

Hospitality Directions US

Our updated lodging outlook

Never in the 29-year history of this publication has the industry been in a comparable situation. The content of this issue has been expanded to account for the current circumstances and to respond to extensive outreach from clients and industry colleagues.

May 2020

March declines were unprecedented, with April's and May's even deeper as COVID-19 impacts US lodging industry



Prior to the outbreak of COVID-19 hitting the US, RevPAR growth had been decelerating, increasing just 0.7 percent in Q4 2019 and 0.9 percent for the year overall. Slightly stronger growth occurred in the first two months of this year, with RevPAR increasing 2.2 percent in January and a front-loaded 1.7 percent in February, as COVID-19 began to impact market performance in the back half of that month.

US hotels experienced unprecedented declines in top-line performance in March, with RevPAR dropping 51.9 percent from the same month last year. The second quarter is expected to experience even greater declines, with RevPAR dropping close to 80 percent from the same period in 2019.

COVID-19's impact on hotels is not universal — big box group properties, luxury hotels and resorts, as well as hotels in gateway cities at the epicenter of the outbreaks, are being impacted disproportionately. An extraordinary number of hotels have temporarily closed.

The length and severity of this pandemic remains uncertain and is discussed in more detail in this expanded edition of *Hospitality Directions US*. For this update, we have assumed that the daily number of new COVID-19 cases in the US peaked in late April. We currently expect annual occupancy for US hotels this year to drop below 40 percent and average daily room rates to drop almost 20 percent, with resultant RevPAR declining over 50 percent from last year. RevPAR in 2020 could fall to a level not seen since 1994.

In 2021, temporarily closed hotels will continue to reopen and demand growth will build as the economy continues to open back up. Occupancy experiences a strong increase over an easy previous year comp. As in the last downturn, ADR is slower to recover, resulting in an expected year-over-year RevPAR rebound of roundly 63 percent.

Challenges to the above outlook continue to include political uncertainty leading up to the presidential election, both domestically and abroad; the speed at which the economy recovers; and whether there is a resurgence of the virus later this year or in 2021.

Our revised outlook for 2020 anticipates

Significant decline in occupancy of

41.4%

Average daily rate falling as hotels try to capture market share - down

19.9%

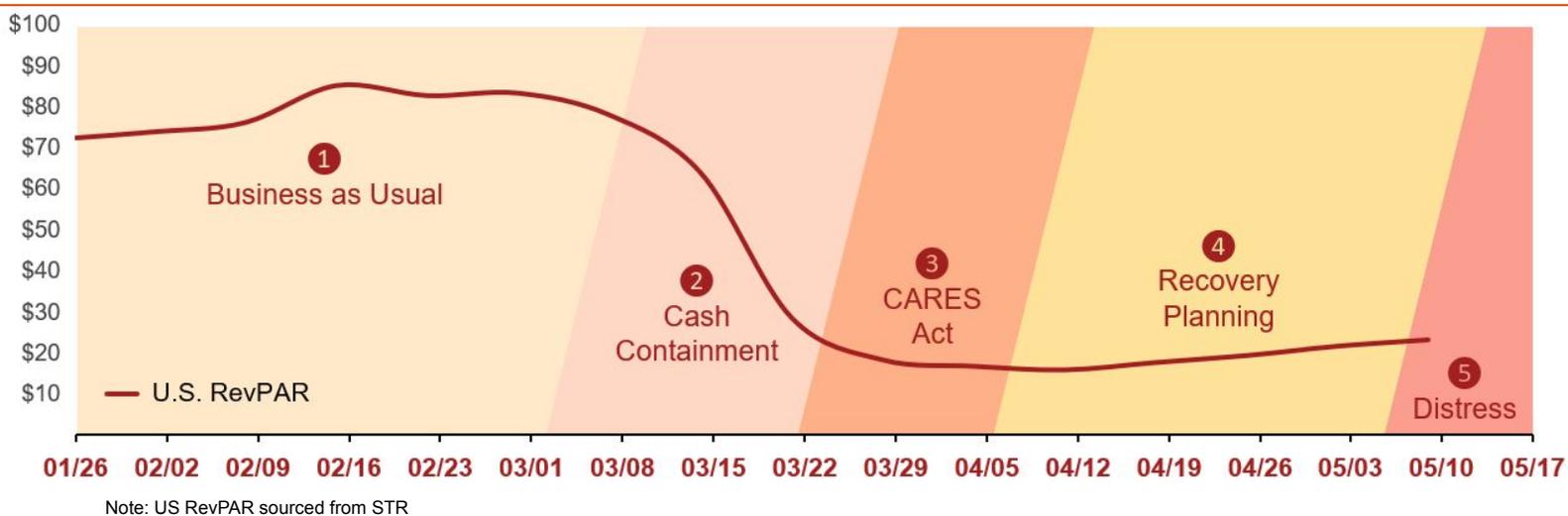
As a result, RevPAR has unprecedented decline - down

