National Report

Hospitality Research

Midyear 2017

Investors Maintain Confidence in Hospitality Market As Occupancy and Revenue Metrics Improve

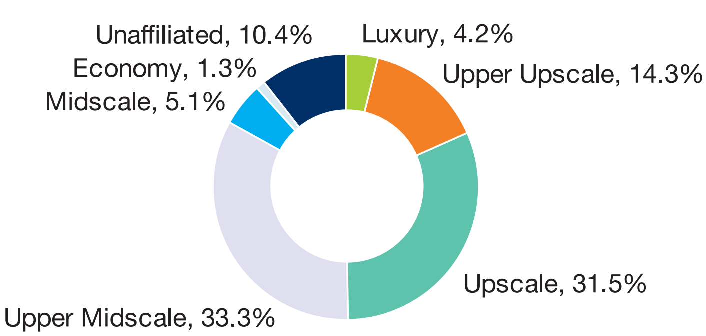
Hotel room demand persists. The U.S. hospitality sector has recorded increases in occupancy and revenue metrics during the year ending in June as room demand remained healthy. Employment growth nationwide and the rising median household income will support travel in the near future. Both domestic and international travel continue to rise, further benefiting room demand. Potential headwinds do exist including the growing construction pipelines in many major markets that may place downward pressure on occupancy, the average daily rate and RevPAR this year and into 2018.

- During the last 12-month period, hiring in office-using sectors rose 2.4 percent nationwide as 734,000 workers were added to staffs. Healthy job growth and a tight employment rate of 4.4 percent bolstered medium household incomes by 2.8 percent during this time. The rising incomes may spur additional leisure travel while increased jobs may further business travel.
- Domestic and international passenger travel in the United States rose 3.8 percent during 2016. In particular, international travel provides hotel operators opportunities for stronger demand drivers as passengers more than doubled in the last three years.
- Texas and California have more than 20,000 rooms each that are expected to break ground in the next 12 months. The increased supply may place downward pressure on occupancy in the coming years.

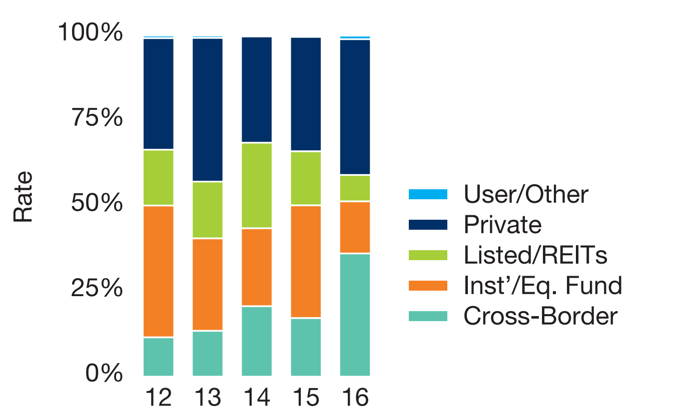
Investors increasingly targeting hotels as demand drivers improve. Hotel operations that spur revenue growth have kept buyers active in this sector. Transaction velocity rose roughly 10 percent nationwide as demand picked up for properties in many of the country's smaller markets. On average, hotel assets changed hands for nearly $100,000 per key, down slightly year over year as fewer properties in upper chain scales changed hands.

- Among chain scales, lower-tier hotels garnered significant investor attention. Trades increased considerably for economy and upper midscale assets during the previous four quarters. Demand for upscale assets held steady with the majority of trades in Marriott and Hilton branded properties.
- Several regions posted significant increases in transaction volume during the last 12 months. The Carolinas and the Central Midwest region led the nation, with the Mid Atlantic, Mid South and Southwest regions following. In prior years, coastal regions typically led sales volume.
- Sales velocity picked up for independent properties during the year ending in June as buyers widened their acquisition expectations. The increased demand for soft brand hotels may further intensify bidding for their properties moving forward as visitors seek experience oriented hotels.

