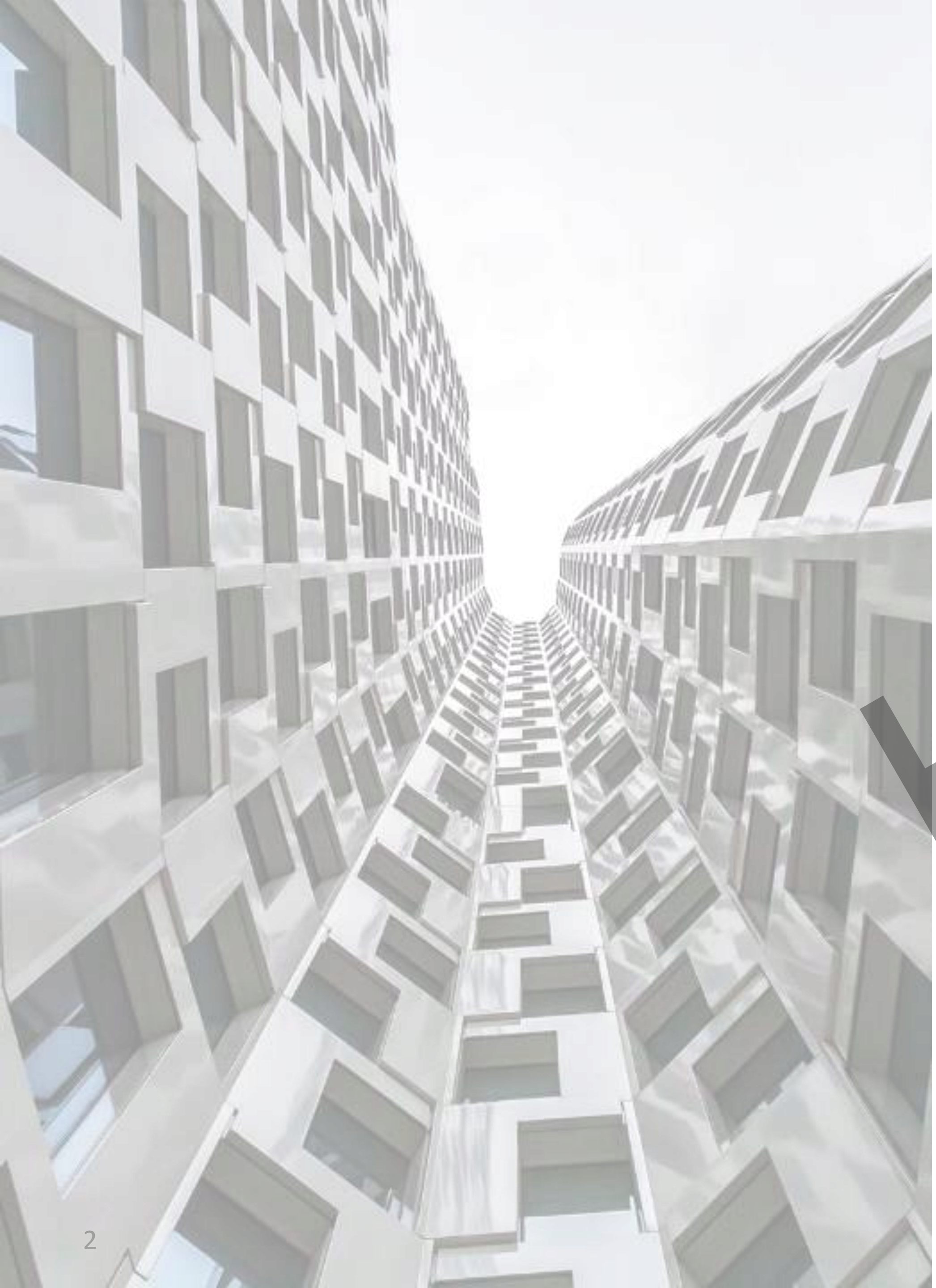
HVS.COM

Current and Expected Trends in Hotel Values

Are hotels still good value?

Russell Kett
Chairman, HVS London
15 September 2020

The information presented in this report should not be disseminated to the public or third parties without the express written consent of HVS. The information in this presentation is provided on an “as is” and “as available” basis and should not be construed as investment, tax, accounting or legal advice