53.1%

Hindsight in 2020

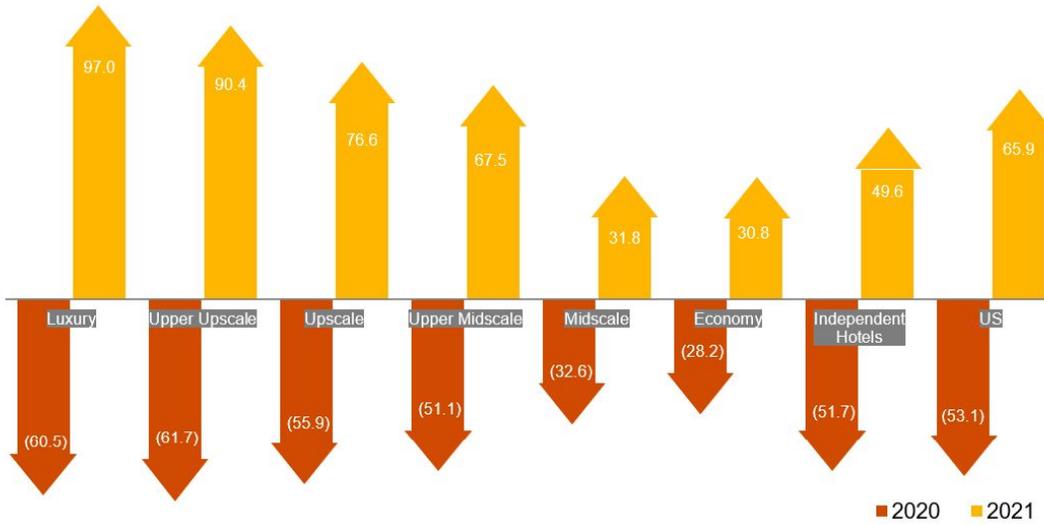
The rapid and severe evolution of the current health and economic crisis in the US has by now been extensively discussed. As context for PwC's lodging forecast, it is nonetheless helpful to briefly review the developments in the hotel sector in recent months.