Current Construction by Chain Scale

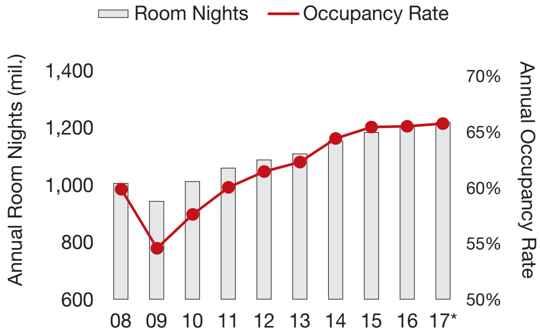


U.S. Hotel Buyer Composition

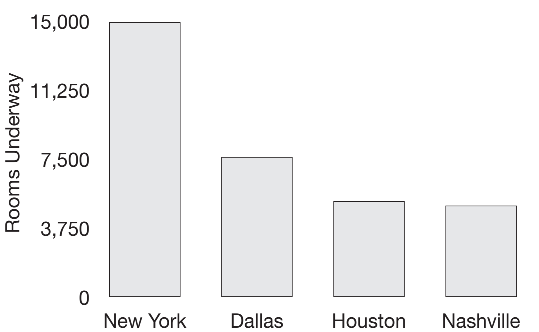


Based on trans. of $2.5M+ (excludes entity-level and partial-interest sales)

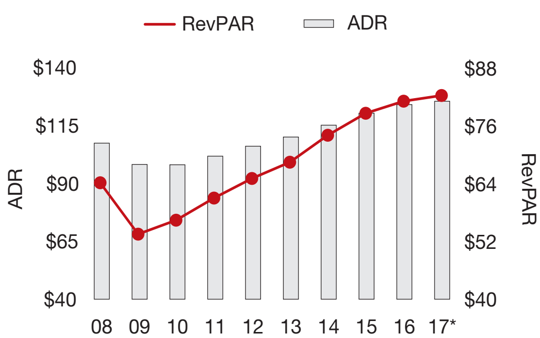
Yearly Occupancy Trend



Largest Construction Pipelines



Annual ADR & RevPAR



* Trailing 12 months through 2Q

Hotel construction pipeline on the rise. Roughly 111,000 rooms in more than 950 hotel projects were completed nationwide during the last 12 months up to June. Moving forward, nearly 187,000 rooms are under development and an additional 222,000 are expected to break ground in the next four quarters. The growing supply additions may place downward pressure in occupancy over the coming year.

- The metros of Houston and New York City received the largest number of rooms as 4,200 and 5,400 rooms were completed within July to June, respectively.
- Hilton Worldwide and Marriott International boosted their inventory during the last 12 months. Both companies averaged between 27 percent and 28 percent increases of new hotel rooms over all supply additions.
- Among chain scales, the bulk of new completions were in the upscale and upper midscale segments with a combined total of 77,000 rooms. Roughly 10,500 unaffiliated rooms were also constructed during this time.

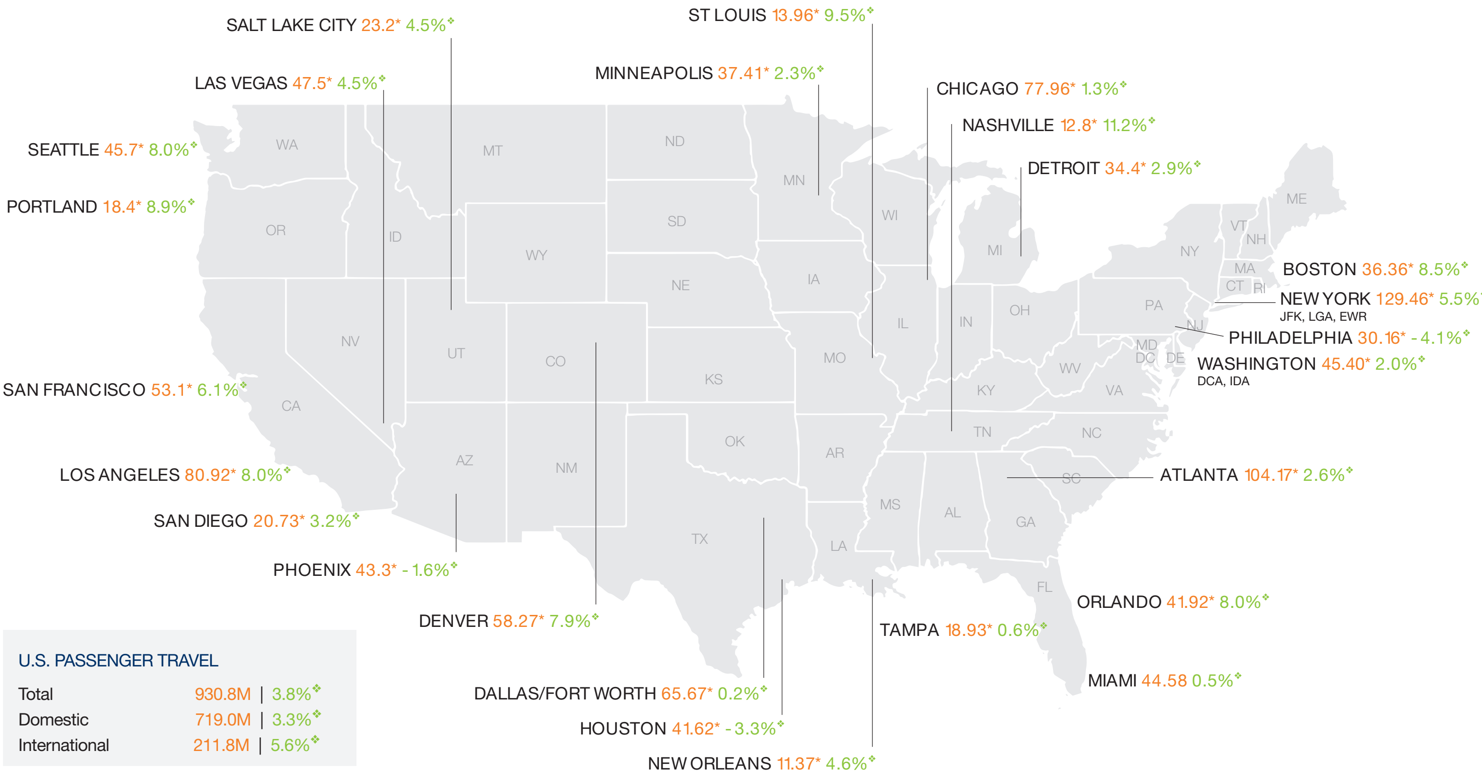
Occupancy climbs amid healthy room demand. Since last June, demand for hotel rooms continued to outpace supply growth, lifting occupancy in the United States 50 basis points to 73.4 percent at the end of the second quarter. First half occupancy rose 40 basis points from the same time period last year to 65.3 percent.