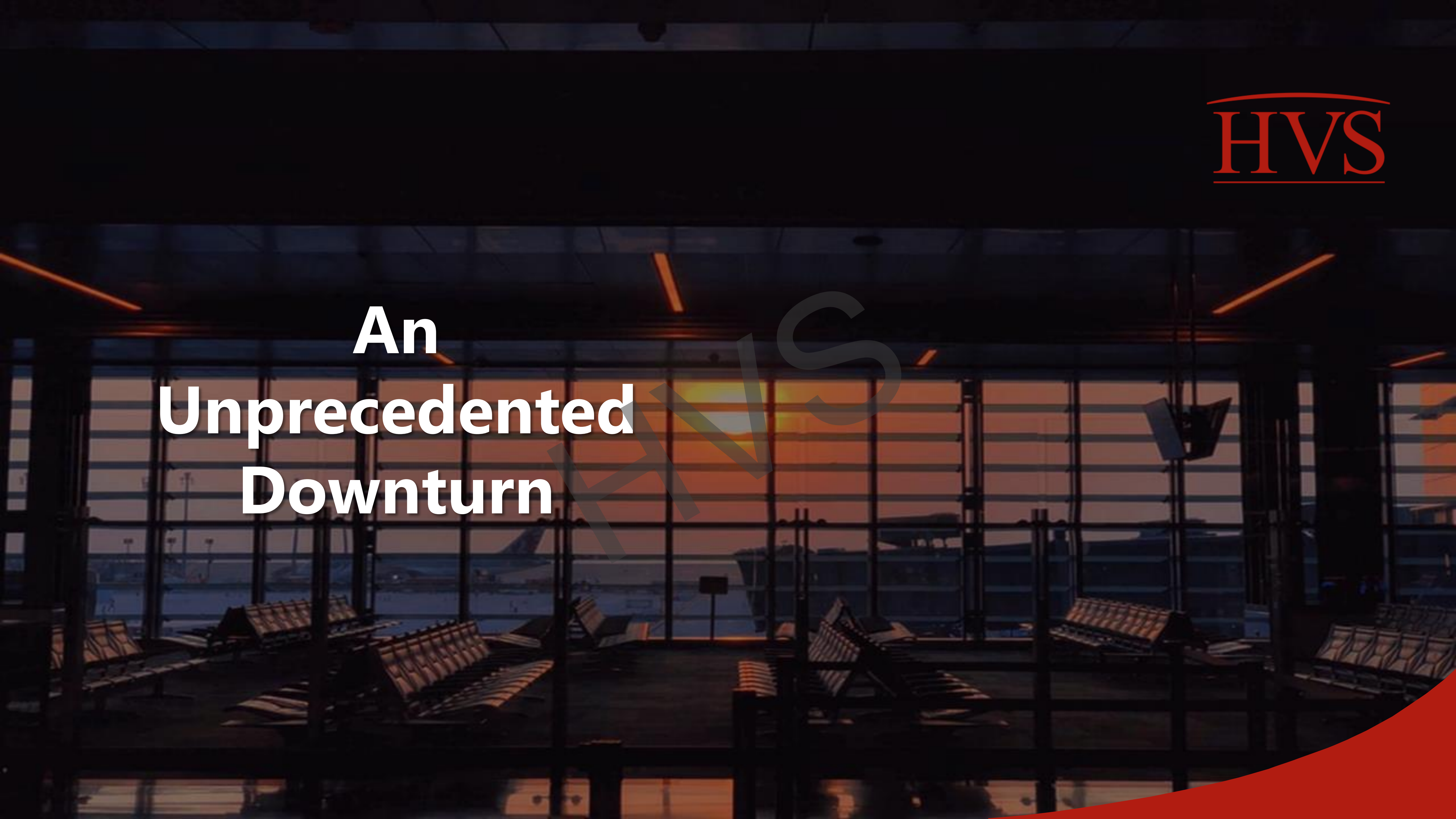


Agenda

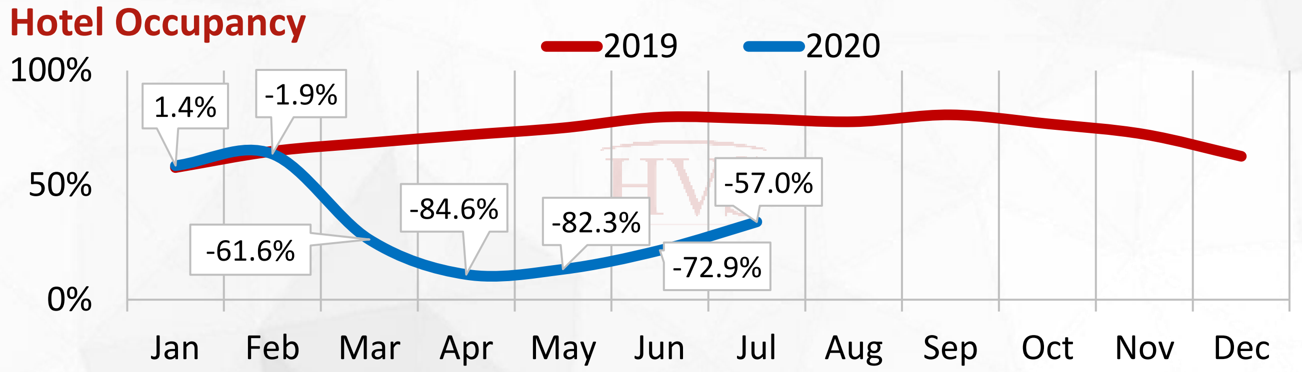
1. An unprecedented downturn
2. Looking ahead
3. Hotel values
4. Conclusions