Figure 1: Illustrative phasing of perceived industry focus as of May 9, 2020



- 1** In late January 2020, when industry stakeholders gathered in Los Angeles at the most recent large investment conference, leaders could not identify significant tangible threats to the hotel sector's long-lasting upcycle (concerns related to a lack of qualified labor and trade tensions with China were voiced as the industry's main risks for prolonging the recovery). Although the novel coronavirus was already making headlines in East Asia at the time and the US declared a public health emergency and restricted travel to/from China only days later, the scale of the looming downturn of the domestic lodging industry was not yet fully recognizable. However, as an increasing number of companies restricted corporate travel, cancellations of international events spread and theme parks closed, performance metrics reported by STR rapidly worsened by early March. The restrictions on transatlantic flights that went into effect on March 13, 2020, and the ensuing images of domestic airports crowded with trying to return home were final proof that the travel sector had largely come to a halt.
- 2** Immediately, cash conservation became the shared focus of owners, asset managers, hotel companies, lenders and third-party operators. Our conversations with a cross-section of industry stakeholders suggest that legacy differences between factions were largely set aside, resulting in swift, collaborative and comprehensive action on payroll reductions, hotel closures and fee abatements, as well as loan forbearances and restructurings. These emergency measures alleviated owners' financial hemorrhaging in the short term, but remaining fixed costs still threaten financial distress for many in the not-too-distant future.
- 3** The Coronavirus Aids, Relief and Economic Security (CARES) Act, which was passed by the US Congress on March 27, 2020, promised timely relief for the hotel sector, due in part to fervent lobbying efforts by industry associations. Understanding terms, assessing eligibility and applying for the Act's SBA Paycheck Protection Program and market loans temporarily required industry participants' full attention because several key considerations initially appeared open to interpretation. Nonetheless, because pre-existing banking relationships partially streamlined access and overall funding was exhausted relatively quickly, numerous — especially smaller — hotel owners/companies initially failed to benefit from the CARES Act. (Note: A second iteration of the PPP was launched in late April.)
- 4** As the CARES Act rush subsided and temporary acceptance of anemic occupancy and rate levels spread, focus selectively shifted to planning for the sector's eventual relaunch. While the timing and circumstances of a comprehensive reopening remain uncertain, individual required components of a roadmap are apparent. The foreseeable concerns of guests and employees regarding hotels' cleanliness has drawn particular attention as an adequate sense of safety is a fundamental prerequisite for the industry's near-term restart. Consequently, industry associations and large hotel companies have been diligently working on new hygiene protocols, some of which have been finalized and published.
- 5** Nonetheless, countless undercapitalized or overleveraged industry participants face considerable challenges in the coming months, indicating that varying degrees of distress will largely characterize the coming phase.

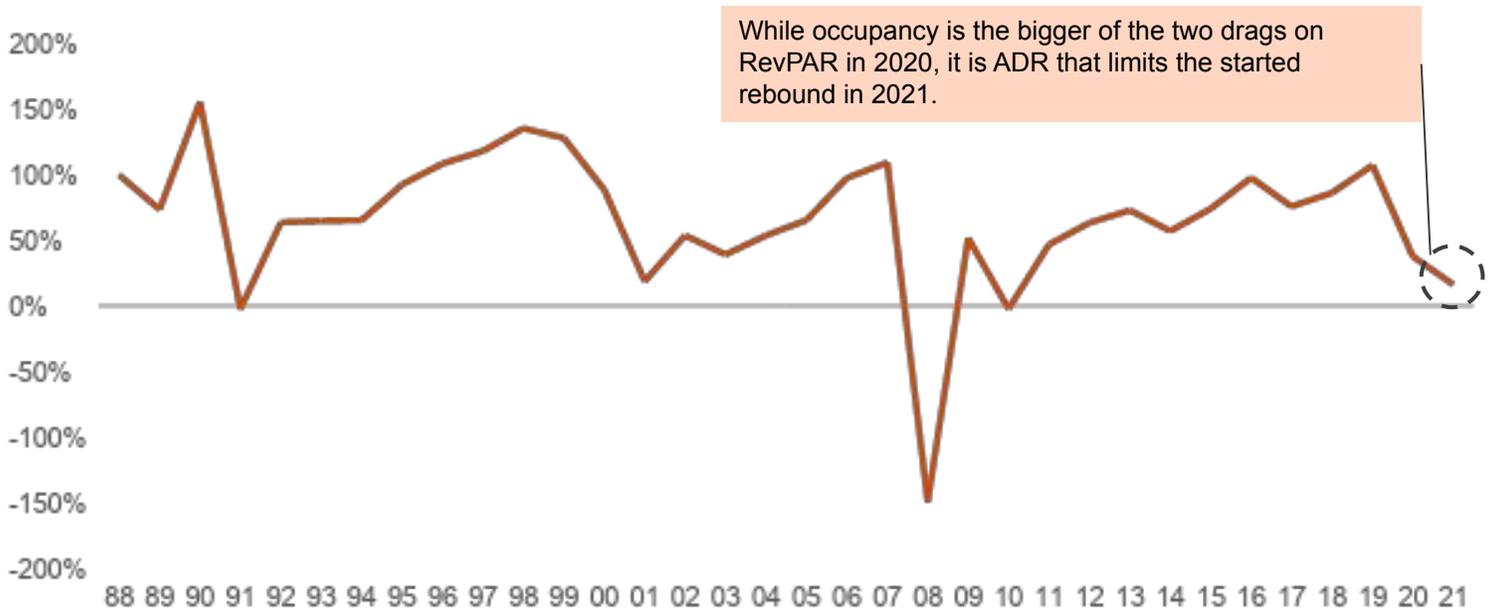
Figure 2: RevPAR percent change, US and chain scales



