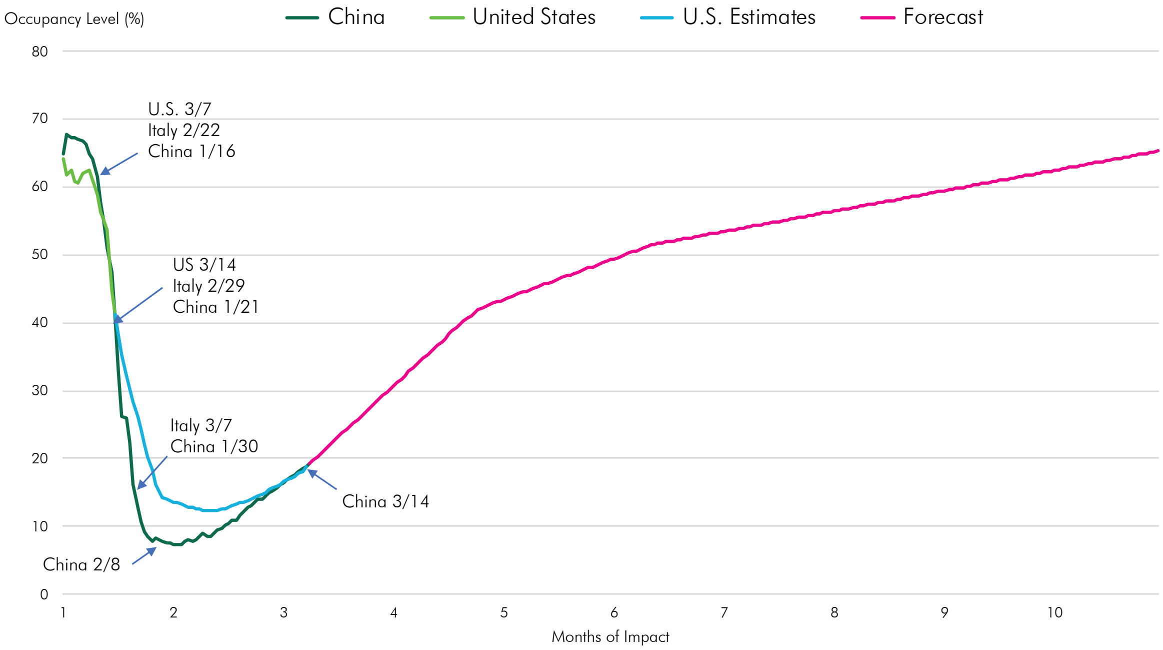
Source: CBRE Hotels Research, STR

Figure 3 shows how China started realizing significant disruption beginning in mid-January. By plotting occupancy levels in Italy and the U.S. starting just before they hit their 100th confirmed case, they seem to be following the same pattern. China is about 7 weeks ahead of the U.S. in terms of impact and is already starting to realize gains in occupancy.

Italy is about a month behind China and reached the mid-teens in occupancy for the week ending March 7. If the lockdown in Italy is successful, they should start seeing a significant slowdown in the rate of new cases and be poised to start occupancy recovery by the beginning of April/May.

The U.S. is about 2 weeks behind Italy and just progressing along the curve, having dropped to 53% occupancy the week ending March 14 and is more than likely decelerating quickly. The U.S. is probably a month or more from reaching the trough. We have plotted a potential recovery scenario using the path and duration of previous demand recovery times. Recovery will take longer from this event because of the interconnectivity of many countries and their reliance on each other for leisure and business demand.

Figure 3: Demand Disruption Curve, Chinese, Italian and U.S. Occupancy Levels and projections



Source: CBRE Hotels Research, STR

We are not predicting that occupancy levels will get as low as those realized in China, given the unproven ability of the United States to enforce travel restrictions and inconsistent policies at the city and state level. There is also a significant base of essential hotel demand. This includes short and long-term housing, construction, airline, and contract workers, stays related to the healthcare industry (workers, patients, and their families), students, people self-quarantining away from their family, etc..