- Large markets that demonstrated significant occupancy increases from last year include Norfolk-Virginia Beach, Orlando and Atlanta. On the other hand, mounting supply pressures in metros including Dallas, Houston and Nashville weighed on vacancy improvement in the last 12 months.
- Nearly all hotel chain scales posted occupancy improvements over the year ending in June. Economy chains boasted the greatest improvement with occupancy increasing 90 basis points to 65.4 percent. The upscale segment posted the only occupancy decrease as the rate ticked down 20 basis points year over year to 80.5 percent.
- Based on location, occupancy in properties in proximity to major thoroughfares climbed 100 basis points during the previous four quarters to 66.6 percent. Room demand in these hotels typically comes from travelers passing by. The highest occupancy rate remains in urban hotels at 80.4 percent, up 50 basis points year over year.

Room demand drives increases in revenue metrics. Rising occupancy nationwide is driving growth in revenue metrics. During the year ending in the second quarter, the average daily rate advanced 2.1 percent to $129.12. The increase in ADR and occupancy generated a 2.8 percent rise in RevPAR during this time to $94.73.

- ADR and RevPAR in independent hotels outperformed all other chain scales, rising 2.7 percent and 3.9 percent, respectively. Economy hotels followed as strong occupancy improvement and a 2.2 percent increase in ADR drove a 3.5 percent climb in RevPAR during the last 12 months.
- Despite higher occupancy in urban areas, suburban hotels outperformed their counterparts in ADR and RevPAR growth during the previous four quarters. ADR in urban hotels rose 0.3 percent while RevPAR inched up 0.9 percent during this time. In the suburbs, ADR climbed 2.3 percent and RevPAR posted a 2.8 percent advance.
- Major markets with RevPAR growth near or above 10 percent include Norfolk-Virginia Beach, Orlando, and San Diego.

Total Airport Passengers in Major Markets

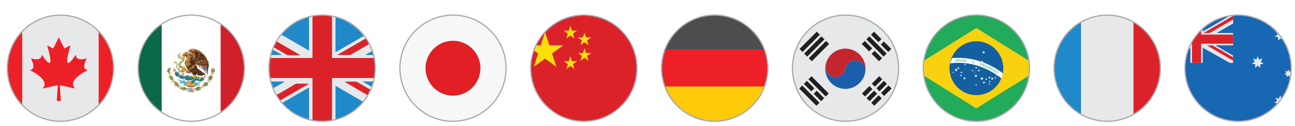


U.S. PASSENGER TRAVEL

Total	930.8M	3.8%*
Domestic	719.0M	3.3%*
International	211.8M	5.6%*

* Total Passengers (Millions)
* % Change 2015-2016

2016 INTERNATIONAL VISITATION



COUNTRY	CANADA	MEXICO	UNITED KINGDOM	JAPAN	CHINA	GERMANY	SOUTH KOREA	BRAZIL	FRANCE	AUSTRALIA
ARRIVALS (MILLIONS)	19.3	18.73	4.57	3.58	2.97	2.03	1.97	1.69	1.63	1.35
Y-O-Y % CHANGE	-7%	2%	-7%	-5%	15%	-10%	12%	-24%	-7%	-7%