Source: PwC, based on STR data

Hospitality Directions Outlook Tables
 For detailed outlook tables covering the US and each of the chain scales, please access the [Hospitality Directions Outlook Tables](#) available online.

Figure 3: ADR contribution to change in RevPAR



Source: PwC, based on STR data

US economic outlook greatly impaired by impacts stemming from COVID-19 outbreak

Government mandates on social distancing, supply chain disruptions and significant declines in oil prices are resulting in a deep global contraction. IHS-Markit estimated that GDP declined at a 4.8% annual rate in the first quarter and expects a 36.5% annualized decline in Q2. Production and employment in the US are declining sharply in the second quarter, following a decline that began in Q1. A gradual reopening of the economy has begun, limiting the decline in second-quarter production.

They believe unemployment will peak at 19.6% in the third quarter and that it will take four years to get the unemployment rate below 4%. Core consumer price inflation (based on the personal consumption expenditures price index) is forecast at 0.9% this year and 1.5% in 2021.

The recovery that IHS-Markit expects is gradual, with GDP taking two years to reach prior peak. Full employment is not regained in their forecast until late 2024.

IHS-Markit expects GDP to decline 8.5% in 2020, on a fourth-quarter-over-fourth-quarter basis.

Source: IHS-Markit (forecast released May 2020); PwC

Table 1: US outlook (May 27, 2020)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Demand growth	4.6%	2.7%	1.9%	4.0%	2.5%	1.5%	2.4%	2.4%	2.0%	-45.9%	62.1%
Supply growth	0.4%	0.3%	0.5%	0.6%	0.9%	1.4%	1.7%	2.0%	2.0%	-7.6%	8.1%
Room starts, % change	57.9%	26.1%	26.6%	35.4%	14.7%	14.7%	-3.7%	8.1%	-8.9%	-70.4%	-40.7%
Occupancy	60.0%	61.4%	62.3%	64.4%	65.4%	65.4%	65.9%	66.1%	66.1%	38.7%	58.1%
% change	4.2%	2.4%	1.4%	3.4%	1.5%	0.1%	0.7%	0.4%	-0.1%	-41.4%	49.9%
Average daily rate	\$101.76	\$106.06	\$110.06	\$115.21	\$120.42	\$124.07	\$126.82	\$129.92	\$131.11	\$105.02	\$116.18
% change	3.8%	4.2%	3.8%	4.7%	4.5%	3.0%	2.2%	2.4%	0.9%	-19.9%	10.6%
RevPAR	\$61.05	\$65.14	\$68.53	\$74.16	\$78.71	\$81.16	\$83.54	\$85.92	\$86.66	\$40.66	\$67.44
% change	8.1%	6.7%	5.2%	8.2%	6.1%	3.1%	2.9%	2.8%	0.9%	-53.1%	65.9%
GDP, % change Q4/Q4	1.6%	1.5%	2.6%	2.9%	1.9%	2.0%	2.8%	2.5%	2.3%	-8.5%	7.8%
Inflation, % change	2.5%	1.9%	1.3%	1.5%	0.2%	1.0%	1.8%	2.1%	1.4%	0.9%	1.5%

