

## Summer Season Boosts Travel, Delivering Record Performance; Investor Caution Rising Amid Mixed Economic Outlook

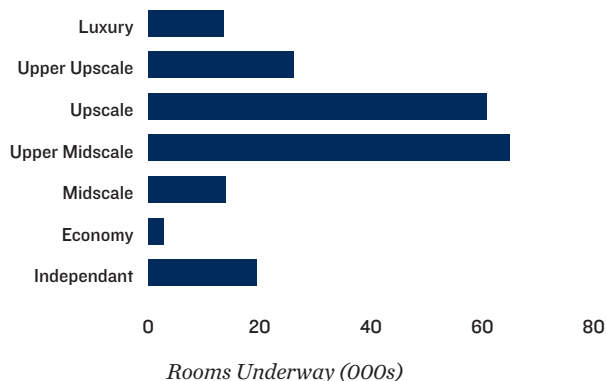
**Hotel sector delivers record performance.** Historically low unemployment is contributing to higher wages and elevated consumer confidence, supporting record travel this year. Sentiment is beginning to shift, however, as subdued economic output and ongoing trade tensions heighten concerns of a potential downturn. Travelers are becoming more price sensitive and financial concerns may lead some people to shorten or delay trips, curbing hotel room demand growth. Occupancy is expected to remain flat in 2019, with muted inflation moderating revenue gains.

- The U.S. experienced another record-breaking summer travel season this year as total domestic passenger air travel increased 3.8 percent year over year in July to an all-time high. Airlines carried more passengers in the first seven months of the year than during any previous comparable period on record dating back to 2003. This trend is driving demand for hotels in popular scenic destinations.
- Business travel is expected to remain strong this year, including to secondary market destinations. Small-business optimism remains well above long-term averages, indicating that owners remain positive about future prospects. Staffing increases and event participation will have an outsized effect on hotel demand in smaller metros.
- Tariffs on Chinese imports, including furniture and textiles, are raising material costs for hoteliers at the same time that a labor shortage is contributing to greater employee expenses. These trends could combine to cut into hotel revenue.

**Unaffiliated hotels lead deal flow.** The hotel sector got off to a slow start in 2019 as transaction volume declined during the first half of the year. Economic uncertainty and financial market volatility clouded investor sentiment and contributed to the pullback. In many cases, a mismatch between buyer and seller expectations hindered exchanges. New capital nevertheless entered the hospitality sector, aided by cap rates that exceed most other property types on average. Private investors completed the majority of transactions, followed by REITs and public institutions. Falling interest rates in recent weeks have widened margins further, which may encourage additional trades.

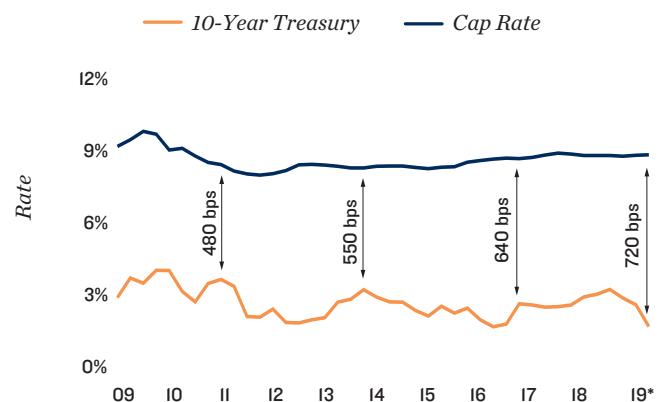
- Sales velocity moderated across chain scales, with the greatest number of deals involving unaffiliated hotels. These properties appeal to travelers seeking authentic local experiences and have outperformed other lodging types, contributing to buyer interest. Low entry costs and initial yields that can reach the 10 percent range also drew a large number of investors to economy assets.
- Investment activity shifted slightly toward smaller metros as a greater share of transactions over the past four quarters involved assets located in the Southeastern U.S. and Upper Midwest.
- The average cap rate across the country rose modestly to the high-8 percent band over the 12-month period ended in June. The highest returns were among midscale, upper midscale, and economy assets in the Mid-South, Southwest and Upper Midwest regions.

