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NYU Conference Takeaways: Despite Some Challenges, The Hospitality Sector Is Still Looking Good

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Recession Forecasting Mixed

The tale of the looming recession was mixed, with some forecasting a shallow, short-lived recession, and others expecting a more significant impact. The overall sentiment remains a positive one, and that cash flow growth should continue. Despite high inflation, other economic markers, such as consumer goods, mortgage default rates, and low unemployment rates, look positive.

ADR will reach new highs in 2022, with further, albeit more muted, growth expected through 2023. With little push-back being seen in the market on higher ADRs, hotel owners are able to tap into this revenue source to combat higher operating costs, inflation, the rebuilding of reserves, and the necessary funding of PIPs and renovations otherwise delayed during the pandemic. Urban gateway cities, such as NYC and San Francisco, are still feeling the effects of the pandemic, as most international travel has yet to rebound. With the recent lifting of inbound testing requirements, the rebounds in these gateway cities will gain steam. Luxury travel also remains strong, and luxury ADRs should also see lift given strong personal income levels.

Demand could reach 2019 levels by next year, pending the return of labor. CEOs still face 20% to 25% labor shortages in select locations, and 10% in others. In these locales, demand may be plentiful, but with labor unavailable, some hotel floors sit empty and out of service. Hotel operators are finding success with tapping into "gig" independent worker options and offering same day pay. Younger team members are prioritizing flexibility, working for a company by which they can be inspired; technology investments; and experiences over material items. Ramping up staff will be critical in order to manage the returning wave of group demand. The pick-up in group room nights that is materializing for the fall of this year is positive, together with the lifting of the testing requirement. The return of group demand was noted as a particular bright light emerging on the horizon. The window to solve the staffing shortage for the industry is closing.

Many held confidence that if the industry just survived an impact as significant as the COVID-19 pandemic, whatever comes from a near-term recession would be readily handled. A hotel's ability to quickly adjust ADRs to manage a recessionary environment, and ultimately move rates up as the market normalizes, is an obvious advantage.

Financing Costs on the Rise, Causing Some Cooling of Transactions

Given recent market volatility and base rate increases, some lenders are retreating to the sidelines. This has allowed remaining lenders in the market to maintain spreads, which is increasing financing costs for borrowers. Given the forming gap in debt financing and general volatility, several groups that have been more equity-investment-focused have pivoted to debt financing with a willingness for higher leverage; however, these options carry higher rates, longer yield maintenance, and warrants. Subordinate lending choices are out there, allowing buyers the ability to get deals done, albeit with added creativity, coordination, and time.

Summary

The tale of the looming recession was mixed, with some forecasting a shallow, short-lived recession, and others expecting a more significant impact. The overall sentiment remains a positive one, and that cash flow growth should continue. Despite high inflation, other economic markers, such as consumer goods, mortgage default rates, and low unemployment rates, look positive.

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There has been a disruption to certain investment sales, particularly those with complicated capital stacks and material repositioning requirements, leading to purchasers asking for price reductions or dropping out of the deal before hard commitments come due.

However, as we move beyond the low points of the pandemic, distressed hotel funds are simply becoming hotel funds looking for opportunistic buys. At **ALIS**, there was much talk about 2022 being busy with REO transactions and opportunities, but the market hasn't realized this yet. There remains much capital in the space seeking assets, which should keep overall transaction volume at healthy levels.

Moreover, sales of select- and limited-service hotels have not yet begun to experience a material impact to cap rates, due in large part to their usage of relationship balance-sheet lenders or government-backed financing programs. Heightened interest in the extended-stay and limited-service sectors also remains, keeping cap rates low. There is also muted interest for investing in retail and office buildings, which is ultimately pushing more capital into hospitality. Moreover, recent changes to the **EB-5 program** could potentially lead to a general rebooting and additional capital availability in the sector.

Construction financing remains challenging given supply chain disruptions, inflation, and ultimately significant costs increases. This is requiring borrowers to become more creative in their mix of funding sources. Developers are also turning now to high cap-rate assets as redevelopment opportunities into low cap-rate assets, rather than building from a vacant site. Construction starts in the hotel sector continue to trend downward.

Additional Topics of Importance to the Industry

- The importance of c**limate initiatives and sustainability** returned to the stage.
  - **Accor** is to drop all single-use plastics by the end of 2022.
  - Many luxury brands are also planning to move away from single-use plastic.
  - **Six Senses Hotels** is currently using large-format bath amenities at all properties in an elegant, sophisticated way that keeps with guest expectations, as well as in-house water filtration to serve guests sparkling and still water without using plastic bottles.
- **Diversity, equity, and inclusion (DEI)** remains a focus for the industry. Continued efforts are needed to bridge the capital-access gap for both equity and debt. This will foster diversity in ownership. Lenders must acknowledge the lack of lending opportunities available to women entrepreneurs. Encouraging lenders to provide more opportunities and flexibility in lending (particularly for construction loans) to women is needed.
- Maximizing revenue per square foot and looking beyond just a RevPAR measure for success is becoming more important in the post-COVID environment.
- A topic repeated many times was the need to **lift the COVID testing requirement for inbound international travelers** entering the United States, which was in fact lifted just shortly following the conclusion of the conference. While that external factor has been solved, the ramping up of immigration was noted as another key need for the industry to thrive operationally.
- Guests are demanding increased technology to digitize their experience, but the issues executives are finding is that prices inflate rapidly in the tech sphere, and the tech itself quickly becomes obsolete. Operators have found that IT vendors develop a new version and stop providing support for the old platform in which owners invested so heavily. Also, labor shortages in the IT-providers' field are making implementation and training assistance difficult to come by. So, without proper training from IT providers, hotel companies are not able to take full advantage of the investments.

In Conclusion

As has been the case after all prior market impacts, the hospitality industry continues to bounce back. Travel, being essential to the human condition, remains a vital part of the overall economy, and the pandemic only further solidified its importance to all of us. Despite volatility in the debt and equity markets, RevPAR and overall performance should continue its recovery from the lows of mid-year 2020.

About Rod Clough, MAI

Rod Clough is the President of HVS Americas. He is responsible for the overall direction, management, and ongoing success of 40+ offices across North and Latin America. Under his leadership, HVS Americas conducts over 3,500 valuation and consulting engagements annually. During his 30-year tenure, Rod has been instrumental in leading the growth of the firm; this includes significantly expanding the number of offices across the United States, as well as launching multiple divisions, including U.S. Hotel Appraisals, HVS Latin America, HVS Brokerage & Advisory, and HVS Asset Management & Advisory. A frequent speaker at the nation's largest hotel conferences, Rod is a designated member of the Appraisal Institute (MAI) and a state-certified appraiser. He earned his BS from Cornell University's School of Hotel Administration and also holds a Colorado real estate broker's license. Furthermore, Rod is proudly Latino and gay, and his firm is welcoming of all races and colors, sexual orientations, ages, genders, and gender identities. Once associates join HVS, they tend to stay due to the extraordinary culture Rod has inspired—a culture defined by the ideals of balance, connectivity, efficiency, collaboration, honesty, integrity, kindness, and excellence, among others. Rod resides in Northern Colorado where he and his husband Jeff are raising their daughter, Rory. Contact Rod at (214) 629-1136 or .