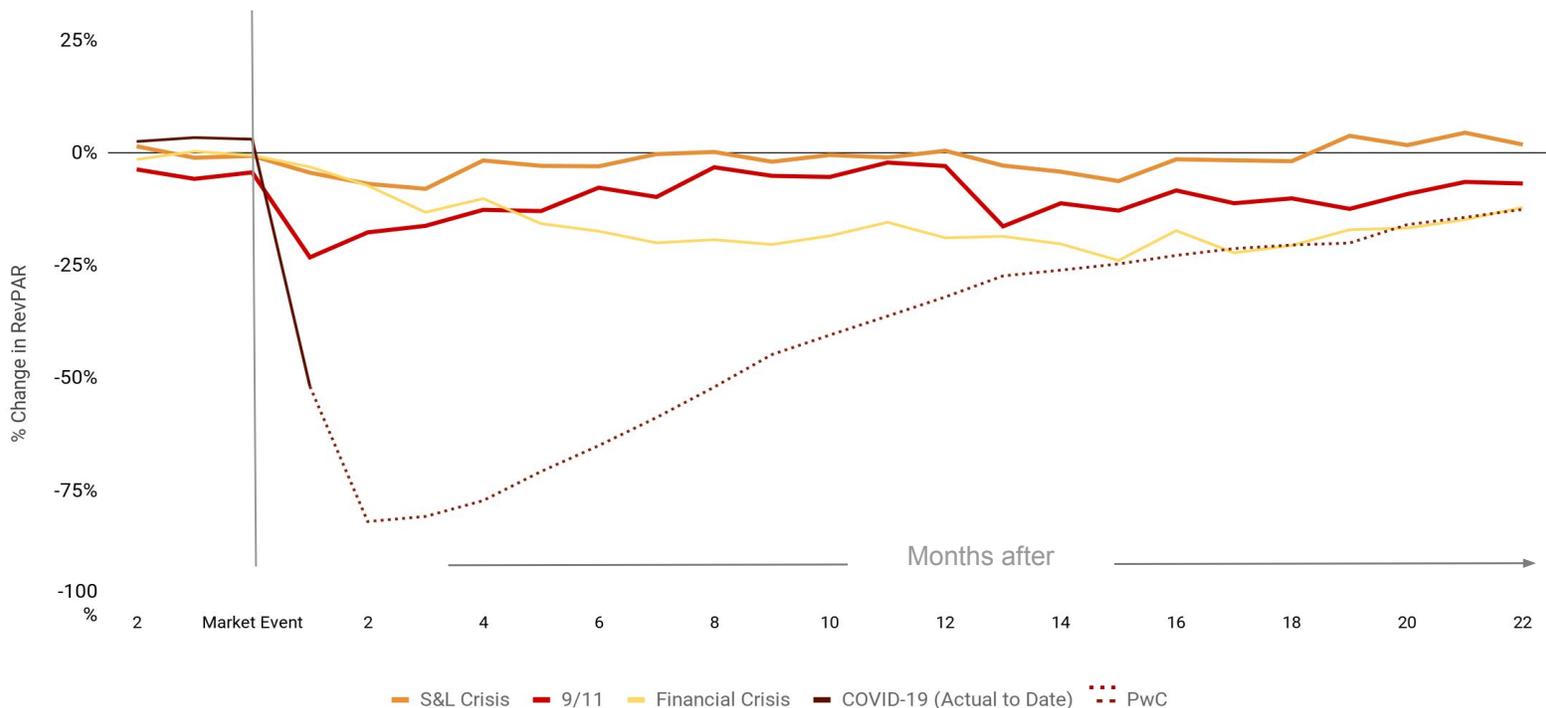
Source: STR; Bureau of Economic Analysis; IHS-Markit (forecast released May 2020); MHC Construction Analysis System; PwC