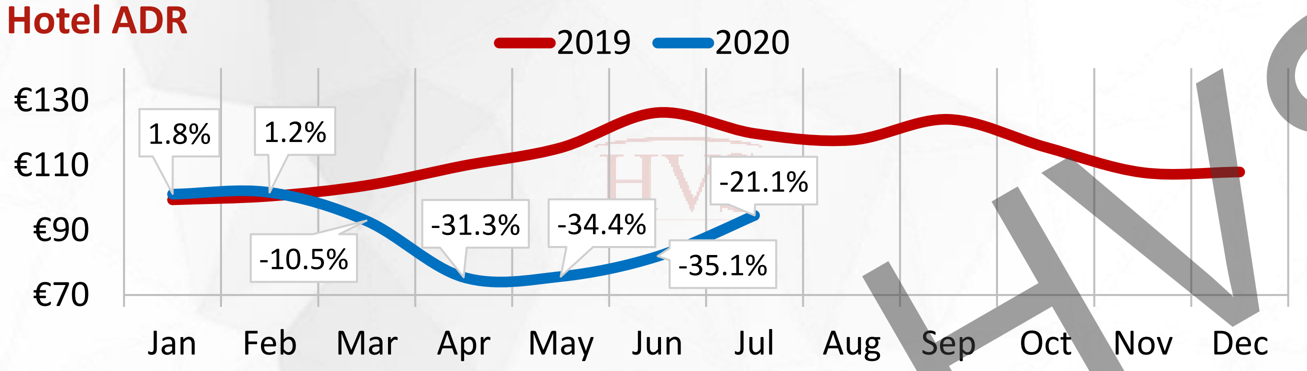
HVS

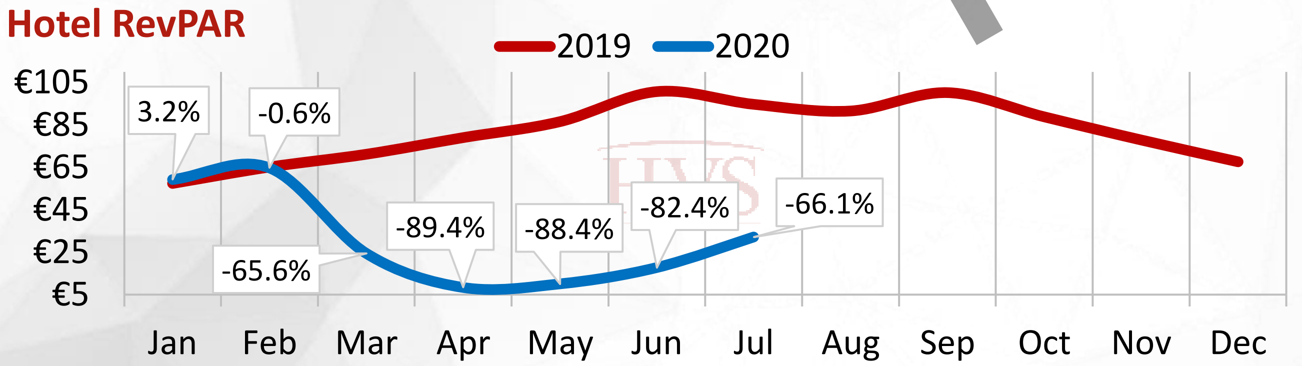
An Unprecedented Downturn



HVS







Data Source: STR

HVS

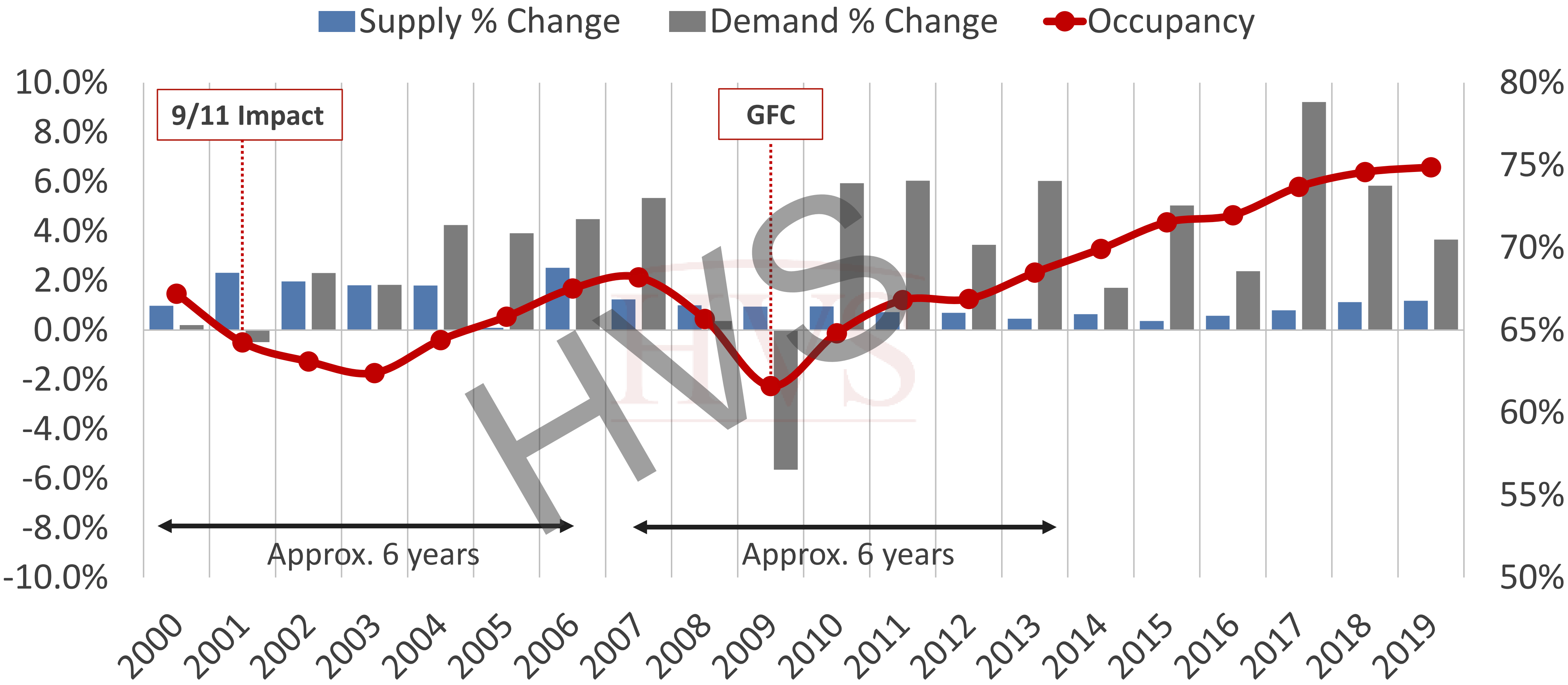
Data for Europe show substantial declines – anticipated to start improving – most European markets now open

