COVID-informed analysis of the New York City market

What's the Deal By Daniel Lesser

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

Historically, New York City (NYC) has enjoyed a strong and diverse volume of demand from the corporate, group and leisure sectors, which has driven its realization of the highest occupancy, average daily rate (ADR) and RevPAR levels within the United States. Over the past two decades, annualized RevPAR growth in NYC remained positive despite substantial increases in new supply. Year-end 2019 marked the 10th consecutive year of record-breaking visitation to NYC, reaching 66.6 million. However, as expected, 2020 visitation statistics reflect a substantial decline due to the COVID-19 pandemic, estimated to be a 65% decline to 22.5 million visitors.

The global outbreak of a "novel coronavirus" known as COVID-19 was officially declared a pandemic by the World Health Organization (WHO) on March 11, 2020. The length and extent of the impact this event will have on the national and regional economies are still unknown. Beginning in early 2021, the number of new, confirmed cases in the U.S. began to decrease, and experts are optimistic that this trend will continue through the remainder of the year as vaccines are distributed. While the COVID-19 pandemic has had an unexpected and pronounced impact on the entire U.S. travel industry, NYC has been more severely impacted. Leading into the pandemic-induced economic downturn, the NYC economy was well past its peak for the cycle and showing signs of softening. However, due to the pandemic, the market is experiencing its most challenging economic period since the Great Depression.

Between 2017 and 2019, NYC RevPAR decreased by an average annual rate of 0.1%, driven by a 0.3% increase in occupancy and a 0.4% decrease in ADR. Like the rest of the nation, RevPAR growth slowed in 2019; however, unlike the rest of the country, NYC RevPAR growth was materially negative. The RevPAR declines aligned with an increase in supply growth in 2019 that turned occupancy negative. In 2019, NYC recorded an occupancy level of 86.2%, ranking second among the major markets.

Last year was off to a similar start, with RevPAR down 0.8% through February. However, as the Covid-19 pandemic swept the nation, RevPAR dropped precipitously beginning in March. While RevPAR declines were greatest in April with an 80% decline, there were signs of modest but steady improvement in the months that followed. Through August, the RevPAR declines gradually improved, with August down 75%. However, the declines regressed through the fourth quarter with RevPAR down 82.6% in December. In total, 2020 RevPAR declined 67.7% on a 45.9% drop in occupancy and a 40.3% reduction in ADR. NYC RevPAR is not anticipated to meaningfully recover until a vaccine is widely distributed and the pandemic is largely behind us.

During the past decade, NYC has experienced significant hotel development, ranging from ground-up construction to repurposed landmarks and iconic facilities. NYC is home to nearly 124,000 hotel rooms, and Manhattan alone had over 92,000 existing hotel rooms as of the end of 2019. Prior to the COVID-19 pandemic, hotel inventory across NYC was anticipated to reach 142,000 rooms by 2021. This significant pipeline has been fueled by consistently strong and continued demand growth from domestic and international markets, led by visitors from United Kingdom, China, Canada, Brazil, France, Australia, and Germany.

The short-term rental market, which includes Airbnb, has and continues to have a dramatic impact on NYC compared with many other major markets. Home sharing accounted for 8.8% of all accommodation revenues (defined as hotel-comparable home sharing revenue + hotel rooms revenue) in NYC in 4Q20 and averaged 4.1% during 2019 compared with the national average of 5.6% in 3Q20 and 3.3% during 2019.

Due to the severe decreases in travel and hotel demand caused by the pandemic, numerous hotels throughout NYC ceased operations, while some remained partially operational for essential workers only. Although many anticipate as the market normalizes and demand rebounds most of these hotels will re-open, it is also reasonable to expect that a portion of the closed properties will not re-open as fully operational transient hotels. While several NYC hotels have announced permanent closure, the lack of attractive alternative makes expensive conversions unlikely. With this said, properties most likely to remain closed post-pandemic include large, under-invested, aged union-operated hotels in Manhattan such as the 1,700-

room Hotel Pennsylvania and the 1,015 Roosevelt Hotel. These two properties, along with the 800-room reduction at the Grand Hyatt New York account for roughly 75% of the rooms expected to be permanently closed.

The ongoing COVID-19 pandemic has had a severe impact on performance during 2020 and continuing into 2021. In the months after a state of emergency was declared, demand captured by hotels that remained open in NYC was generated primarily by the Department of Homeless Services and by essential workers, such as healthcare contracts and National Guard. This demand partially offset significant occupancy declines, though it came at the cost of ADR given the relatively low rates of such contracts.

NYC hotel investment sales activity increased significantly following the economic downturn in 2008, reaching a peak in 2015 and remaining strong through 2019. As the most highly sought-after investment market for offshore investors, NYC recorded approximately US$2.6 billion in total transaction volume in 2019. The broader macro market has strengthened considerably over the past decade, having a positive effect on pricing and transaction volume. In 2020, the trend has shifted to favor domestic buyers given the international travel restrictions and uncertainty throughout the global financial markets.

Due to the impact of the COVID-19 pandemic, 2020 NYC hotel sale volume declined approximately 78% to US$593 million. The lack of traditional financing options has been the most notable hindrance throughout 2020 and continuing into 2021. Many lenders granted and extended temporary forbearance agreements to allow borrowers to retain ownership, and many investors have taken the “wait-and-see” approach. Debt financing has become more expensive and difficult to obtain with more stringent underwriting standards. However, it is expected that financing options will improve, and sale volume will increase during 2021, given that acquisition pricing is anticipated to be attractive in the near term.

The long-term outlook for NYC is that the area will return to its historic status as a positive operating environment for hotels and as a desirable location for investors. However, because of the extension of social distancing orders and both domestic and international restrictions on travel, performance metrics for the market are anticipated to continue to be challenged in the near term. The recovery is anticipated to last another 12 to 36 months in most submarkets, due largely to the continued restrictions on group gatherings and events, and a shift to remote working at many corporations. A continued roll-out of vaccines should support a market rebound.

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