Hospitality Research

Third Quarter 2018

Hotel Room Demand Escalates in Smaller Metros/Towns, Fueling Occupancy And Boosting Investor Interest

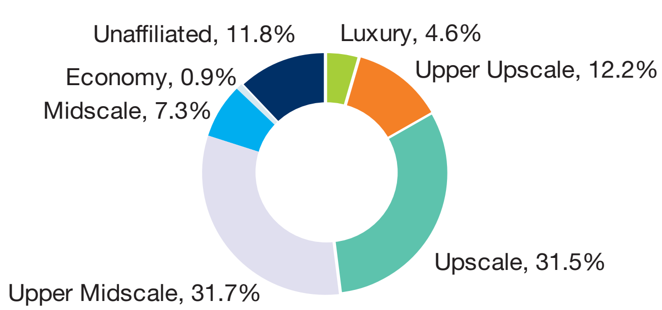
Rising travel predictions favor hotel sector. The accelerating economy, supported by strong employment growth and rising confidence levels, bodes well for hotel property performance. Consumer and business confidence remain at record levels, reinforcing expectations of healthy consumption and business spending this year. Elevated confidence levels will likely buoy room demand through the remainder of the year, keeping occupancy at a record high and supporting RevPAR growth.

- Healthy economic momentum and elevated consumer confidence levels have boosted travel expectations for 2018. Summer travel, in particular, is expected to rise 6 percent from last year and the majority of these trips will be to domestic destinations. Rising travel should reinforce hotel occupancy, which remains at a more than 30-year record high.
- Travelers are increasingly seeking hotels in suburban areas and smaller metros/towns. Occupancy in both locations has picked up considerably in the past 12 months after holding relatively steady in the prior year. Many local tourism offices are working vigilantly to lure tourists to these destinations.
- Older millennials, particularly in their mid to late 30s, are increasingly planning family vacations, with 44 percent anticipating to take one this year. This surpasses the percentage of boomers and Generation Xers who plan to do the same. Most of these trips will be road trips, potentially supporting demand for interstate hotels.

Upper upscale and upscale hotels command buyer attention. Healthy economic growth, improving occupancy and steady gains in RevPAR are driving investors' appetite for hotels. During the year ending in the second quarter, transaction velocity nationwide picked up 4 percent from last year. Increased competition for hotels and rising revenues elevated property values 6.8 percent during this same time to $107,700 per room on average.

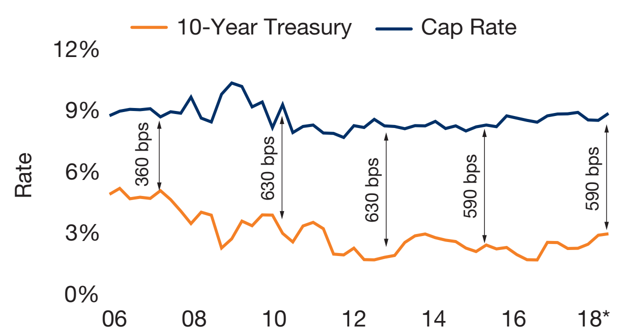
- Trades picked up considerably in upper upscale and upscale hotel properties during the past 12 months, with the number of sales rising roughly 26 percent and 17 percent, respectively. Properties under the Marriott and Hilton flags were particularly popular. Hotels in both segments changed hands with first-year returns in the high-7 to low-8 percent band on average.
- Rising room demand in many of the nation's smaller markets continues to drive buyer interest in these areas. Properties in the Southwest and Carolinas regions were increasingly targeted during the past four quarters, with transactions rising 51 percent and 23 percent, respectively. In the Southwest region, demand picked up considerably throughout Arizona and New Mexico during the past 12 months.
- Higher average first-year returns continue to lure investors to the hotel market. Properties on average trade with cap rates in the mid-8 percent band but can vary by as much as 200 basis points depending on location and flag.

Breakdown of Construction Pipeline by Chain Scale



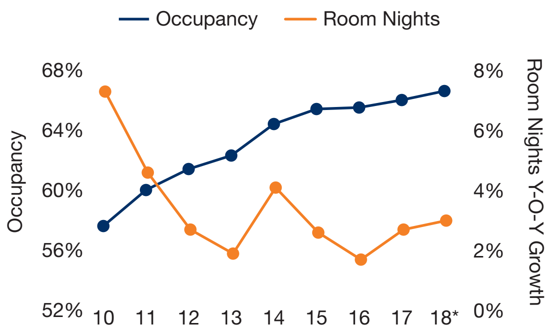
Source: STR, Inc.

