

Hospitality Directions US

Our updated lodging outlook

The content of this issue has been expanded to account for the current circumstances and to respond to extensive outreach from clients and industry colleagues.

November 2020

Significant spike in daily COVID-19 cases expected to prolong recovery of the US lodging industry



The length and severity of this pandemic has greatly increased since our last publication and is discussed in more detail in this expanded edition of Hospitality Directions US. In our May edition, we had assumed the then consensus view that the daily number of new COVID-19 cases in the US peaked in late April. We now know this did not occur, and that the current daily number is over four times that level. This has significantly impacted the recovery timeline. We currently expect annual occupancy for US hotels this year to drop to 44 percent, and average daily room rates to drop 21 percent, with resultant RevPAR declining 47 percent from last year. RevPAR in 2020 is expected to fall to a level not seen since 1996.

It has been an uneven recovery, with destinations reliant on business, group and international demand suffering the most. Continued uncertainty and flexible booking policies are resulting in the majority of guests booking within 24-48 hours of arrival, straining forecasting and staffing models.

As Federal aid and temporary forbearance relief runs out, industry leaders now fear another wave of re-closures, with office reopenings being pushed into 2021, delaying the resumption of business travel and group demand that typically compensates for slowed leisure travel post-Labor Day. With additional legislative action stalled as we enter the period between the recent election and change in administration, the industry is poised for an unprecedented wave of foreclosures.

We forecast that in 2021 temporarily closed hotels continue to reopen and demand growth builds as the economy continues to open back up after a vaccine becomes widely available (currently assumed in 2H 2021). Occupancy and ADR decline in Q1 on a tough prior year comp (January and February 2020 were pre-pandemic) and then see a strong increase over an easy prior year comp in Q2 through 4, resulting in a year-over-year RevPAR rebound of 19 percent.

Challenges to the above outlook continue to include political uncertainty leading up to the presidential inauguration; the speed of the business travelers' return after a vaccine; and the length and severity of a resurgence of the virus in Q4 and into 2021.

Our revised outlook for 2021 anticipates

Slow recovery in demand resulting in **occupancy** of

52.7%

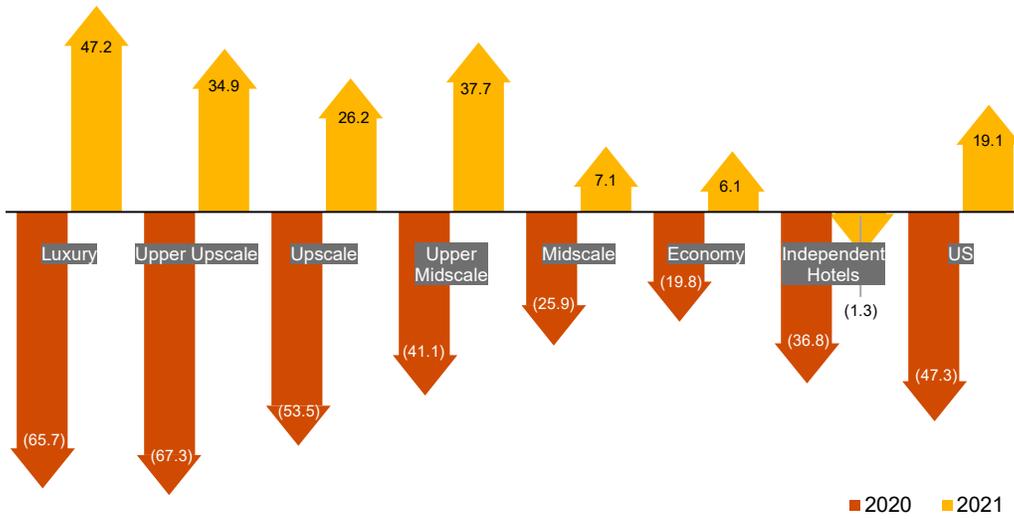
Average daily rate remains relatively flat as hotels struggle to capture market share - up