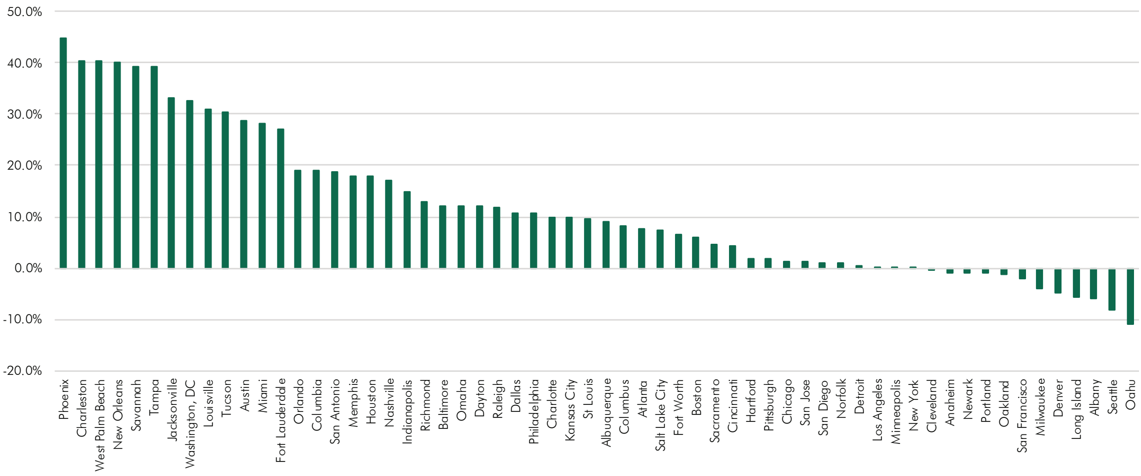
Given the low levels of business, leisure, and group demand, many hotels will close or convert to other uses, like hospitals or housing for quarantined populations. This could cause higher occupancy levels for properties that remain open or those that find a more stable source of demand while the pandemic continues.

Estimating Market and Chain Scale Impacts

We expect the impact to be greatest in gateway cities that cater to international and business travelers, and that accommodate large groups for conventions and conferences. Similarly, 9/11 primarily impacted these same markets and spared many drive-to markets.

Markets that have their peak season during the spring (March-May) will also see a more severe impact since these months can generate a significant portion of their full year revenues and profits. U.S. hotels average about 5% more revenue during the spring travel season. These hotels will not only realize the same declines in occupancy that most markets will see, but also lose out on the large ADR (room rate) premium hotels were able to charge during the peak time.

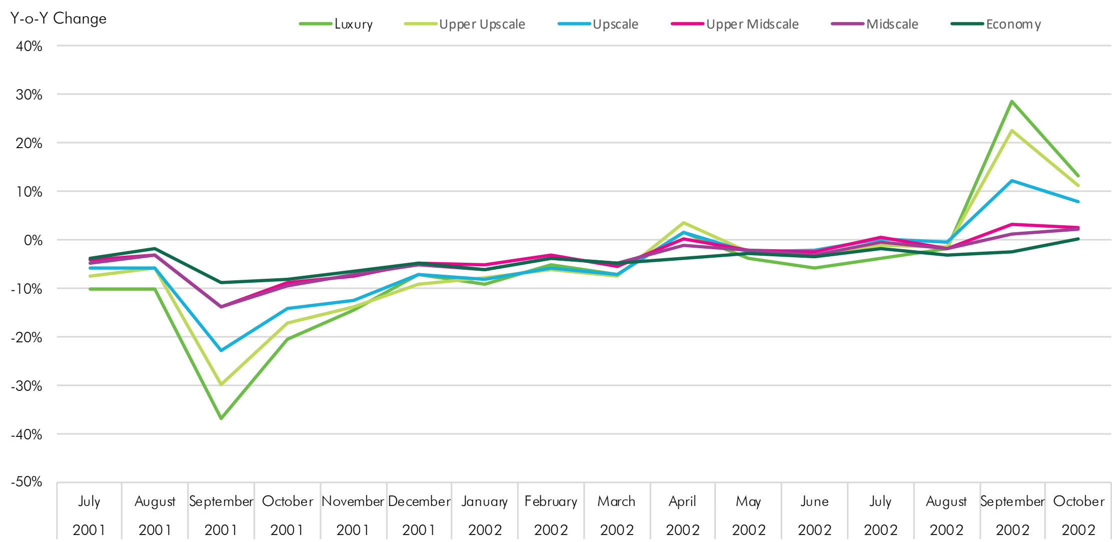
Figure 4: Average Spring Revenues as Compared to the Rest of the Year



Source: CBRE Hotels Research, STR

Not all chain scales will feel the impact evenly. Luxury, Upper Upsscale and Upscale properties will be affected the most because of their dependency on group, business, and international visitations. This follows trends during previous recessions. Figure 5 shows the change in occupancy in the aftermath of 9/11 in the U.S. illustrating that luxury, upper upscale, and upscale properties took the brunt of the deductions in demand, but also recovered quicker in the year following the attacks. This same trend holds when we look at the demand impact to hotels during the GFC.

Figure 5: Y-o-Y Change in Occupancy during and after September 11th, 2001.