Travel Highlights

- Passenger travel in the many of the nation's largest airports can highlight up-and-coming travel destinations and the potential for improvement in hotel occupancy and revenue metrics. The Los Angeles International Airport registered an 8 percent increase in passenger volume in 2016 from the prior year, making it the second most traveled airport in the nation. During this same time, hotel occupancy increased 100 basis points in the Los Angeles metro while RevPAR jumped 10.9 percent year over year. Additionally, hotels located near airports tend to have some of the highest occupancy rates, compared with interstate, resort, suburban and small metro hotels.
- Many hotel operators are capitalizing on rising international visitation by customizing amenities to entice travelers. A hotel chain in California will now accept Chinese mobile payments amid rising tourism from the country. The number of tourists from China grew 15 percent in 2016 from the prior year and that number is expected to increase. While international travel overall is increasing, one of U.S. largest contributors to international visitation, Brazil, registered a 24 percent drop in arrivals in 2016. The country was battered with political turmoil and a recession last year, lowering arrivals. Many Florida markets were impacted from fewer tourists visiting from the country and several of these metros, including Orlando, posted occupancy declines last year.

Marcus & Millichap

Capital Markets

By WILLIAM E. HUGHES, Senior Vice President, Marcus & Millichap Capital Corporation

- **Monetary policy in transition.** Despite the Fed raising its benchmark short-term rate three times in seven months and signaling another rise before the end of the year, long-term rates have remained stable. The yield on the 10-year U.S. Treasury bond remained in the low- to mid-2 percent range throughout the third quarter of 2017. The Federal Reserve wants to normalize monetary policy and, in addition to raising its funds (or overnight lending) rate, has announced it will begin to taper its balance sheet by allowing an initial $10 billion in securities to mature without reinvestment. By reducing its acquisitions of securities, 10-year Treasury rates should drift upward, thereby widening the spread between short- and long-term rates.
- **Increase in interest rates over the course of the year, pushing up the cost of capital.** While commercial real estate fundamentals remain strong, rising costs associated with debt financing will tighten the spread between cap rates and lending benchmarks. This environment could weigh on transaction activity as investors evaluate their yield options. Cap rates have remained relatively stable over the last year, but upward movement in Treasury rates has amplified the expectation gap between buyers and sellers.
- **Capital markets remain highly competitive, with a broad assortment of fixed-rate products available.** Year to date, CMBS market share has moved from a quarter of the market up to comprising one-third of hotel lending. Loan-to-value for CMBS typically is in the low-60 percent range. Lending by national and regional/local banks comprises a quarter of the lending activity this year with smaller loan sizes and LTV averaging from 60 percent to upwards of 90 percent for SBA products.

National Hospitality Group

Peter Nichols
Vice President | National Director, NHG
Tel: (212) 430-5100 | peter.nichols@marcusmillichap.com

Prepared and edited by
Catherine Zelkowski
Research Analyst | Research Services

For information on national hospitality trends, contact:
John Chang
First Vice President | Research Services
Tel: (602) 707-9700| john.chang@marcusmillichap.com

Price: $250

Recent Marcus & Millichap Transactions

Hotel Name	State	Rooms
Wyndham Garden Hotel Newark	NJ	349
Clarion Orlando International Airport	FL	330
Surfside Marina	TX	281
Clarion Conversion	KS	257
Holiday Inn & Suites Beaumont	TX	253
Atrium Hotel & Conference Center	KS	216
Cabot Lodge Jackson North	MS	200
Crowne Plaza	OH	200
A2B Budget Hotel	GA	196
Fontana Village Resort	NC	194
Denver's Best Inn & Suites	CO	190
Ramada Florence Center	SC	190
Days Inn Birmingham South	AL	159
Red Roof Inn St. Louis Westport	MO	158
Holiday Inn & Suites	WI	146
Clarion Inn & Suites Syracuse	NY	143
Days Inn New Orleans	LA	138
The Hotel Blue	NM	140
Best Western Plus Westbank	LA	138
Roadway Inn	FL	125
Suburban Extended Stay South Bend	IN	117
Days Inn Knoxville East	TN	116
Holiday Inn Yakima	WA	114
Motel 6 Tulsa South	OK	114