Table 2: Chain scale outlook, percentage change from prior year

Chain scale	2020					2021				
	Demand	Supply	Occupancy	ADR	RevPAR	Demand	Supply	Occupancy	ADR	RevPAR
Luxury	(66.9)	(21.2)	(58.0)	(6.1)	(60.5)	150.2	25.1	100.0	(1.5)	97.0
Upper upscale	(62.6)	(16.2)	(55.4)	(14.2)	(61.7)	131.8	21.3	91.1	(0.3)	90.4
Upscale	(51.4)	(4.7)	(49.0)	(13.6)	(55.9)	83.3	11.1	65.0	7.0	76.6
Upper midscale	(45.4)	(2.7)	(43.9)	(12.8)	(51.1)	66.9	7.7	55.0	8.1	67.5
Midscale	(26.6)	(3.0)	(24.4)	(10.9)	(32.6)	30.2	6.4	22.3	7.8	31.8
Economy	(23.6)	(3.4)	(21.0)	(9.1)	(28.2)	26.6	3.9	21.9	7.3	30.8
Independent hotels	(47.9)	(11.3)	(41.3)	(17.6)	(51.7)	52.3	3.2	47.6	1.4	49.6
US total	(45.9)	(7.6)	(41.4)	(19.9)	(53.1)	62.1	8.1	49.9	10.6	65.9

Source: PwC, based on STR data

Figure 4: Year-over-year RevPAR change after Market Event



	S&L Crisis	9/11	Financial Crisis
Market Event / Month	S&L Crisis / Gulf War (Aug.1990)	Terrorist Attacks (Sep. 2001)	Lehman Bankruptcy (Sep. 2008)
Economic Conditions	<ul style="list-style-type: none"> Decelerating GDP growth Recession Peaking savings and loan crisis 	<ul style="list-style-type: none"> Bursting of dot-com bubble Decelerating GDP growth Recession 	<ul style="list-style-type: none"> Decelerating GDP growth Recession Historically low CRE risk premium Ubiquity of CMBS
Prior Lodging Industry Conditions	<ul style="list-style-type: none"> Flat RevPAR prior to onset of the crisis "Non-economic" hotel development Significant lodging oversupply 	<ul style="list-style-type: none"> RevPAR declines prior to the terrorist attacks Above-average quarterly supply growth 	<ul style="list-style-type: none"> RevPAR declines prior to the onset of the financial crisis Frothy valuations Above-average quarterly supply growth Previously decelerating performance
Recovery & Key Impact	<ul style="list-style-type: none"> Eight quarters to recover to pre-market event RevPAR levels Emergence of REITs, fundamentally changing the lodging landscape 	<ul style="list-style-type: none"> 14 quarters to recover to pre-market event RevPAR levels Subsequent US intervention in Iraq significantly prolonged the recovery 	<ul style="list-style-type: none"> 18 quarters to recover to pre-market event RevPAR levels Lenders amended and extended loans instead of foreclosing Accelerated pace of sector consolidation

Forecasting in Unprecedented Times (1 of 2)

The term “unprecedented” has been frequently — and justifiably — used to describe the current crisis. The adjective invariably implies an added layer of complexity for forecasters, as prior reference points do not exist. Therefore, while copious considerations have been factored into PwC’s industry outlook, some important variables cannot yet be adequately defined and incorporated, reaffirming a key difference between this and prior downcycles. As additional context for forward-looking conversations, listed below are select considerations that could shape the hotel industry’s recovery in an unpredictable, yet meaningful way.



