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## Navigating at peak: A SWOT analysis of the U.S. hotel industry

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*(The views and opinions expressed in this blog are strictly those of the author.)*

What started as a bursting of the U.S. housing bubble in 2006-07, then mushroomed into a failing subprime mortgage/credit market, ultimately resulted in the worst financial crisis since the Great Depression of the 1930s. Ten years ago, the Great Recession was ushered in by a full-blown international banking crisis sparked by the collapse of blue chip investment banks Bear Stearns and Lehman Brothers.

Through the end of Q3 2018, Wall Street is enjoying another heyday as profits for commercial banks are at a record high, the stock market is in its longest bull run in history, the U.S. economy is humming, and the Trump administration's deregulation and tax cuts rule the day. Furthermore, the globe is awash with diverse pools of debt and equity capital that increasingly favors real estate as a preferred vehicle for returns on and of capital.

As 2018 sunsets and the dawn of 2019 emerges, I have prepared the following SWOT analysis for the ever-changing and complex U.S. lodging industry.

### Strengths

- The hotel industry is enjoying a ninth consecutive year of increasing profits while continuing to achieve record-setting rooms revenue metrics.
- Notwithstanding muted revenue growth coupled with upward pressure on expenses, the sector has been attaining exceptional operating efficiencies, productivity and margins.
- America is the world's beacon for safety and security, attracting visitors and investors from throughout the world.
- GDP of the U.S. economy expanded at an annualized rate of 3.5% from July to September 2018, after the 4.2% pace during Q2, and is on track for the best annual performance since 2005.
- The Conference Board Consumer Confidence Index continues to increase and is at an 18-year high.
- Despite recent stock market turbulence, the longest bull market in American history is still intact as the S&P 500 is trading about 9% below the record high notched in late September.
- Driven in part by the waning effects from recent tax cuts and the recent increase in federal spending, Goldman Sachs has forecast a near-term economic slowdown.

However, neither it nor Blackstone Group anticipate a recession prior to 2021.

- Rising affluence in emerging economies is leading to expansion of the global middle class, leading to increased numbers of travelers and expenditure of tourism dollars in the U.S.
- Nationally, hotel room night demand has been increasing within the major segments, namely corporate, group meeting/convention and leisure.
- Limited availability of construction finance and building labor shortages have meant new hotel supply increases nationally remain below long-term averages.
- On a relative long-term basis, U.S. interest and capitalization rates remain low.
- Copious amounts of debt and equity are available from a broad array of sources,
- Hotel asset prices remain robust with little, if any, investor anticipation of near-term value erosion.

## **Weaknesses**

- U.S. travel and immigration bans create negative postures and restrictions on foreign visitation.
- Trade wars may create negative pressure on inbound overseas tourists to the U.S.
- The lodging sector is overly segmented with travelers confused by continued rollout of new hotel brands.
- Airbnb now has twice as many downloads as 10 of the top hotel company apps combined.
- Labor shortages and rising influence of unions create upward pressure on wages and benefits.
- Hotel property tax burdens and insurance premiums have increased dramatically.
- Safety and security issues pertaining to hotel guests and employees are becoming ever more challenging.
- Hotel bed bug infestations across the country are on the rise.
- Guest privacy and anonymity has resulted in lodging facilities becoming attractive locations for human trafficking.

## **Opportunities**

- The Tax Cuts and Jobs Act of 2017 created new incentives for investment into certain communities that have been designated as Qualified Opportunity Zones by the U.S. Treasury Department.
- With daily tenancies and continuous repricing of room rates, investment in lodging assets represent a terrific hedge against future inflation.
- Increasing amounts of bleisure travel
- Sector pivot to a customer-centric pricing model
- Reduction of third-party commission rates
- Opportunities to acquire and renovate/reposition +/-35-year-old full-service hotels at an all-in basis equal to or less than the cost to develop new select-service assets.
- Opportunities to acquire exterior corridor 1950s and '60s motels and renovate and reposition into cool and hip experiential products

- Modular construction allows for efficient, cost effective and high-quality development.
- Continued expansion of industry sustainability and eco-friendly initiatives
- Technological advances continue to increase operating efficiencies
- Increased legal restrictions on short-term home-sharing rentals
- Creation of experiential hotel lobbies and/or food and beverage facilities that are not available through home-sharing rentals
- Hotel industry expansion into the home-sharing sector
- Hospitality mergers and acquisitions activity anticipated to remain robust

## **Threats**

- Airbnb has been overhauling its business model to further take on the hotel and travel industries.
- Pop-up hotels and nomad-focused hostel, hotel and co-working spaces
- A variety of factors can cause the next downturn including but not limited to:
  - U.S. corporate debt bubble burst
  - Weakening global growth
  - Slowing U.S. housing market
  - Increase in oil price;
  - Dramatic or swift rise of interest rates
  - Rise of commodity prices due to increasing import tariffs

In order to remain competitive, cutting-edge hotel market participants routinely consider the sector's highly fluid strengths, weaknesses, opportunities and threats. While the aforementioned SWOT analysis covers a broad array of factors on a macro basis, it is extremely important to consider how each one may impact the future performance of an individual hotel when underwriting an acquisition or development opportunity.

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