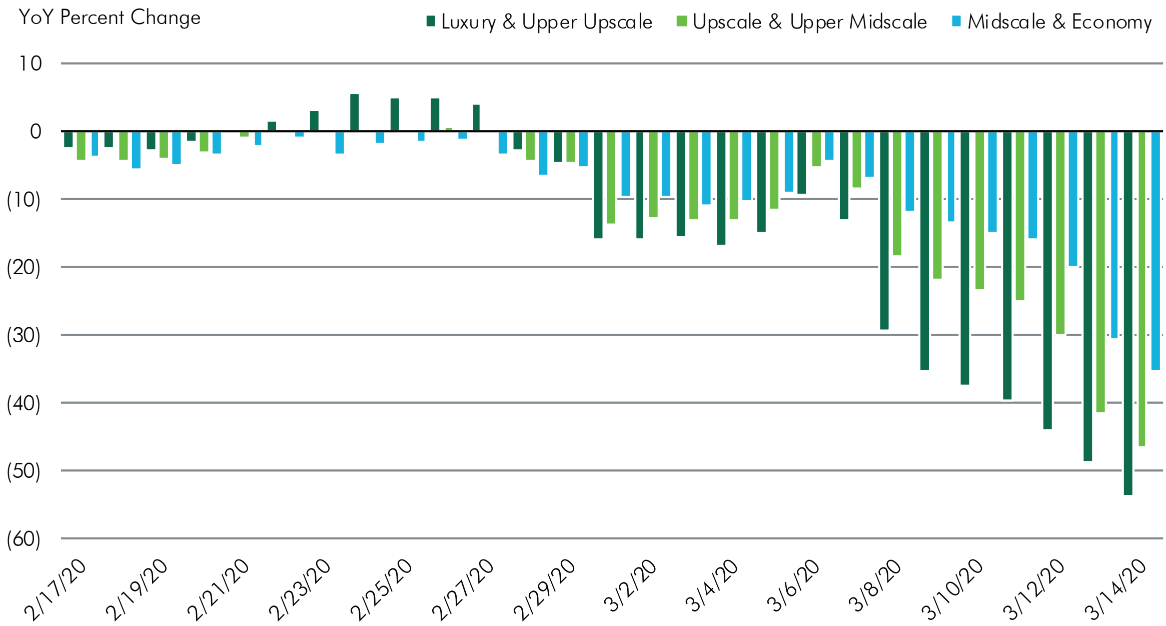


Source: CBRE Hotels , STR

In recent weeks, luxury and Upper Upscale properties showed a 45% decline in RevPAR for the week of March 8-14, compared to a 20% decline for Midscale and Economy properties.

Urban and Airport locations have borne the brunt of impact so far. As the pandemic progresses, all locations will see significant declines.

Figure 6: Y-o-Y Change in US RevPAR during the COVID-19 Pandemic



Source: CBRE Hotels, STR, March 2020

Outlook

Expectations of marginal improvements in performance for the U.S. lodging industry in 2020 have been replaced by severely downgraded forecasts by CBRE Hotels Research. In mid-February, as the COVID-19 outbreak began to spread around the world, CBRE released its March 2020 Hotel Horizons® forecast to a 0.1% decline in RevPAR for 2020.

A decline in demand of 28% will be the primary impact of lodging performance. ADRs are also expected to decline 10.8% for the year. The 37% decline in RevPAR is the largest decline the U.S. lodging industry has realized since we started collecting data in the 1930s. Q2 2020 is forecasted to bear the brunt of RevPAR losses with year-over-year declines estimated to reach close to 70%.

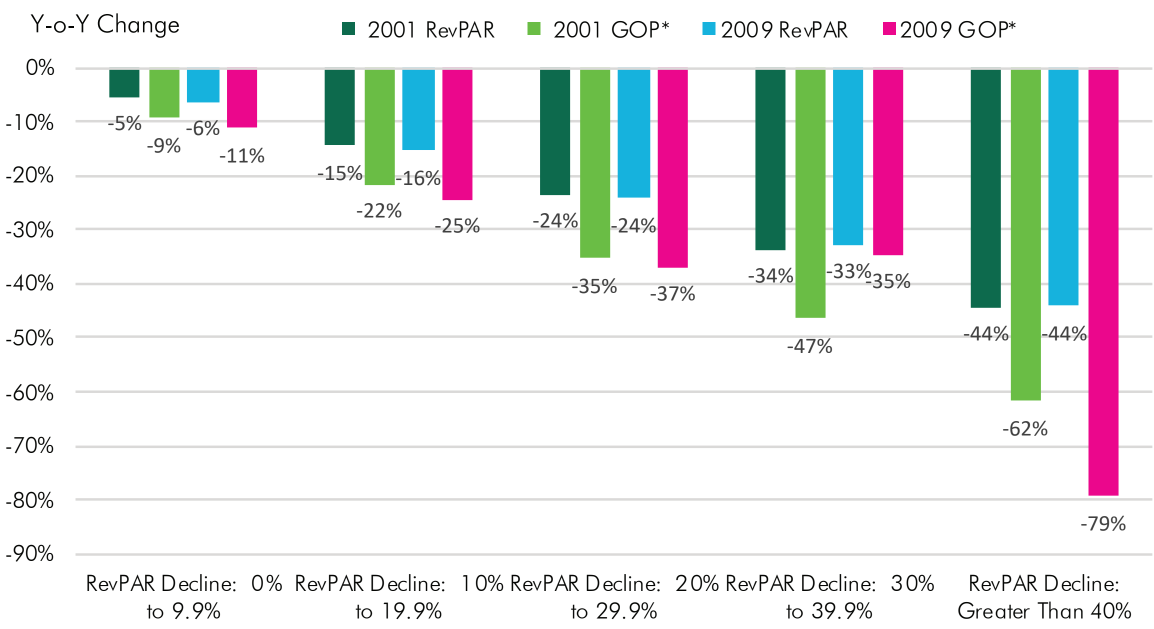
Figure 7: U.S. Hotel Industry Forecasts with COVID-19 Impact