The data excludes hotels that are closed. Given that an important number of hotels temporarily closed from March 2020, we expect the decline to be more significant than the presented in the graph.

HVS

Demand proved resilient to previous shocks

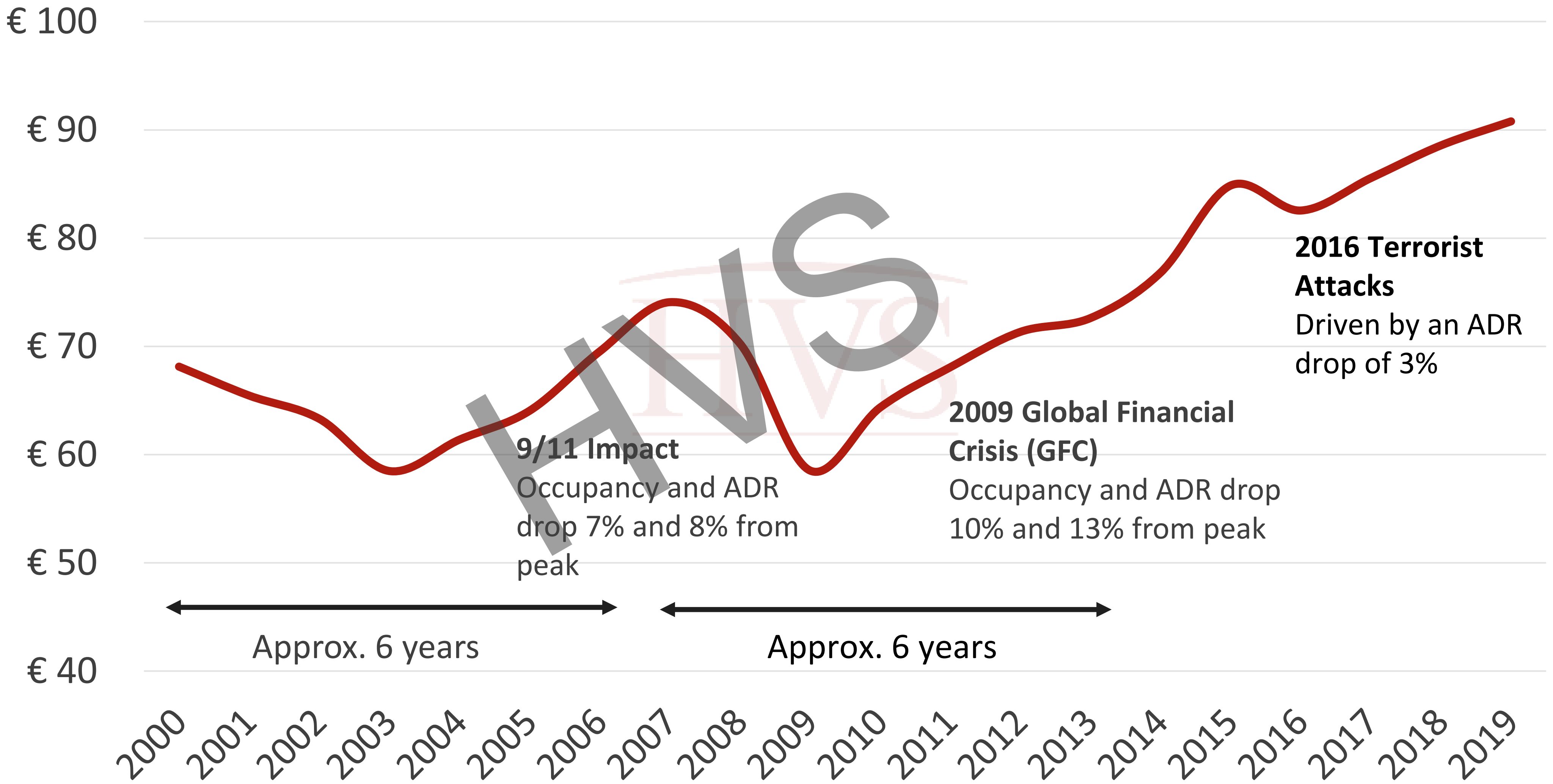
Europe Overall



Sources: Eurostat; UNWTO; STR

RevPAR recovery averaged 6 years

Europe Overall



Source: STR

HVS

Looking Ahead

Winners and losers in the recovery

More Vulnerable

- Full-service hotels, dependent on group business or MICE
- Hostels with dorms
- Luxury hotels
- Gateway markets that depend on international travel
- "Fly to" markets that depend on air travel
- Airport hotels
- Independent properties
- Markets influenced by the energy sector
- Airbnb and private rental

Secondary and tertiary markets
↓
hold up better & trade at a smaller discount to 2019 values

Gateway and primary markets
↓
more volatile, larger value declines in the near term, with greater potential for accelerated appreciation thereafter

Less Vulnerable

