

Holiday Season Brings Increased Travel to Hotel Sector; Investors Target Limited Service Properties

Holiday travel ramps up as summer season concludes. A strong summer travel season supported further occupancy and revenue growth in the hospitality sector through the third quarter of this year. Property performance generally slows during the fourth quarter, but the beginning of the holiday travel season may support additional room nights through year end. Overall, occupancy continues to remain at record levels as healthy employment gains and rising wages support consumer spending.

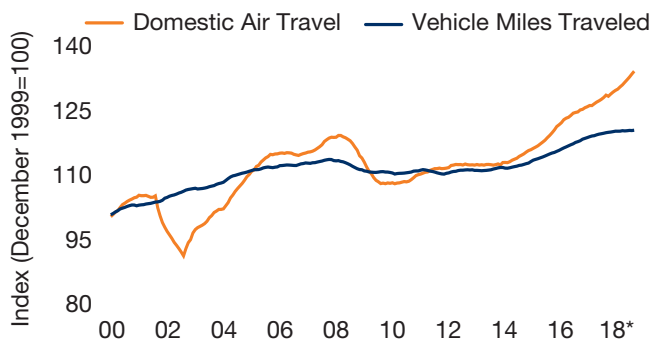
- Summer occupancy, between the months of June and August, rose 70 basis points from the same time period last year as room demand rose at a healthy clip. The strong travel season generated a 3.3 percent increase in RevPAR compared with the prior year.
- More Americans are expected to travel this holiday season. In particular, an estimated 48.5 million planned to drive to their destinations on Thanksgiving. Those with longer drives may choose to stay at interstate hotels en route. Interstate hotels have registered considerable improvements recently, and annual occupancy was up 80 basis points ending in September.
- Some families may choose to spend their holiday vacations in warmer locales. Markets like Miami, Phoenix and San Diego could benefit from rising room demand from these travelers. Phoenix in particular generates most of its room demand outside the summer months.

Limited service hotels remain a focus for investors.

Steady economic growth, coupled with improving hotel property performance metrics, continues to sustain demand for hotel properties nationwide. Transaction velocity edged up nearly 6 percent during the 12 months ending in September with Florida, California, Georgia and Texas leading sales volume among states. Heightened competition for hotels overall lifted property values 9 percent during this same time to \$110,700 per room.

- High first-year returns are driving interest for hotel properties from investors seeking less volatility and greater yields than other investment options. Assets change hands with cap rates averaging in the mid-8 percent band but can vary as much as 200 basis points based on location and chain scale. These returns are enticing buyers from Asian countries, like Singapore and China, who are increasingly targeting hotels in the U.S.
- Evolving consumer preferences toward experiences may generate investor interest for soft brands. These hotels tend to offer the unique amenities that customers desire while sustaining the reputation of a large flag.
- Limited service properties, along with the upper midscale segment, dominated transaction velocity during the prior four quarters. Economy hotels offered lower entry costs and first-year yields averaging in the low-10 percent band while upper midscale properties traded with cap rates near the national average.

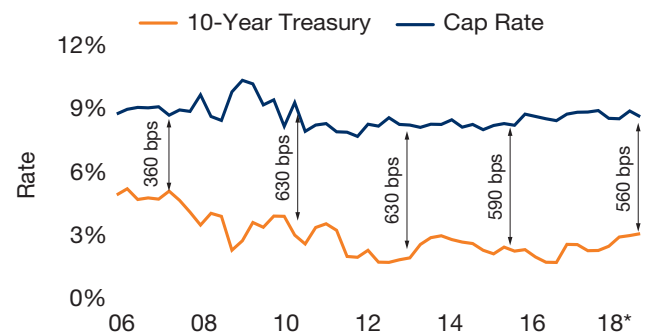
Air and Vehicle Travel Up Significantly



* Through August

Note: Indexed on trailing 12-month average domestic passenger enplanements and total vehicle miles traveled

