SWOT analysis of the U.S. lodging industry

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Over the past several weeks, Omicron has blindsided the world. The new variant is spreading rapidly throughout the U.S. and abroad, and has dashed the hopes of many that believed the pandemic was coming to an end. Many are reminded of March 2020 when the COVID-19 virus was first introduced into society. Despite all the negativity, optimism and enthusiasm are two emotions I would rather embrace than exhaustion and melancholy.

Could this be the last wave that brings us to herd immunity or the catalyst we needed to push for broader vaccinations? Either outcome would certainly be a 'win' for many seeking a return to some semblance of normalcy, so long as this variant continues to cause mild symptoms.

This year has been no less remarkable than last, and as 2021 sunsets and the dawn of 2022 emerges, the following is my SWOT (strengths, weaknesses, opportunities, and threats) assessment of an ever-changing and complex U.S. lodging industry.

Strengths

- According to the National Bureau of Economic Research, the COVID recession lasted just two months, the shortest in U.S. history.
- Furthermore, according to the U.S. Department of Commerce Bureau of Economic Analysis, America's economy is now bigger than it was pre-COVID as the quarterly GDP level rose to US$19.4 trillion in the second quarter, higher than the US$19.2 trillion in the fourth quarter of 2019.
- U.S. consumers, flush with trillions of dollars of fiscal stimulus, are snapping up manufactured goods and scarce materials at a record pace.
- Although during the near-term interest rates are anticipated to rise, on a relative long-term historical basis they have and will continue to remain ultra-low.
- Corporate earnings experienced a boost from recently unleashed pent-up consumer demand resulting in record high U.S. stock market indexes during 2021.
- New lodging construction is relatively muted due to a reduced inflow of new projects as compared to pre-COVID levels, and hotel openings during the first half of the year which exited the pipeline. The prolonged effects of the pandemic, above average inflation, rising interest rates, labor and material shortages, as well as price increases will continue to be key factors in decision-making for developers during the near term.

- The world is awash in capital chasing yield, the competition for which is placing upward pressure on pricing of many asset classes, including commercial real estate. There has and continues to be an unprecedented amount of domestic and overseas debt and equity investors for all capital stack tranches in connection with single existing and proposed assets, portfolios, and mergers and acquisition financings and refinancings.
- During 2021, pricing of single U.S. hotel properties has been robust as evidenced by the:
- Five sales above US$2 million per room.
- Considering there have only been 9 U.S. hotel trades ever with a price over US$2 million per room, it is notable that more than half of such sales occurred during the year of a global pandemic.
- Six sales above US$1 million per room.
- Considering there have only been 33 U.S. hotel trades ever with a price over US$1 million per room, it is notable that nearly 20% of such sales occurred during the year of a global pandemic.
- Eight trades above US$200 million each.
- Five trades above US$300 million each.
- Two trades above US$600 million each.
- One trade above US$800 million.
- The announcement earlier this year of Hyatt Hotels Corp. acquisition of Alila Ventana Big Sur in Big Sur, California, for US$2.508 million per unit, represents a new high-water mark in the U.S.
- Three months later Hyatt sold the Alila Ventana Big Sur for US$150 million, or US$2 million more than what amount originally paid, setting yet another per unit record for a U.S. hotel of US$2.542 million. Furthermore, the buyer, Host Hotels & Resorts, entered into a long-term management agreement with Hyatt to operate the facility, which more than likely was a requirement for the transaction to occur.
- Record submarket per unit pricing has been established with sales earlier this year of The Four Seasons Resort Orlando at Walt Disney World Resort in Orlando, Florida, and the Mountain Chalet Aspen in Aspen, Colorado, for US$1.374 million per room and US$1.079 million per key, respectively.
- The US$740,000 per key sale of Residence Inn by Marriott Maui Wailea hotel in Hawaii is the highest-ever price per unit paid for a U.S. select-service hotel.
- Four blockbuster Las Vegas trades including the US$1.075 billion sale of The Mirage, US$3.89 billion sale of Aria Resort & Casino and Vdara Hotel & Spa, the US$5.65 billion sale of the Cosmopolitan of Las Vegas, and the US$6.250 billion sale of the Venetian Resort Las Vegas & Sands Expo and Convention Center Las Vegas.
- Lodging sector mergers, acquisitions, and spinoffs during 2021 include:

- A joint venture between Blackstone and Starwood Capital Group acquired the 561-property (62,500 rooms) portfolio and brand Extended Stay America and its paired-share REIT, ESH Hospitality, Inc. The US$6 billion transaction reflects perceived upside by astute institutional debt and equity sponsors with demonstrated historical success investing in lodging assets.
- Blackstone Real Estate Partners acquired Condor Hospitality Trust portfolio of 15 limited-service hotels for US$305 million, or roughly US$160,000 per room.
- Hyatt Hotels Corp. acquired Apple Leisure Group (ALG), a leading luxury resort-management services, travel and hospitality group, from affiliates of KKR and KSL Capital Partners for US$2.7 billion in cash. ALG's property asset light portfolio of brands includes 33,000 hotel rooms concentrated in all-inclusive resorts in Mexico, the Caribbean and Europe.
- A joint venture between Highgate and Cerberus Capital Management agreed to acquire CorePoint Lodging in a deal valued at US$1.5 billion. A majority of CPLG's pure play select-service hotel owner focused portfolio is affiliated with the La Quinta by Wyndham brand.
- As part of the bankruptcy process of Singapore based REIT Eagle Hospitality Real Estate Investment Trust, Monarch Alternative Capital purchased a portfolio of 10 full-service hotels located in four states for a total consideration of US$360 million.
- Pyramid Hotel Group and Benchmark Global Hospitality, two of the largest third-party U.S. hotel management companies with 210 hotels combined, merged and now operate under the moniker Benchmark Pyramid.
- Aimbridge Hospitality acquired Prism Hotels & Resorts, whose third-party management portfolio included 48 properties.
- Terrapin Hospitality acquired K Partners and increased its portfolio from 35 managed properties to 70, with 7,335 rooms spanning across 13 states.
- Institutional investment platforms, many of whom are lodging centric, dominate the hotel acquisition arena.
- Hotel asset prices are anticipated to remain robust with little, if any, investor anticipation of near-term value erosion.

Weaknesses

- Corporations are facing increased challenges transitioning return to office initiatives.
- Several major firms including Amazon and PwC are now allowing employees to work remotely indefinitely.
- A booming U.S. economy is contributing to global supply chain struggles, placing upward pressure on prices, and resulting in a surge of inflation.
- Companies across industries have been unable to fill labor positions needed to support consumer demand.
- U.S. lodging sector labor shortages and a continued rising influence of unions, creates upward pressure on wages and benefits.
- The return of business travel and large group industry meetings returning to pre-COVID levels remains highly uncertain and less likely the more time that passes before the pandemic finally ends. A growing list of 2022 global events have canceled, rescheduled or moved to virtual.
- Virtual meetings have become a permanent phenomenon and will endure beyond the eventual end of the pandemic.
- Although in some large, hard-hit U.S. cities there have been some short-term reductions, generally hotel property tax burdens and insurance premiums continue to dramatically increase.
- The lodging sector continues to be overly segmented with travelers confused by the persistent rollout of new hotel brands.
- The sector continues to be challenged with competition from the short-term rental industry.

- Safety and security issues pertaining to hotel guests and employees continue to be ever more demanding.

Opportunities

- With a hybrid model of working, bleisure (business and leisure) travel is expected to increase.
- Investment in lodging has historically proven to be a hedge against inflation as scientific knowledge allows for continuous re-pricing of the daily leasing of guest rooms.
- Converting hotels to alternative uses, including multifamily, senior living, student and work force housing.
- Technological advances continue to increase operating efficiencies.
- Like the airline industry, lodging operators experimenting with a la carte pricing for services and amenities.
- Hospitality mergers and acquisitions activity is anticipated to remain robust.
- The luxury property market is experiencing a period of expansion in the branded residences space, with the number of global branded developments having tripled in the past decade and expected to continue to dramatically grow during the foreseeable future.
- Long term, well-capitalized opportunistic investors that bet big, at the right basis, and early in the cycle acquiring and/or investing in loans, assets and operating companies will likely reap tremendous financial rewards that generate outsized returns, particularly contrarian sponsors who acquire large urban corporate and group meeting/convention hotels at fractions of replacement cost.
- Distress deals are coming soon; however, many compelling opportunities will not represent distressed pricing.

Threats

- Development of additional COVID variants resulting in further curtailment of travel and leisure activities and in extreme cases more shutdowns.
- Inflationary pressures on hotel operating expenses, which may result in a rise in costs exceeding increases of revenues.
- Forbearance periods are coming to an end, which will force unpleasant borrower/lender discussions.
- Increasing number of lawsuits in connection with ADA accessibility information on hotel industry websites.
- Growing cybersecurity risks that can lead to costly breaches and/or reputational damage.
- Increasing weather and climate disasters will recalculate real estate and insurance risks.

In conclusion, sophisticated hotel market participants routinely consider the sector's highly fluid strengths, weaknesses, opportunities and threats. While the aforesaid 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.