- Hotels that primarily rely on transient segments
- Markets accessible by car to recover faster than those dependent on air travel
- Suburban, small metro town properties
- Extended-stay hotels / serviced apartments with self-contained units
- Properties affiliated with strong brands
- Economy / midscale properties

Noticeable recovery anticipated from 2021

HVS

	Historical		Forecast				
	2018	2019	2020	2021	2022	2023	2024
Occupancy	72%	72%	35%	61%	66%	72%	72%
Percent Change		*0.3%*	*-52.1%*	*75.9%*	*8.3%*	*9.2%*	*0.0%*
Average Rate in €	113	111	93	97	104	109	117
Percent Change		*-2.1%*	*-16.2%*	*3.8%*	*7.8%*	*5.0%*	*7.0%*
RevPAR	82	80	32	59	69	79	84
Percent Change		*-1.8%*	*-59.8%*	*82.7%*	*16.8%*	*14.6%*	*7.0%*

Source: STR (Historics) and HVS (Projections)

HVS

Assumptions

2020 – strong declines in both occupancy and average rate based on year-to-June actuals and monthly estimates for the rest of the year

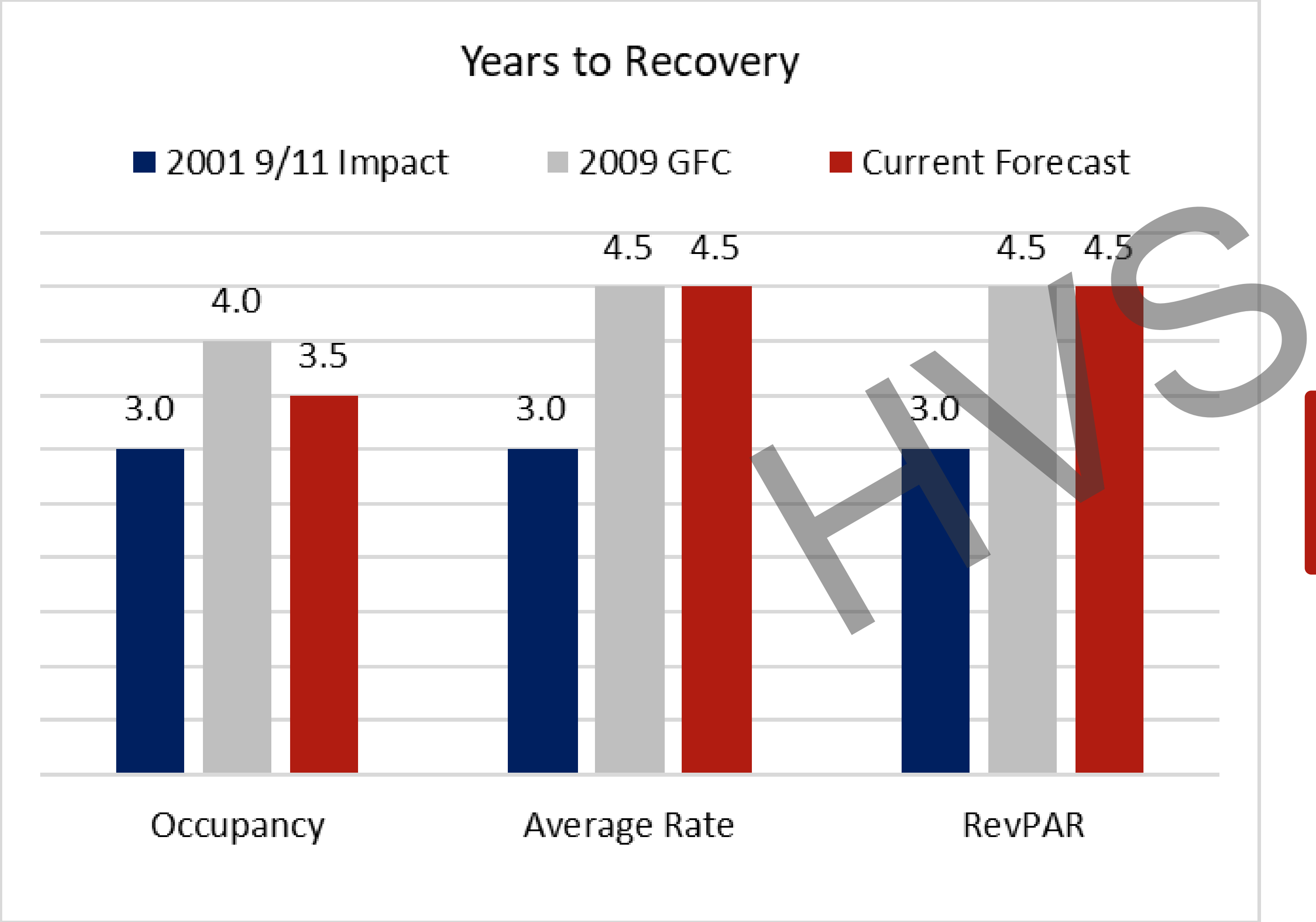
From 2021 we project occupancy to build up first and recover by 2023, i.e. within 3½ years