Treasury and Cap Rate Trends

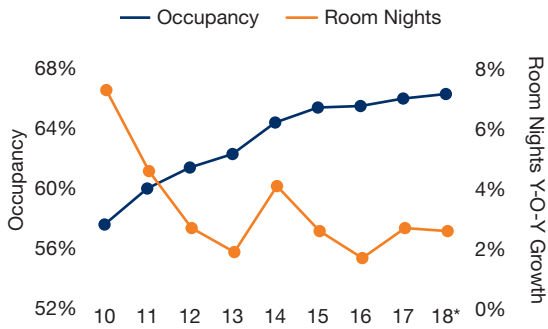


* Through 3Q18

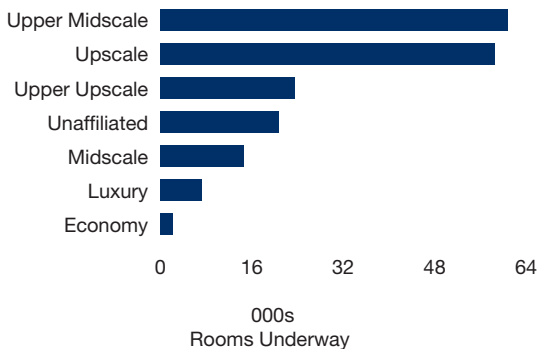
Note: Sales \$2.5 million and above

Source: Real Capital Analytics

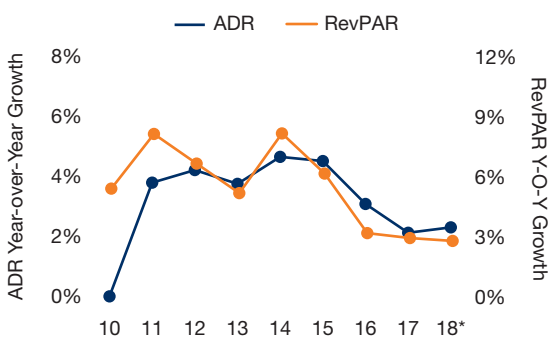
Yearly Occupancy Trend



Rooms Under Construction**



Annual ADR & RevPAR



Midscale hotel development picks up. In the 12 months ending in September, nearly 113,500 rooms were placed into service in almost 990 hotels nationwide. An additional 188,000 rooms are underway and 207,000 rooms are in the planning pipeline and expected to break ground in the next four quarters.

- Dallas led the nation’s largest markets in term of number of rooms added to inventory during the year ending in the third quarter with 4,245 rooms. New York City and Boston followed, adding nearly 4,300 and 2,970 rooms, respectively.
- The upscale and upper midscale segments continue to lead construction, with nearly 65 percent of all rooms underway located within these two segments. The number of midscale hotels under development is picking up. Nearly 15,000 rooms are in construction and an additional 22,870 are expected to break ground within the next year.
- Marriott International and Hilton Worldwide were the primary drivers of new construction during the past four quarters. New rooms under Marriott and Hilton made up 28.7 percent and 27.5 percent of total supply, respectively.

Widespread demand boosts national occupancy. Room demand rose 2.8 percent since last September, supporting a 40-basis-point increase in occupancy to 66.2 percent. In the prior annual period, occupancy also registered a 40-basis-point rise.

