Room for Recovery

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Hospitality CCIM Feature

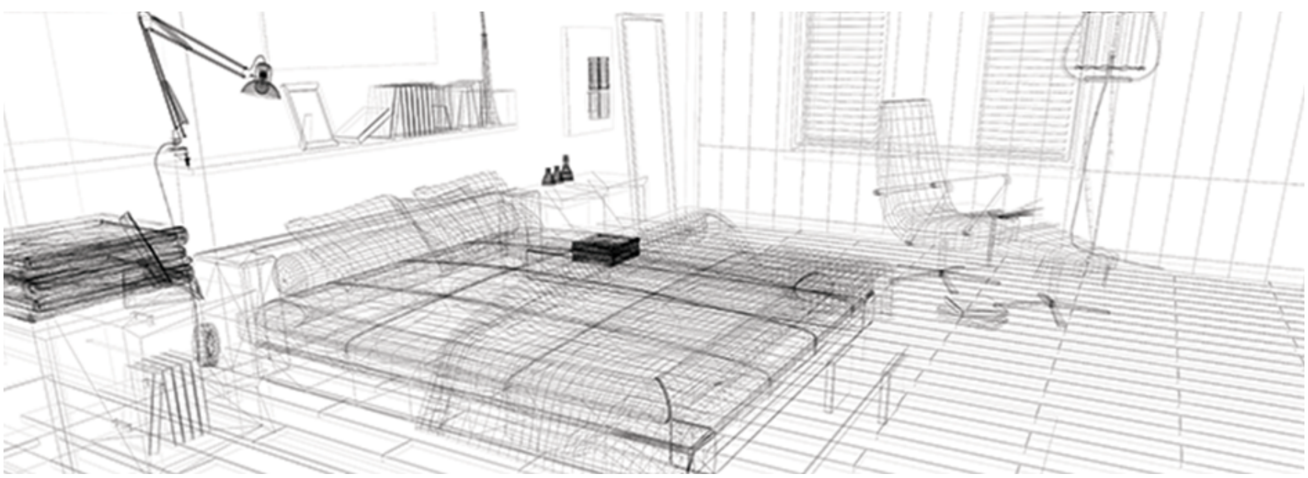
The hospitality sector was devastated in 2020, but vaccinations, industrywide efforts, and returning demand are reasons for hope.

By Nicholas Leider |

Perspective isn't the easiest thing to maintain when facing unprecedented challenges — and the COVID-19 pandemic provided plenty of those for commercial real estate markets in the year-plus since the resulting shutdown affected nearly every facet of daily life in the U.S.

But with a year in the rearview mirror, hotel property owners, operators, investors, and guests alike have gained enough perspective to know there is light at the end of the tunnel. Plenty of variables will dictate just how far the sector has to go to reach it — but it's a comforting thought for an industry that's been to hell and is on its way back in 2021.

“Hope is going to be driven by the widespread dispersion of a vaccine,” says Geraldine Guichardo, global head of research for JLL's Hotels & Hospitality Group and head of Americas Hotels Research. “Once people feel more comfortable traveling and do not fear the risk of becoming contagious, there is real pent-up demand to travel again."



But overcoming unprecedented challenges will not be possible without some suffering, in this case in the form of distressed sales, bankruptcies, and closures. While every market — bull or bear — is unique, there are lessons to be learned from history.

“Look at what happened as we emerged from the Great Recession,” says Daniel Lesser, president and CEO of New York-based LW Hospitality Advisors. “Nobody was holding national meetings or conventions, but Las Vegas, for instance, was booming. I'm very optimistic, just seeing the amount of money that's out there chasing quality opportunities in the hotel space. That says a lot to me because these are smart, sophisticated folks with a track record of success."

Setting the Scene

Before looking ahead at what hopes to be a sunny future, 2020 deserves a complete reckoning to fully understand the damage caused in the wake of COVID-19's arrival on American soil. Numbers cannot tell the entire story, but the narrative they do share is an ugly one.

According to a February report from CBRE, overall demand for hotels dropped 35.9 percent in 2020 compared to the previous year. Occupancy dropped 36.8 percent. Average daily rates dropped 29.6 percent. The most telling is that RevPAR (or the revenue generated per available room) dropped a whopping 55.5 percent.

"U.S. hotels suffered the worst annual occupancy level in 2020 since the Great Depression in the 1930s," according to the CBRE report. "The biggest declines in RevPAR in 2020 occurred in larger gateway markets. These markets suffered from a lack of group demand, fewer inbound international travelers, and a reliance on airline travel."

What has proven so devastating about the pandemic is just how quickly and completely demand vanished. Hotels, to nobody's surprise, exist on a day-to-day influx of room reservations, with food and beverage income and other ancillary spending flowing from the occupancy. Hotel owners and operators watched demand for their offerings vaporize in a matter of hours in March 2020, as state and local governments across the U.S. announced shelter-in-place orders and lockdowns.