Average rate – expected to lag behind, but we project a narrowing of the gap by 2024 (deflated to 2019 levels), i.e. 4½ years

Differences in recovery times between markets and individual properties are expected

RevPAR recovery anticipated to take until 2024

HVS



Years to Recovery reflects time from trough year to the peak (a return to prior levels)

Occupancy Forecast

- Demand recovery expected once travel restrictions are lifted and COVID-19 virus contained

Average Rate Forecast

- Average rate – similar time to recover as in previous downcycles
- We expect rate to be a key marketing tool used to stimulate certain demand
- Availability of shadow supply (e.g. Airbnb) also influences average rate recovery

Source: HVS

Expect the wider supply pipeline to shrink

Given the recent events, supply growth now expected to be lower, at a slower pace, than previously anticipated

Under-construction projects may face **delays with materials/FF&E**, pushing back opening dates

Market conditions will likely lead to delayed openings. Some projects may be placed **on hold** indefinitely

Financing challenges will delay construction start dates

Changes in market conditions may render proposed projects unfeasible; some projects may be **postponed or cancelled**

Some **properties may close and not re-open**, resulting in negative supply growth

HVS

HVS

- Operating costs cut to the bone, minimize expense levels, opportunity to rethink policies, procedures and service standards from top to bottom
- Limiting "touchpoints," supplemented by increased reliance on technology, supports reductions in staffing and service costs
- Food and beverage service curtailed, reduced or re-engineered
- New cleanliness & safety protocols produce additional operating costs but can be mitigated by other operational savings (e.g. payroll)
- Retaining these savings will enhance operating leverage as demand and revenue recovers
- Owners and operators reporting lower break-even occupancy levels: e.g. 25%-35% limited-service hotels, 40%-45% full-service hotels

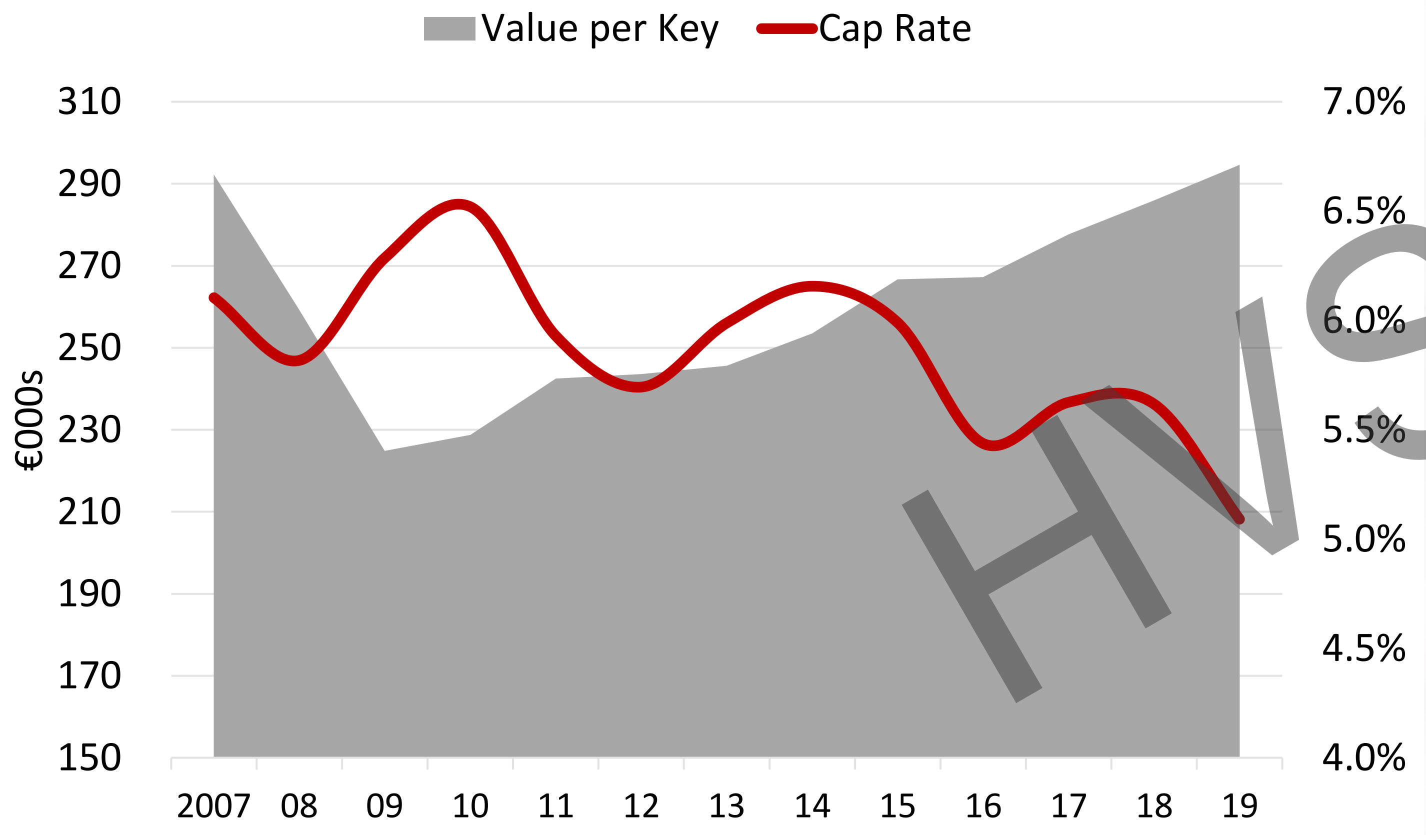
Positive operating leverage and enhanced operating efficiency will support EBITDA recovery