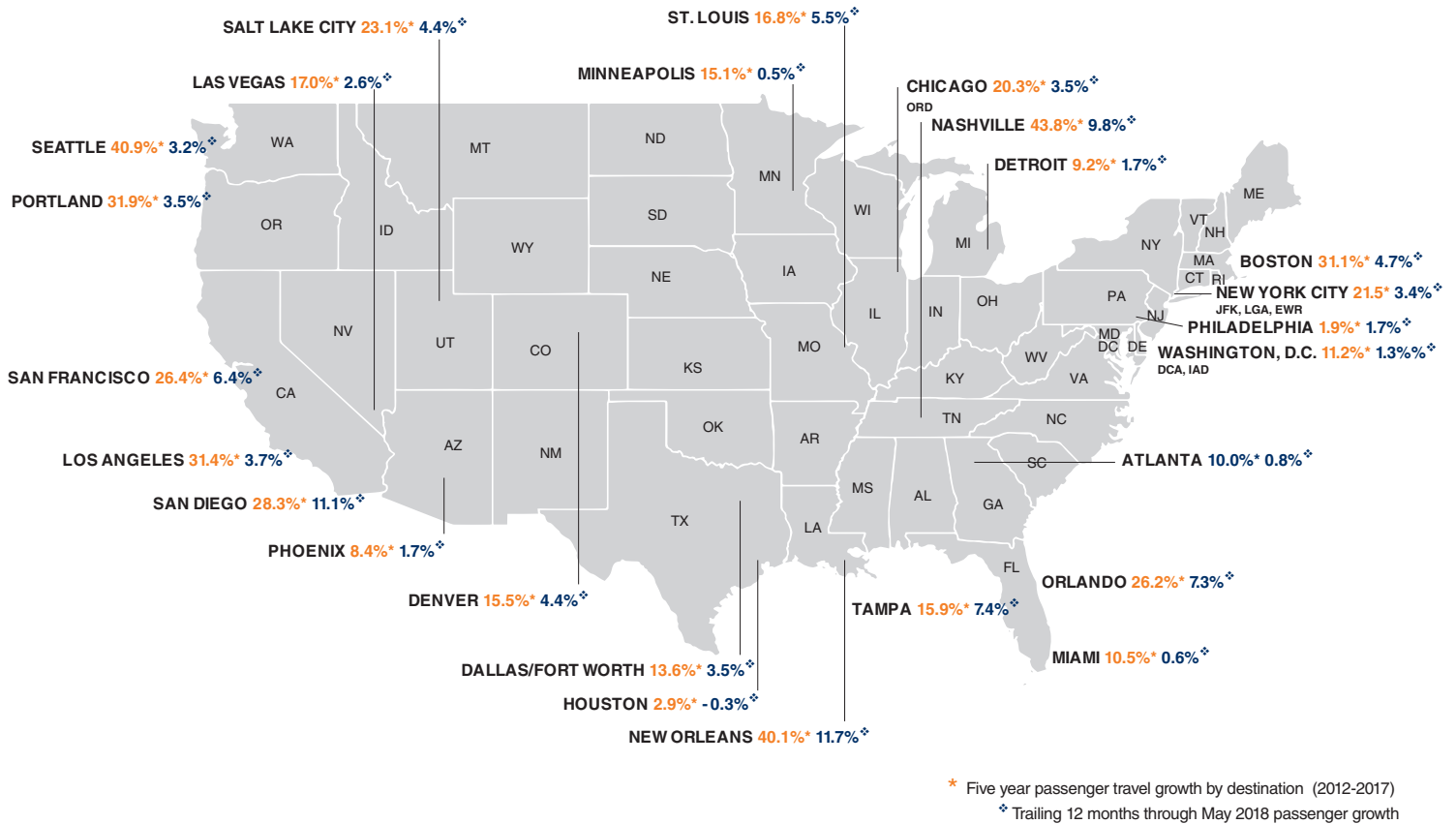
- Two playoff games, events surrounding a Super Bowl win and several large citywide events have driven considerable occupancy improvement in Philadelphia. Annual occupancy is up 310 basis points since last October to 71.1 percent. The gain erases the 120-basis-point drop posted the prior year.
- Wildfires throughout much of California could affect occupancy rates moving forward. In Northern California, roughly 52,000 people were evacuated from their homes and 200,000 individuals were under mandatory evacuation orders in the southern part of the state as of mid-November. These evacuees could seek shelter in hotels, lifting occupancy rates.
- A new tourism campaign and interest in college sports has been fueling room demand throughout West Virginia. That state registered the largest occupancy increase, rising 570 basis points to 62.4 percent.

Healthy room demand supports gains in revenue metrics. Steady occupancy improvement is supporting increases in the average daily rate and RevPAR. During the 12 months ending in September, ADR rose 3.2 percent to \$85.44 while RevPAR edged up 2.5 percent to \$129.07.

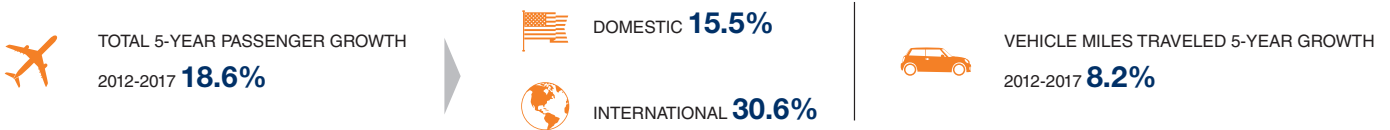
- Luxury hotels led increases in revenue metrics, with ADR climbing 3.3 percent to \$332.91 and RevPAR rising 4.9 percent to \$248.50. Rising occupancy in independent hotels supported a 2.5 percent increase in the average daily rate and boosted RevPAR 3.6 percent. Economy hotels also fared well, with ADR and RevPAR edging up 2.7 percent and 3.3 percent, respectively.
- Strong room demand for resort-style hotels lifted ADR 3.2 percent during the last four quarters to \$177.56. This combined with a 100-basis-point increase supported a 4.6 percent increase in RevPAR. Interstate hotels also generated above-average RevPAR growth, climbing 3.6 percent as ADR edged up 2.4 percent and occupancy jumped 80 basis points.
- Miami and Orlando led RevPAR growth among the nation’s largest markets as Hurricane Irma generated significant room demand and elevated rates late last year. Revenue metrics may beginning to normalize as demand stabilizes.

