January 31, 2020
DJIA: **28, 256** | RMZ: **1,292** | 10-Yr Treasury Note: **1.51%**

Green Street Advisors

ALIS: Hoteliers Keep Dancing While the Music is Playing

Overview:

We recently attended the *Americas Lodging Investment Summit* (ALIS) in Downtown LA, which is one of the largest and most important conferences for the hotel industry. Highlights from the conference include:

Low Expectations for Fundamentals: Given a backdrop in which lodging fundamentals have steadily decelerated since '15, and are now barely positive (e.g., RevPAR growth of 0-1%), most hoteliers have low expectations in terms of growth looking forward. The consensus view seems to be that RevPAR growth will be in the -1% to +1% range for the next couple years (Green Street's '20 Upper Upscale RevPAR growth forecast is +0.4%), which would translate into slightly declining NOI due to pressure on the expense line. Labor costs are an obvious source of rising expenses, but plenty of owners are also nervous about higher property taxes and insurance costs. As is often the case in tough times, hotel operators are creatively trying to wring out efficiencies through staffing levels and scheduling tweaks.

Don't Expect Relief from Supply Growth: Supply growth has hovered in the 2% range for the past couple years and based on a steady development pipeline (~4% expansion of inventory under construction), it's unlikely that pace will decline anytime soon. Given the negative impact that supply is broadly having on fundamentals, the tension between owners and brand companies (e.g., Marriott, Hilton) is higher than usual. Owners clearly would prefer less supply, which would boost performance at their properties. On the other hand, hotel brand companies are incentivized to grow their systemwide room counts through new management and franchise contracts (i.e., new construction). Venting from owners is understandable. Eventually, rising replacement costs and poor fundamentals will slow down the development engine and the pendulum will swing back in favor of owners. But for now, there is little they can do to alter the situation.

Keeping an Eye on Coronavirus: Most conversations at least touched on the escalating headlines surrounding the Coronavirus outbreak originating in Wuhan, China. It's too soon to know what impact this health emergency may ultimately have on lodging fundamentals, but recent performance trends have stayed consistent. Hoteliers should be relieved to know that historical precedence (e.g., Zika in '16, Ebola in '14, SARS in '03) suggests that events like this aren't as impactful as one might think. However, it's still early and this time could always be different. While many in the travel industry are understandably frustrated with the hyperbole around Coronavirus, ironically the heightened focus likely plays a positive role in controlling outbreaks. If society didn't take these threats seriously, perhaps the track record of limiting the fallout wouldn't be as strong. In any case, the human toll of outbreaks like Coronavirus are tragic, the threat should be taken seriously, and we will continue to monitor events and assess the impact for lodging and other sectors (e.g., malls serving international visitors, industrial).

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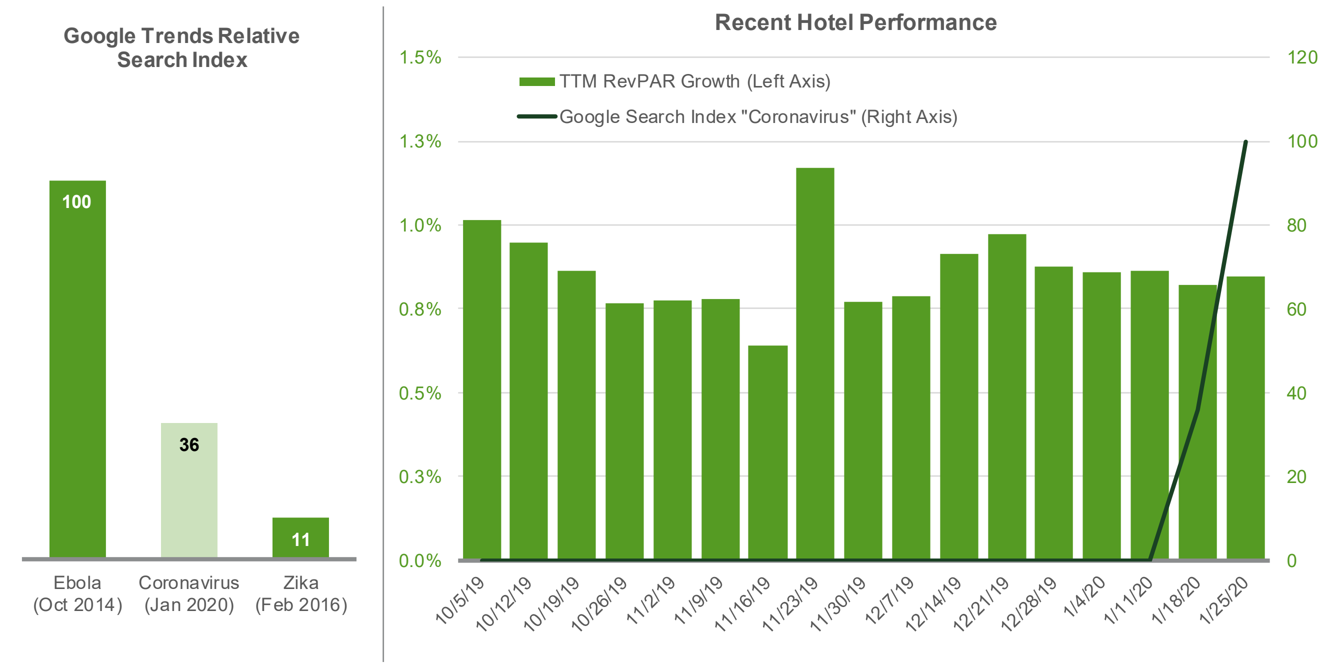
Important disclosure on page 4

Exhibit 1: Coronavirus Impact on Hotel Fundamentals

Keep a Watchful Eye: So far, concerns over Coronavirus are higher than they were for Zika in '16, but below where they were during the Ebola outbreak in '14. Recent performance data doesn't show a change in RevPAR growth trends, but it's too early to have a definitive answer on this front.