Treasury and Cap Rate Trends

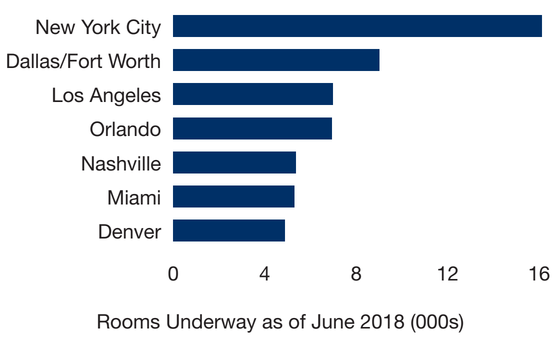


* Through 2Q18
Note: Sales $2.5 million and above

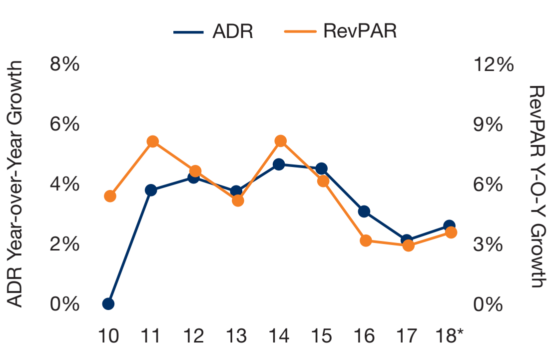
Yearly Occupancy Trend



Largest Construction Pipelines by MSA



Annual ADR & RevPAR



* Forecast
Sources: Marcus & Millichap Research Services; STR, Inc.

New York and Dallas lead construction. Nearly 119,000 rooms were completed nationwide during the year ending in the second quarter across more than 1,000 hotels. More than 186,800 rooms are underway and an additional 221,900 rooms are expected to break ground within the next 12 months.

- The upscale and upper midscale chain scales are leading the construction pipeline with more than half of all rooms underway located within these two segments. Construction of independent hotels is picking up; more than 22,000 rooms are under construction. Nearly 8,800 rooms were completed in independent hotels during the past four quarters.
- New York City and Dallas/Fort Worth had the largest number of deliveries during the prior 12-month period. In New York, more than 6,500 rooms were completed while 5,900 rooms were placed into service in the metroplex. These two markets also contain the largest number of rooms underway.
- Marriott International and Hilton Worldwide led deliveries during the year ending in June. New rooms under Marriott and Hilton made up 32.5 percent and 25.6 percent of total supply, respectively.

Strong half boosts annual occupancy. Strong room demand throughout the first half of 2018 supported an 80-basis-point increase in occupancy from the same period last year. The healthy increase in the rate supported a 60-basis-point increase in annual occupancy during the past 12 months to 66.3 percent in June.

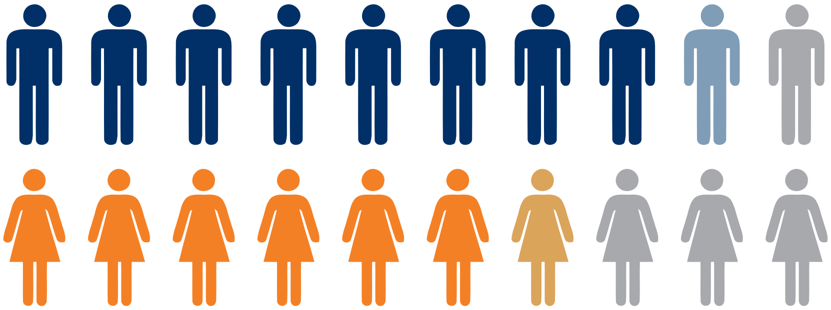
- All chain scales recorded occupancy increases during the past four quarters. Independent, luxury and midscale hotels led increases, with occupancy rates rising 80 basis points in each segment. Luxury hotels had the highest occupancy overall at 74.6 percent.
- Demand picked up considerably for resorts. Occupancy in these hotels jumped 100 basis points during the prior 12-month period to 70.1 percent in June. Occupancy in Florida, a popular state for visitors staying in resorts, surged 200 basis points during this time to 74.2 percent.
- Occupancy in smaller metros and towns picked up notably during the past four quarters. Here, occupancy advanced 90 basis points during this time to 57.6 percent following a 20-basis-point increase in the prior year.

Elevated room demand supports RevPAR gains. Rising occupancy is underpinning growth in ADR and RevPAR. The average daily rate climbed 2.3 percent during the past 12 months to $128.33 while RevPAR rose 3.3 percent during this same time to $85.05. ADR and RevPAR increased 2.7 percent and 3.1 percent, respectively, in the prior year.