### Rooms Underway\*\*



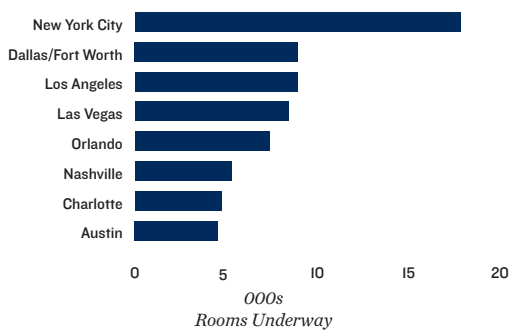
\*\* Rooms under construction as of June 2019.  
Sources: Marcus & Millichap Research Services, STR, Inc.

### Treasury and Cap Rate Trends



\* Cap rate trailing 12 months through 2Q19; Treasury rate as of Aug. 30.  
Note: Sales \$2.5 million and above.  
Sources: Marcus & Millichap Research Services; Real Capital Analytics; Federal Reserve

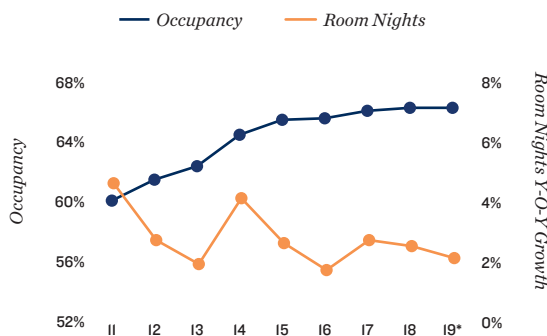
**Largest Construction Pipelines by MSA\*\***



**Upper upscale development picks up.** Approximately 990 hotels containing nearly 112,600 rooms were placed into service nationwide during the past year ending in June. An additional 201,500 rooms are underway, with another 225,300 expected to break ground within the next 12 months.

- The upper midscale and upscale chain scales continue to lead construction, comprising roughly 67 percent of all rooms completed since June of last year. The number of upper upscale hotels in development is expanding with over 26,000 rooms underway.
- New York City led the nation's largest markets in hotel development, with about 5,100 rooms added to inventory over the past four quarters. Dallas, Boston and Nashville followed with more than 3,500 rooms completed in each market. Relative to existing supply, Nashville grew the most at 7.7 percent year over year.
- Marriott International and Hilton Worldwide were the primary drivers of new construction, representing 30.2 and 25.9 percent of recent completions, respectively. Hyatt is increasing its share of the development pipeline to 5.9 percent of rooms being built.

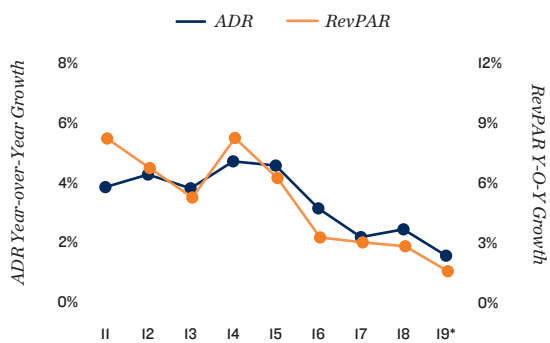
**Yearly Occupancy Trend**



**Occupancy improves among more affordable hotels.** Despite a 2.1 percent increase in room demand since last June, the annual occupancy rate dipped 10 basis points to 66.2 percent at the end of the second quarter. This is the first national occupancy decline since 2010 as elevated supply growth weighed on operations.