To punctuate COVID-19's crushing effect on the hospitality industry, look to the spike in delinquency rate for commercial mortgage-backed securities. Chugging along around 1.5 percent at the end of 2019 and into 2020, it spiked to 24.3 percent in June and has remained above 20 percent since the onset of the pandemic — that means one in five properties are still in immediate danger. The overall CMBS delinquency rate jumped to 10 percent, fueled largely by lodging and retail.

But after the initial shock of the pandemic, activity began to resume in various sectors of the travel and leisure industry, with hotels opening to a completely altered consumer landscape.

"Leisure travel proved to be a stronger segment of demand throughout the pandemic as travelers experienced lockdown fatigue and planned last-minute trips, escaping to drive-to destinations," according to JLL's Hotel Investment Outlook for 2021.

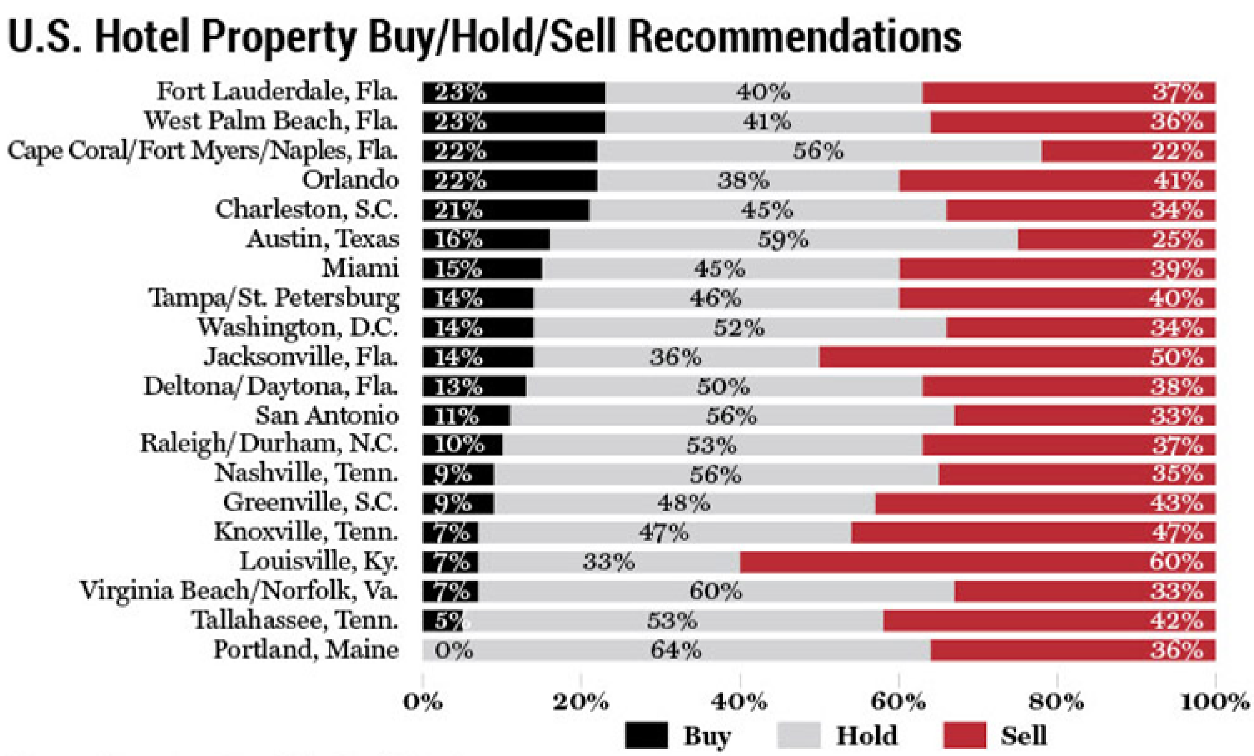
On a year-over-year basis, the numbers were as bleak as expected. But relative to days immediately following the initial lockdown, occupancy rates, for example, began to inch upward. Overall occupancy for all hotels cratered from 63 percent in February 2020 to 20 percent in April, according to CBRE. But that figure gradually increased through the summer months, holding steady between 40 and 50 percent before increasing rates of COVID-19 in November pushed occupancy back down.

Luxury hotels bore the brunt of this difficult market, with occupancy down 71.8 percent year-over-year in 4Q2020, while upper-upscale properties saw a 64.2 percent YOY decline. Economy hotels, meanwhile, saw an occupancy decrease of only 14.8 percent in 2020.

Road to Recover

While 2020 has become synonymous with chaos and disruption, COVID-19 and its fallout didn't disappear when the calendar flipped to the new year. But as vaccines were approved, distributed, and now being administered across the country, the hospitality real estate market can begin to look ahead to the future of the sector.