HVS

Hotel Values

Market values reached prior peak levels in 2019…

Timeline of the European hotel investment cycle



Note: Cap rates displayed as a 12-Month Average.

Market Peak

Values peaked in 2007 but began to slide following the market shock in H2 2008

Market Trough

Values bottomed out in 2009

Average value per key declined by 23% from peak to trough

Recovery

Values reached prior peak in 2019, reflecting a 12-year recovery

Cap Rates

Cap rates began to rise in H1 2009 and peaked in H2 2009. Cap rates began to rapidly decline once hotel performance bottomed out, as cap rates were based on depressed TTM EBITDA

 Source: Real Capital Analytics; HVS

...but have declined in 2020

Loss of income
Sharp revenue declines → more significant decreases in EBITDA (possibly negative)

Debt
Market has pulled back from the hotel sector. Lower LTV ratios and/or higher spreads could result in higher interest rates, despite recent cuts by central banks

Bid-Ask gap between buyers and sellers
Currently hampering transactions but is expected to narrow with ongoing financial pressure

HVS

Market value: willing buyer and willing seller

HVS

Downward Pressure

- Unprecedented revenue and EBITDA decline
- Economic recession
- Longer recovery of MICE business
- Uncertainty regarding return of normalised travel patterns
- Potential for prolonged recovery, re-infection
- Cash drain may force owners to sell

Upward Pressure

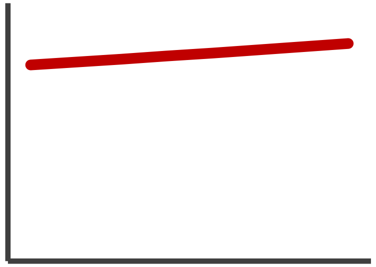
- Improved business operating model
- Return of positive operating leverage
- Yield-hungry funds lining up capital should create competition and help to sustain values
- Low cost of capital likely to continue
- Some lenders will wait for values to rise before losses are recognised

HVS

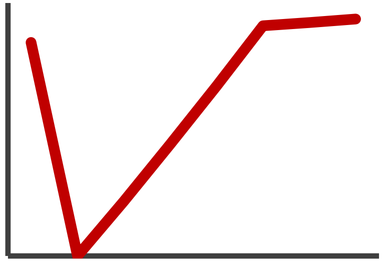
Scenario Analysis – assessing EBITDA to estimate value ranges

Model reflects potential range and degree of impact on hotel values. Impact of current conditions on an individual property depends on characteristics of the property, its market and its location

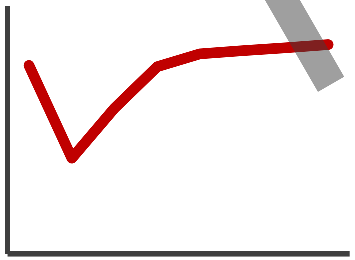
Base Line
Stable market conditions ignoring the impact of Covid-19



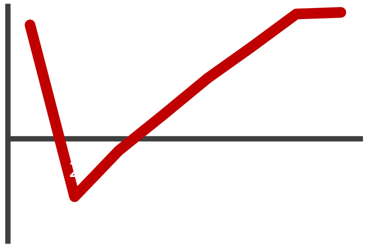
Most Likely Case
Significant EBITDA impact in the first year. Degree of impact and decline to diminish over time as the market recovers



Best Case
Moderate declines in EBITDA. Decline is assumed to diminish over time as the market recovers



Worst Case
Greatest negative EBITDA in the first year, followed by diminishing negative impact as the market recovers.
Long recovery period



HVS

In all scenarios, the capital market is assumed to result in higher discount rates in 2020, diminishing as the market recovers