- Visitors continue to value affordable accommodations and unique experiences, supporting occupancy improvements in both the economy and independent hotel segments. Less development supports the higher rates, as together both chain scales only represent 12.2 percent of the current construction pipeline.
- Boston professional sports teams brought home both a World Series title and Super Bowl victory, contributing to a 110-basis-point jump in annual occupancy to 75.4 percent in June. Occupancy also improved by triple digits in New Orleans and Phoenix to 70.1 percent and 70.3 percent, respectively. Warm climates combined with popular travel destinations aided operations.
- Occupancy continues to improve in small towns. The annual rate rose 70 basis points to 58.0 percent in June. A similar increase occurred among interstate hotels as lower fuel prices encouraged more summer road trips.

**Annual ADR & RevPAR**



**Healthy room demand supports gains in revenue metrics.** Occupancy levels remain near historical highs, supporting steady gains in the average daily rate and revenue per available room. During the 12 months ending in June, ADR and RevPAR each rose 1.7 percent to \$130.54 and \$86.46, respectively.

- Strong demand for lavish experiences contributed to a 2.9 percent jump in ADR for luxury hotels to \$340.24 at the end of the second quarter, surpassing other chain scales. Rising occupancy among independent hotels supported a segment-leading 3.2 percent increase in RevPAR to \$83.14. Economy hotels also fared well, with RevPAR up 2.0 percent to \$37.64.
- Higher occupancy contributed to above-national-level revenue growth among hotels in small towns and along interstates, with RevPAR up 2.9 percent and 2.6 percent, respectively, over the past four quarters.
- Among the nation's largest metros, San Francisco led RevPAR growth with a 6.3 percent gain to \$205.27. Other coastal areas, including San Diego and Norfolk/Virginia Beach, experienced increases in RevPAR above 3 percent, bolstered by strong spring and summer visitation.

\* Forecast

\*\* Rooms under construction as of June 2019

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

## Factors That Could Impact Travel in 2019

### International Relations Affecting Tourism



#### Chinese Visitation to U.S. Has Begun to Decline Following Years of Growth



**Annual Visitor Growth: 15.8%**  
2012-2018 Average

Total International: **3.3%**



**2019 Drop in Visitors: -3.1%**  
Year-to-Date through May

Total International: **-1.9%**

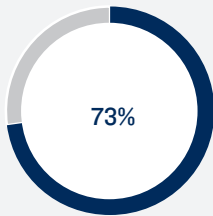
#### Chinese Visitors Spend:

**\$6,700** per trip on average,

**50%** higher than visitors from other countries

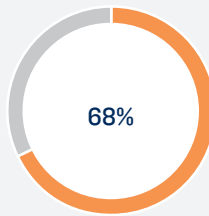
### Travel Barriers and Motivations By Generation

#### Number One Barrier to Travel Across Generations: Cost



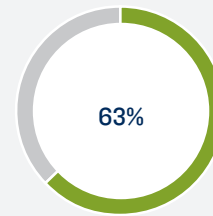
**Millennials**

**Other Major Barriers:**  
Too Hard to Leave Work;  
Logistics/Planning



**Gen X**

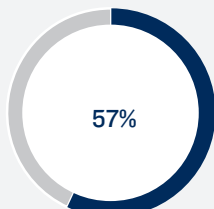
**Other Major Barriers:**  
Too Hard to Leave Work;  
Air Travel Hassel



**Baby Boomers**

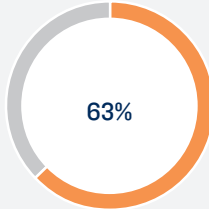
**Other Major Barriers:**  
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#### Millennials' Number One Travel Motivation Differs From Other Generations