“A lot has changed in a year,” says Bram Gallagher, Ph.D., senior economist with CBRE. “The pace of immunizations has increased, and we've had two recent stimulus packages — it's been mostly good news of late. That being said, the first two quarters of 2021 are still going to look a lot like the last half of 2020. But the market is improving and should return to near 2019 performance in aggregate by late 2023 or 2024 realistically.”



Source: Emerging Trends in Real Estate 2021 survey
Note: Cities listed are top 20 rated for investment in the hotel sector; cities are ordered according to the percentage of “buy” recommendations.

Leisure travel is expected to return relatively quickly, with millions of people ready to escape after largely remaining in place for a year plus. Business and international travel, however, could continue to remain depressed. For the everyday traveler, the increasing vaccination rates provide hope of a return to something in the realm of normal.

“It really comes down to confidence,” says Lesser. “Frankly, that's what's missing for a lot of people right now — the confidence to get on an airplane or stay at a hotel. [These properties] have been proactive in trying to build that confidence, but I don't know if it's up to hotels, airlines, and rental car companies. To some extent, it just comes down to getting vaccines in arms.”

Deals in hospitality real estate, meanwhile, should inch upward after last year, which saw overall volume drop by 60 percent, according to JLL.

“We predict that global transaction volume could be up between 35 to 40 percent in 2021,” says Guichardo. “The activity will largely be driven by resort markets and urban centers that are highly dependent on fly-to international travel.”

Those primary urban markets — namely New York, San Francisco, Chicago, and Los Angeles — will face difficulties thanks to a reduction in both international travel and air travel from within the U.S. Business travel, which is expected to lag behind leisure, is another roadblock to recovery for these major metropolitan markets.

“Convention business, group travel — these sectors may be slower to recover,” Gallagher says. “Trade shows and conventions, typically scheduled a year or two ahead of time, may not occur later this year. We may see reduced activity which could be a bit of a headwind for large urban markets."

As daily life ground to a halt through the spring and summer of 2020, many speculated about what COVID-19 could mean for densely populated cities. Social distancing isn't exactly the first thing that comes to mind when thinking about the New York subway or Chicago “L,” for instance. With offices closed and many amenities of city life unavailable to its residents, a portion of the population began relocating to suburban or exurban settings.

But is this trend an immediate reaction to the pandemic or a long-term societal shift in preferences? The answer to this question will not be evident for years or decades to come. Commercial real estate experts, however, seem to believe that city life may change — but the Big Apple isn't going to be a ghost town anytime soon.

“If somebody doesn't believe New York's coming back, they probably don't have a great outlook on the rest of the world,” Lesser says. “Frankly, I think the smart money goes into New York now at a deep, deep discount to three years ago.

Regardless, secondary and tertiary markets continue to benefit from this initial response. With air travel slowly inching upward, destinations reachable by car for both leisure and business travel have become more appealing.

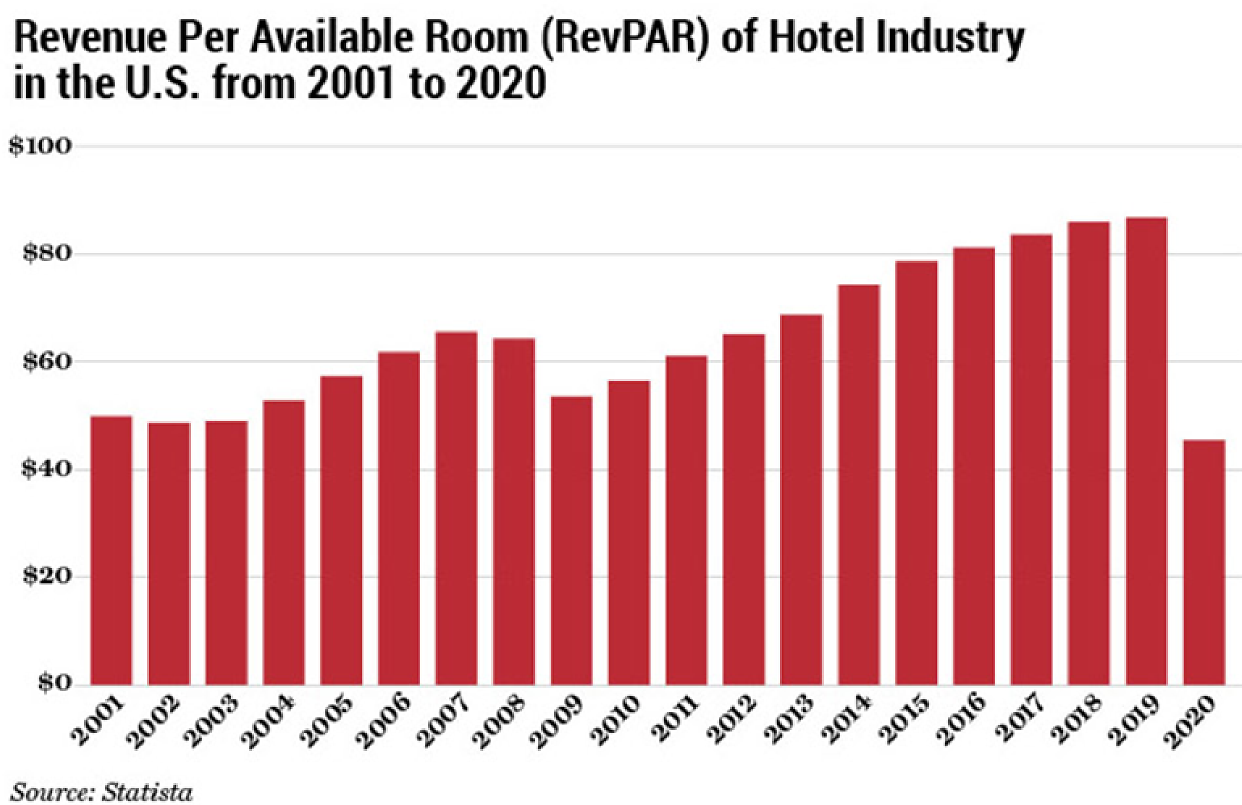
“Look at Atlanta, St. Louis, or Jacksonville,” Gallagher says. “These places are trying to capture some of the business lost by primary markets this fall and into next year. It's not game-changing demand, but drivable locations have potential.”