- Economy hotels registered the largest in the average daily rate during the past 12 months, climbing 3.0 percent to $63.02. The increase combined with a 40-basis-point boost in occupancy contributed to RevPAR edging up 3.7 percent during this time to $36.94.
- Independent, luxury and midscale hotels also logged RevPAR gains above 3.7 percent during the past 12 months as strong occupancy improvement supported growth. The highest increase was among luxury hotels. The rate grew 4.1 percent to $246.49 in this segment.
- During the year ending in June, ADR and RevPAR in suburban hotels rose at a faster pace than its urban counterparts. In the suburbs, ADR and RevPAR climbed 2.4 percent and 3.2 percent, respectively, while ADR in urban areas edged up 1.4 percent and RevPAR advanced 1.9 percent.

Strong Travel Forecasts Support Elevated Room Demand This Year

2018 TRAVEL EXPECTATIONS*



87% of U.S. travelers planned a summer vacation

64% of U.S. travelers who planned a family vacation will travel by car

91% of travelers planned to travel domestically this summer

47% of travelers planned to visit beach destinations this summer

38% of travelers anticipated city vacations this summer

PLANNED FAMILY VACATIONS BY GENERATION**

MILLENNIALS	44%
GENERATION X	39%
BABY BOOMERS	32%

FIVE-YEAR PERFORMANCE BY LOCATION***

LOCATION	RESORT	SUBURBAN	AIRPORT	URBAN	SMALL TOWN/METRO	INTERSTATE
OCCUPANCY CHANGE	640 BPS	510 BPS	510 BPS	360 BPS	340 BPS	320 BPS
REVPAR GROWTH	33.1%	29.7%	31.0%	20.8%	24.5%	21.3%

* Based on TripAdvisor and AAA surveys in May 2018
** Based on AAA survey in March 2018
*** Based on annual rates ending in June
Sources: Marcus & Millichap Research Services; AAA; STR, Inc.; TripAdvisor

Capital Markets

By David Shillington; President of Marcus & Millichap Capital Corporation

- **Diverging trajectories: short-term vs. long-term rates.** With two rate hikes so far in 2018, the Fed continues to push the federal funds rate upward, directly impacting short-term indices such as Prime Rate and LIBOR. However, global economic trends and investor sentiments have pushed the long end of the rate curve higher. The spread between short-term and long-term Treasury yields has been at one of its narrowest levels in recent history. The trend is affecting hotel loans that are priced using these short-term indices, such as adjustable rate short-term and construction loans. Conversely, the long-term, fixed-rate loans maintain favorable pricing. Benefiting from this trend are borrowers using permanent loans offered by banks and life companies, as well as securitized CMBS lenders.
- **Asset allocation and lending concentration remain an issue.** Many lenders who jumped back into the lending space during early part of the recovery are still carrying a sizable loan portfolio on their balance sheet. While construction and permanent loans are gradually being refinanced as they approach maturity, some banks are taking a cautious stance in increasing their exposure to the hotel sector.
- **Alternative lenders increasingly active.** Seizing the opportunity to gain some of the market share previously filled by commercial banks, alternative lenders are increasing their presence in the hotel lending space. These lenders offer a short-term, bridge program designed to help hotel owners and buyers finance transitional assets. A few will also lend on ground-up construction projects. Borrowers benefit from the increasing capital flow from these alternative lenders and costs are being kept in check by increased competition.

Recent Marcus & Millichap Transactions

Hotel Name	State	Rooms
Crowne Plaza Grand Rapids Airport	MI	320
Crowne Plaza Jacksonville Airport	FL	317
Surfside Marina	TX	281
Holiday Inn Allentown	PA	253
The Plaza Hotel & Suites Wausau	WI	225
Embassy Suites Pittsburgh Airport	PA	223
Best Western Plus	CO	210
Crowne Plaza Cincinnati Blue Ash	OH	200
Travelodge Inn & Suites Jacksonville	FL	193
Comfort Suites DFW North Grapevine	TX	190
Denver's Best Inn & Suites	CO	190
Ramada Florence Center	SC	190
The Breakers	CA	178
Comfort Inn & Suites	NY	166
Ramada Kansas City	MO	164
Embassy Suites Williamsburg	VA	161
Travelodge Suites Eastgate	FL	158
Miami Airport Hotel	FL	150
Ramada Geneva Lakefront	NY	148
Ramada South Padre Island	TX	146
The Hotel Blue	NM	140
Hampton Inn Pittsburgh	PA	140
Days Inn Orlando	FL	139

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Price: $250

Sources: Marcus & Millichap Research Services; AHLA; BLS; CoStar Group, Inc.; Lodging Econometrics; Moody's Analytics; Real Capital Analytics; STR, Inc.