Sources: STR Inc., Google

Values Starting to Erode: In the face of flat/declining NOI, hotel values have held up remarkably well. While values have held steady for the past couple years, the consensus view is that they will see downward pressure going forward (Green Street's Lodging CPPI saw a slight decline in 2H19). One offset to the weak growth outlook's impact on asset values is abundant foreign capital, much of it new to the hotel industry. It appears many of these newcomers are being seduced by the sector's high initial yields (nominal cap rate of ~8% vs. ~6% for other property types). While initial yields are higher, this doesn't account for higher-than-average cap-ex requirements and weaker growth prospects. When taking all these factors into consideration, lodging looks relatively pricey in the private market. Green Street's unleveraged, risk-adjusted return estimate for lodging is in the mid-5% range, which compares to ~6% for the average property type.

Home Sharing Isn't Going Away: The hotel industry appears to have begrudgingly accepted that home sharing (e.g., Airbnb) is here to stay. Part of the reason is that regulation is catching up to level the playing field with hotels (e.g., occupancy taxes, regulatory arbitrage). Another factor is data suggests that home sharing is growing the pie more than it is taking share away from hotels, as it attracts a different type of guest (e.g., leisure, longer stays). Green Street continues to believe that while there will always be some level of competition between home sharing and traditional hotels, the two segments can coexist.

Focusing on Loyalty: With a tougher backdrop for fundamentals largely driven by elevated supply growth, hotel brands are stepping up their focus on loyalty programs to win market share. Loyal guests are attractive because they tend to travel more (i.e., spend more) and they cost less because direct-booking commissions are much lower than 3rd party commissions (e.g., Expedia). This is a zero-sum game for the industry, but it probably helps branded hotels (e.g., Marriott, Hilton) at the margin relative to independents.

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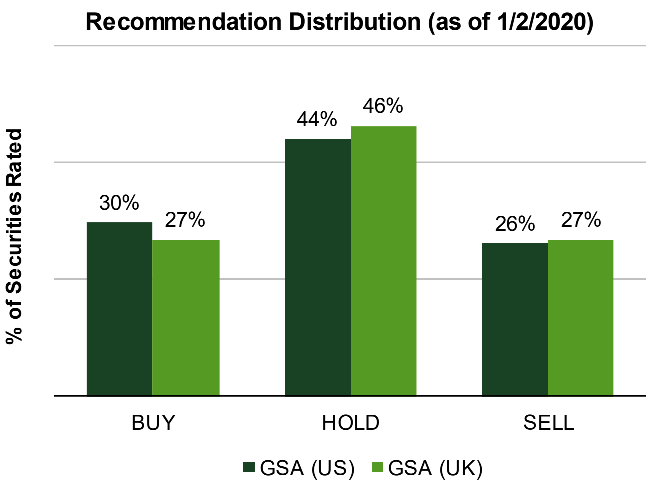

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Year[3]	Buy	Hold	Sell	Universe
2019	31.6%	22.4%	17.8%	24.0%
2018	-5.1%	-6.6%	-9.2%	-7.0%
2017	6.4%	0.2%	2.1%	2.6%
2016	14.9%	14.7%	13.1%	14.4%
2015	8.3%	0.9%	-1.7%	2.4%
2014	41.6%	31.5%	27.3%	33.3%
2013	4.1%	0.6%	1.7%	2.2%
2012	24.5%	24.7%	18.9%	23.0%
2011	18.9%	7.6%	-4.7%	7.6%
2010	43.3%	32.8%	26.6%	33.8%
2009	59.0%	47.7%	6.0%	37.9%
2008	-28.1%	-30.9%	-52.6%	-37.3%
2007	-6.9%	-22.4%	-27.8%	-19.7%
2006	45.8%	29.6%	19.5%	31.6%
2005	26.3%	18.5%	-1.8%	15.9%
2004	42.8%	28.7%	16.4%	29.4%
2003	43.3%	37.4%	21.8%	34.8%
2002	17.3%	2.8%	2.6%	5.4%
2001	34.9%	19.1%	13.0%	21.1%
2000	53.4%	28.9%	5.9%	29.6%
1999	12.3%	-9.0%	-20.5%	-6.9%
1998	-1.6%	-15.1%	-15.5%	-12.1%
1997	36.7%	14.8%	7.2%	18.3%
1996	47.6%	30.7%	18.9%	32.1%
1995	22.9%	13.9%	0.5%	13.5%
1994	20.8%	-0.8%	-8.7%	3.1%
1993	27.3%	4.7%	8.1%	12.1%
Cumulative Total Return	**21133.4%**	**1353.7%**	**42.0%**	**1617.6%**
Annualized	**22.0%**	**10.5%**	**1.3%**	**11.1%**

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(2) Beginning July 5, 2017, all companies in Green Street's North American coverage universe are included in the performance calculation. Previously, inclusion in the calculation of total return had been based on whether the companies were listed in the primary exhibit of Green Street's "Real Estate Securities Monthly" and had a rating other than "Not Rated".

(3) From 1993 until July 3, 2017, the returns for each year cover the period following the first RESM issued in the respective year through the first RESM issued in the following year and are not based on a calendar year. Subsequent to July 5, 2017, returns are based on calendar months.

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