Changing Expectations

While many experts continue to speculate on what's in store for 2025 or 2030, there are plenty of changes and opportunities for the hospitality industry to tackle in 2021.

Total volume of transactions for 2021 could increase 35 to 40 percent from last year's muted levels, according to JLL. “We expect investors to not only continue favoring assets in less dense and resort markets, but also those assets that implemented swift changes to support changing guest expectations by focusing on technological advancements and wellness,” the report states. While gateway cities and those dependent on air travel may face near-term difficulties, these locations do present opportunities for acquisition.

And after much of 2020 was spent on the sidelines, private equity funds and high-net-worth individuals have plenty of dry powder with increasing pressure to find appealing targets.



“Private equity groups have been raising a flurry of capital to invest and now are facing pressure from their investors to find a space to invest this capital in,” Gallagher says. “For opportunistic players, the hotel space can prove to be an attractive investment, particularly as more assets emerge at an attractive basis.”

“I don't recall there ever being as much capital as right now, just chasing yield,” Lesser says. “U.S. commercial real estate is still very appealing. Drilling down further, looking at hotels, it's been proven time and time again on a risk-adjusted basis, hotels can provide superior returns.”

With a significant portion of hospitality properties in serious trouble, opportunities will not be few and far between.
Distressed assets will be hitting the market, with some inevitably being purchased for conversion to uses other than hotels. But the long-term health of the market sector does not appear to include a significant contraction in supply.

“It's no secret that several hotels have closed or will close as a result of the pandemic but, over the next couple of years, the pipeline of hotel development will improve as developers and investors see performance rebound and have more certainty as to the industry's path forward,” Guichardo says.

As for the consumer experience inside hotels in a post-COVID-19 environment, technology will be key.

“A lot of updates will include quicker adoption of technology that was already growing in use before 2020,” Lesser says. “Things like keyless entry, self-check-in, even the delivery of a toothbrush to your room by a robot — we will see these measures embraced because the market is extremely competitive.”

An emphasis on space, sanitation, and safety will also drive how solutions are delivered to satisfy customer preferences.

“Hotel parent brand companies should start thinking about how hotels can be reconfigured to feature larger bedrooms that allow guests to work productively, work out comfortably, and rest easily,” Guichardo says. “We saw evidence of this in 2020 with the outperformance of extended-stay hotel product, which typically features oversized bedrooms with small kitchenettes.”

Some additional modifications could be extensions of industrywide trends from before the pandemic. Less frequent visits from housekeeping, for example, were marketed as a way to reduce the carbon footprint of the guest and the property. Now, such an initiative nicely dovetails with a desire to reduce interactions.

Open spaces will still be a priority for guests, so property owners and operators may have to examine what areas of a property are not essential to maximize revenue. These spaces — both indoors and out — can then be offered as comfortable and safe spaces outside the room to work or relax.

While hotels face plenty of uncertainty, as much as any major sector of commercial real estate, the outlook isn't as dire as it was six or 12 months ago. Increasing vaccination rates, industrywide efforts to improve safety, and steadily increasing demand for travel and leisure all point to a slow march toward normalcy in a post-COVID-19 world.