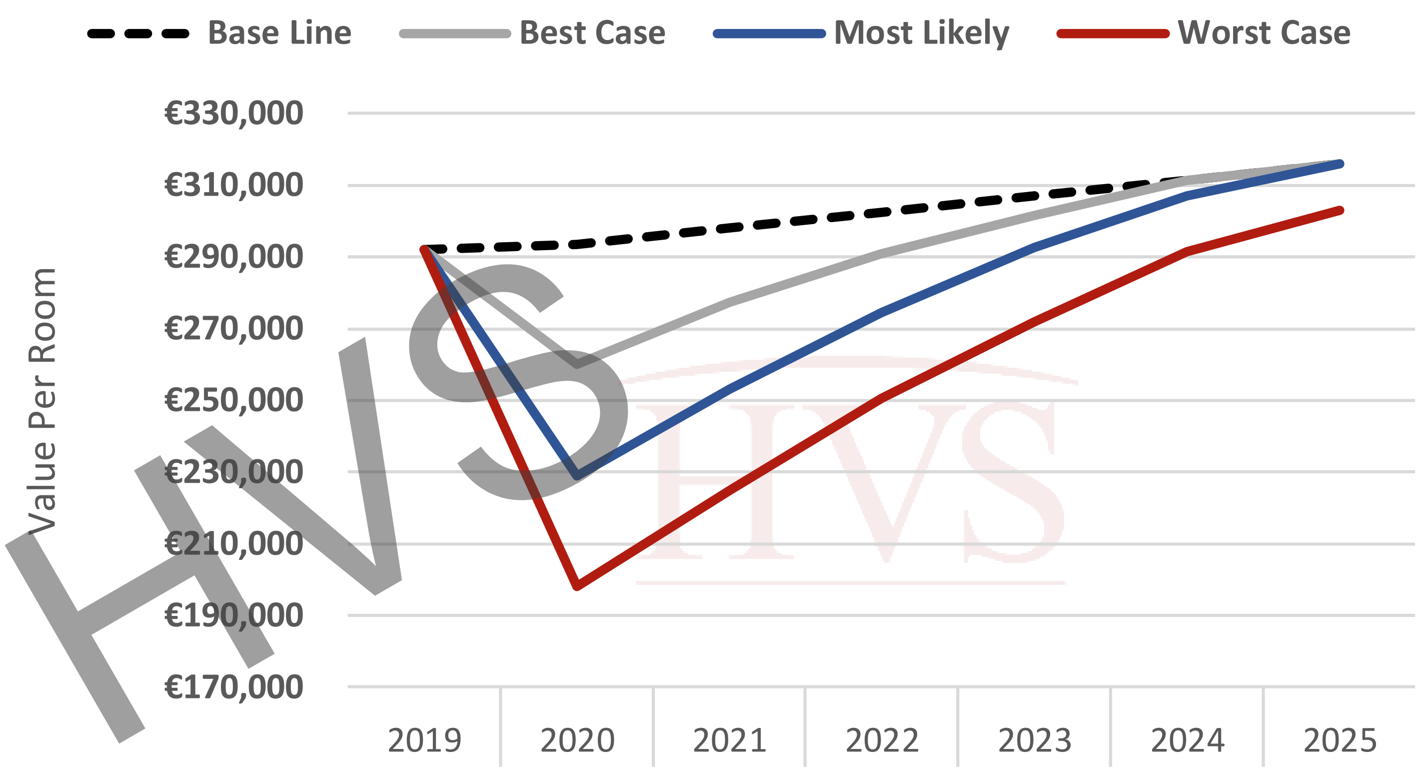
Hotel values evolve for each scenario

Best Case – the value decline is **5%-10%** as of 2020. EBITDA recovers to 2019 levels by 2024

Most Likely Case – the value decline is **10%-20%** as of 2020. EBITDA recovers to 2019 levels by 2024

Worst Case – the value decline is **20%-30%** as of 2020. EBITDA recovers to 2019 levels by 2025.

For context, our HVI showed a **23%** decline in value in the last downturn



Relationship to 2019 value

	2019	2020	2021	2022	2023	2024	2025
Best Case	100%	89%	95%	**100%**	103%	107%	108%
Most Likely	100%	80%	88%	95%	**102%**	107%	108%
Worst Case	100%	68%	77%	86%	93%	**100%**	104%

Source: HVS

Conclusions

Conclusions

RevPAR levels depressed until travel and other restrictions lifted, individuals comfortable travelling again and staying at hotels (vaccine will help)

Occupancy recovers faster than average rate – hotels use price to stimulate demand recovery

Supply growth slows – projects under construction delayed, new projects postponed or abandoned

Hotel operations suspended in the interim, to minimise EBITDA losses

Hotel values decline – to remain depressed until EBITDAs "hit bottom" and there is evidence of recovery

Hotel discount rates elevated in the near term – location, market and property specifics to determine the degree of elevation

Weight of capital might limit price discounting for hotel assets → most specialist hotel investors have not changed their investment strategy

Over the longer term, values will recover as cash flows improve and capital markets return to more traditional parameters

Opportunity for high returns – well-capitalised buyers to acquire hotels at prices well below replacement cost and recent norms

HVS

HVS.COM

Thank you!

Russell Kett FRICS

rkett@hvs.com

+44 7802 411142

15 September 2020