THE VIRUS

- COVID-19 continues to move through the US at an unforeseeable pace and in an incongruent pattern. Furthermore, mandated/recommended social distancing measures and their subsequent easing have been inconsistent across the country. **As a result, a cohesive countrywide industry relaunch does not seem viable.**
- The pandemic’s impact on other continents and countries has also been erratic and will continue to evolve, potentially resulting in **prolonged restrictions on inbound travel** and/or limited bilateral reopenings.
- The uncertain prospective behavior of COVID-19 next winter raises concern, also in the Southern Hemisphere, where the winter season begins in June. Even if limited to select pockets, a potential rebound or **“second wave” could trigger outsized reactions.**
- According to the Mayo Clinic,¹ the discovery of a **vaccine** is not a given. And if that breakthrough does occur, a vaccine’s approval, production and distribution **would likely take 12+ months.**
- In the meantime, disciplined containment of further spread, the continued expansion of viral and antibody **testing**, the roll-out of efficient **contact tracing** and — ideally — the development of **effective treatment** would have **reassuring effects.**



THE TRAVELER

- While leisure trips to drive-to, low-density destinations are widely expected to restart travel, the relaunch order and timing of **other larger and more lucrative demand segments remain somewhat speculative.**
- **Elevated levels of unemployment** may further aggravate the evident direct effects of current pandemic containment measures on travel demand.
- While thorough hygiene protocols are undoubtedly a prerequisite for any renewed travel, **altered perceptions of related risks** (especially among older demand segments) may take time to de-escalate.
- The appetite for historically important generators of lodging demand (such as conventions, trade shows, sports events or festivals) could remain muted for the foreseeable future.
- Companies, which have elevated safety directives for employees and clients, may not only continue to **restrict corporate travel and events, but also phase the reopening of offices**, thereby further delaying corporate-transient lodging demand in metropolitan areas.
- New and now proven technology solutions (e.g. for web-based collaboration), combined with growing fiscal and environmental accountability, may also have a noticeable and **sustained adverse effect on business travel.**
- Several other consumer verdicts have yet to fully mature, including whether/how perceptions of hygiene will likely shift the balance between (a) hotels and short-term rentals or (b) branded and independent hotels in the pandemic’s wake.

Note: (1) <https://www.mayoclinic.org/diseases-conditions/coronavirus/in-depth/coronavirus-vaccine/art-20484859>

Forecasting in Unprecedented Times (2 of 2)



THE INDUSTRY

- Never before has the travel sector endured this degree of duress. Therefore, **the full breadth of consequences will likely only manifest itself gradually.**
- While consensus exists that **a share of the existing US hotel inventory may not reopen** post pandemic, opinions vary widely on the likely number of at-risk rooms. Furthermore, the outlook for a sizeable pre-crisis development pipeline is still unclear.
- Similarly, the **airline sector**, which has also been dramatically disrupted, **could experience contraction and/or consolidation**, causing additional ripple effects across the broader travel industry.
- Efforts are underway to help **re-instill confidence in consumers** that all components of travel are safe. While a coordinated cross-industry approach could be especially compelling, the (partially competing) hygiene measures/concepts of individual companies, associations and venues will hopefully coalesce to achieve a similarly reassuring perception among travelers.
- While a broader network solution likely has less urgency from the perspective of **employees**, ensuring the **safety of their immediate surroundings** is equally important to the sector's recovery.
- The relative alignment to date between lodging-industry stakeholders has facilitated initial measured responses to the sector's outsized challenges. However, breached loan covenants, incongruent views on hotel reopenings or other friction points could begin to **fracture relationships between owners, lenders, brands and operators.**
- New hygiene protocols, which may entail capital-intensive technology and lower occupancy levels, could require **inorganic price adjustments** across rooms, food & beverage and other departments. Setting and communicating these prices would need to balance fiscal urgency, competitive dynamics and consumer tolerance.
- The industry also needs to account for the **absence of international leisure and corporate demand** in the short to medium term.
- The CARES Act and its two iterations of the Paycheck Protection Program have provided much-needed relief to smaller industry participants. However, **governmental support may eventually decrease or cease.**
- Although sector stakeholders have repeatedly emphasized the industry's improved leverage ratios relative to the 2008/2009 crisis, **considerable consolidation is inevitable** under these general conditions.

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Definitions

Abbreviated terms include average daily rate (“ADR”), revenue per available rooms (“RevPAR”), and real gross domestic product (“GDP”). Growth rates are percentage change in annual averages.

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