* Forecast
 **As of Sept. 2018
 Sources: Marcus & Millichap Research Services; STR, Inc.

Rising Passenger Travel Highlights Potential Up and Coming Destinations



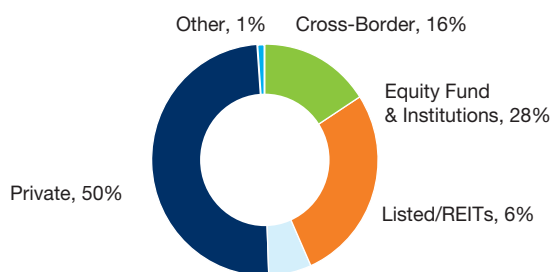
NATIONAL TRAVEL STATISTICS



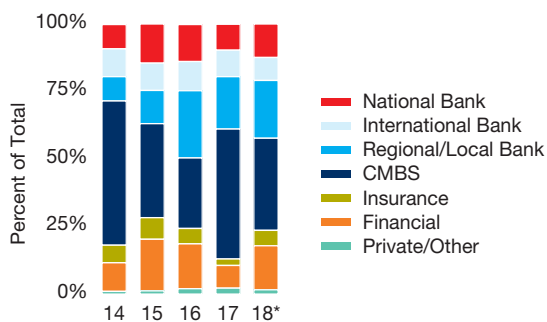
Travel Highlights

- Airline passenger travel can be an indicator of up-and-coming travel destinations and highlight areas of potential growth in hotel occupancy, ADR and RevPAR. During the year ending in May, passengers flying to Tampa International Airport rose 7.4 percent from the prior year. Occupancy in the metro jumped 110 basis points during this time, while RevPAR and ADR generated above national average increases.
- Hotels near airports and along interstates can benefit from travelers passing through those locations. Airport hotels, in particular, had the highest annual occupancy rate among location types in September. The rate climbed 60 basis points since last October to 74.0 percent. This increase, coupled with a 2.4 percent rise in the average daily rate, supported a 3.3 percent climb in ADR to \$87.39. Interstate hotels posted one of the largest occupancy increases, jumping 80 basis points during the past four quarters to 57.7 percent.
- International visitors have played a large role in passenger travel growth during the past five years; however, political uncertainty began to slow the pace of growth since 2016. Despite the slowdown, international travel continues to make steady gains, rising 4.1 percent during the year ending in May.

3Q18 Hotel Acquisitions By Buyer Type



Hotel Mortgage Originations by Lender



* Through 2Q
 Include sales \$2.5 million and greater
 Source: Real Capital Analytics

CAPITAL MARKETS

By DAVID G. SHILLINGTON, President,
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- Lesser effect of rising interest rates.** The hotel sector bucked the trend when it comes to how asset valuation is responding to the pressure created by the rising cost of debt. Hotel cap rates have remained steady for the last couple of months while those of other commercial properties have begun to rise. Moreover, the gap between Treasury yields and hotel cap rates is relatively wider when compared with other property types. This extra room allows hotel values to better absorb the interest rate pressure. As interest rates continue to rise, cap rates may eventually adjust upward; however, this phenomenon is not currently taking place within the hotel sector as of the fourth quarter.
- Construction financing remains challenging to obtain.** Capital flows to the lending space are still restricted and loan underwriting remains stringent. The perceived lending risk associated with the current stage of the hotel business cycle is playing a key role in lenders' decision. Construction lenders are putting more emphasis on loan sponsorship background, relevant development experience, and financial strengths. Local and regional banks continue to hold the largest share of the construction lending market while a handful of institutional debt funds are focusing on larger projects in primary markets. The limited availability of construction financing has kept room inventory in check in most markets, allowing demand growth to outpace supply and supporting strong asset values.

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