Year	Occ	Occ^	ADR	ADR^	RevPAR	RevPAR^	Supply
2016	65.4%	0.1%	$ 124.06	3.0%	$ 81.14	3.1%	5,021,012
2017	65.9%	0.7%	$ 126.81	2.2%	$ 83.52	2.9%	5,106,199
2018	66.1%	0.4%	$ 129.96	2.5%	$ 85.94	2.9%	5,206,614
2019	66.1%	0.0%	$ 131.20	1.0%	$ 86.73	0.9%	5,311,653
2020F	46.8%	-29.3%	$ 117.09	-10.8%	$ 54.76	-36.9%	5,411,741
2021F	60.2%	28.7%	$ 125.78	7.4%	$ 75.72	38.3%	5,495,484
2022F	64.0%	6.4%	$ 134.15	6.7%	$ 85.89	13.4%	5,515,177

Source: CBRE Hotels, STR, March 2020

The introduction of wide-spread and substantial government and central bank support policies is expected to help companies survive a difficult Q2 and drive the recovery from Q3 onwards. If containment efforts are successful and people are permitted to begin traveling again by Q3, we expect a swift recovery as the fundamental reasons for travel remain strong and consumers of travel have pent-up demand to leave the house. Our outlook shows that RevPAR will almost recover to 2019 levels by 2022, but not before losing nearly $100 billion in rooms revenue alone by 2022 based on pre-COVID-19 forecasts.

Figure 8: Impact on Profits and multiple RevPAR Change Scenarios



Source: CBRE, Trends® in the Hotel Industry

Note:* Profit Before Management Fees and Non-Operating Income and Expenses

To provide context to the expected declines in profits for U.S. hotels during 2020, we analyzed the operating performance of properties during 11 economic recessions from 1938 through 2009. By far the greatest declines in revenues and profits were experienced by U.S. hotels during the two most recent recessions, which more closely mirror our expectations for the year ahead.

In 2001, of the properties in our sample that experienced a decline in RevPAR, only 2% saw RevPAR fall by more than 30%. On average, these properties suffered a 35.3% drop in total revenue which resulted in a 54.2% decline in gross operating profit (GOP). During the 2009 recession, 10.2% of the properties that experienced a decline in RevPAR saw their rooms revenue drop by more than 30%. On average, these properties also suffered a 35.3% drop in total revenue, but the decline in GOP averaged 57.0%.

To account for a wide range of potential outcomes, we have bucketed properties by the year-over-year change in RevPAR during 2001 and 2009 to show how GOP changes as a result of the lost rooms revenue. We have also analyzed the relative contribution of the declines in occupancy and ADR to the decreases in RevPAR. Given the expected RevPAR decline of 37% in 2020, our projections show an estimated decline in profits at the GOP level of 71% for the year.

To achieve these results operators will have to make severe reductions to employees' hours and compensation. Fortunately, we are in a low inflation period which should help keep the costs of goods, services, and utilities low. Further, recent changes in Food and Beverage operations and marketing practices have helped to lower fixed operating costs. We expect many owners will shut down completely to during this period as any additional revenues from operating will not be enough to cover the variable costs of keeping the property open, like how hotels in seasonal locations shut down during the off-season. This may lessen the impact to profitability.

While it is no solace, U.S. hotels are entering this industry recession in a much more profitable position than past recessions. Occupancy levels reached another record high in 2019 and profit margins are 450 bps greater than the long-run average. We expect challenging times ahead for the U.S. lodging industry but believe travel and the services associated with it will once again recover and quickly outpace historical peaks once this pandemic is eradicated.