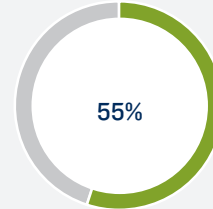
**Millennials**

**Joining Family/Friends  
on Trips**



**Gen X**

**Avoiding Burnout at Work**



**Baby Boomers**

**Avoiding Burnout at Work**

### Five-Year Performance by Location\*



Resort



Suburban



Airport



Urban



Small Town/Metro



Interstate

**Location**

**Occupancy Change**

**330 bps**

**70 bps**

**70 Bps**

**20 bps**

**130 bps**

**110 bps**

**RevPAR Growth**

**18.1%**

**13.0%**

**12.7%**

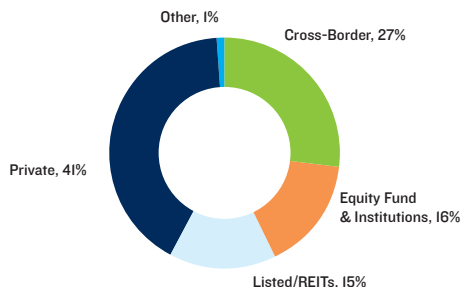
**7.7%**

**14.2%**

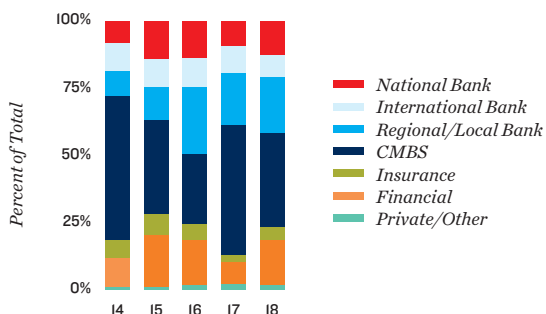
**11.2%**

\*2Q 2014 to 2Q 2019  
Sources: Marcus & Millichap Research Services; U.S. National Travel and Tourism Office. U.S. Travel Association; STR, Inc.

### 3Q19 Hotel Acquisitions By Buyer Type



### Hotel Mortgage Originations by Lender



Include sales \$2.5 million and greater  
Source: Real Capital Analytics

#### National Hospitality Group

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## CAPITAL MARKETS

By DAVID G. SHILLINGTON, President,  
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- Fed efforts to extend economic runway facing increased headwinds.** The Federal Reserve's decisive action, including its rate drop in July, to support the economic growth cycle may be outweighed by the escalating trade war. Uncertainty and caution increased following the Aug. 1 announcement that additional tariffs would be levied, some of which went into effect on Sept. 1, sparking a flight to safety and the recent inversion of the 10-year and two-year Treasuries. Though the Fed's 25-basis-point reduction of the overnight rate and early end to quantitative tightening could pose some inflationary risk, the Fed has communicated a willingness to let the economy "run hot" in an effort to spur growth. Should core inflation rise above 2 percent, it will not be seen as an immediate risk. Falling interest rates, a byproduct of the trade war and the Fed's efforts to boost the economy, will bolster leveraged yields for investors by a small degree as lenders also look to widen spreads. With the yield on the 10-year Treasury now down considerably from the cycle peak last October and at its lowest level since the record low set in 2016, investment options that may not have penciled even in the second quarter may now be feasible.

- Lenders maintain abundant liquidity, manage interest rate movement.** Financing for hospitality transactions remains readily available across a wide range of lenders, including local, regional and national banks, life insurance companies, and CMBS sources, with leverage requirements varying by provider. National banks and life insurance companies generally accept a maximum loan-to-value ratio of 55 percent, rising to 65 percent for regional and local banks and 70 percent for CMBS loans. Lending rates, meanwhile, are broadly similar regardless of lender type. Fixed rate returns fall into the 3.9 to 6.75 percent range depending on the size of the loan, while bridge financing is available with rates up to 8.5 percent. Recent financial market volatility and the drop in both the 10 and two-year Treasuries into the high-1 percent range have added downward pressure to lending rates, but some organizations have instituted rate floors to preserve their spreads. As such, investors should not expect a one-to-one movement between the broader interest rate environment and financial offerings.

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Sources: Marcus & Millichap Research Services; AAA; AHLA; BLS; Bureau of Transportation Statistics; CoStar Group, Inc.; Moody's Analytics; Real Capital Analytics; STR, Inc.; U.S. Department of Transportation