0.3%

As a result, **RevPAR** continues to decline in Q1 and then begins recovery - up

19.1%

Figure 1: RevPAR percent change, US and chain scales

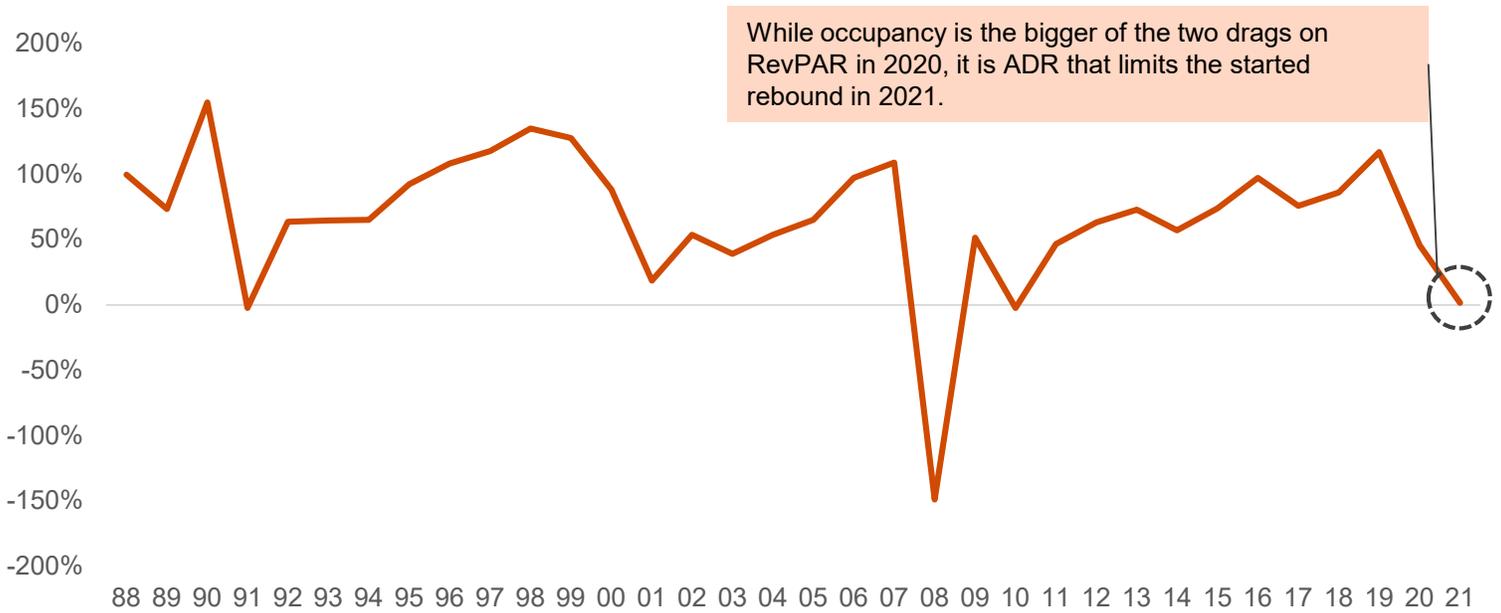


Hospitality Directions Outlook Tables

For detailed outlook tables covering the US and each of the chain scales, please access the [Hospitality Directions Outlook Tables](#) available online.

Source: PwC, based on STR data

Figure 2: ADR contribution to change in RevPAR



Source: PwC, based on STR data

Although GDP rose 33.1% in Q3, rising infection levels are expected to hinder growth

Despite real GDP growth of 33.1% in the third quarter, GDP remains 3.5% below the peak reached in the fourth quarter of 2019, and 5.0% below IHS Markit's pre-pandemic estimate. Furthermore, IHS Markit anticipates fourth quarter GDP to decelerate sharply from 33.1% to 3.7%, resulting in a GDP contraction of 3.6% for the year. This expectation is in large part due to a new pandemic relief bill not expected until early 2021, the outcome of the Presidential election being contested by the Trump Administration, surging COVID-19 cases, and a possible government shutdown in mid-December.

The unemployment rate fell sharply to 6.9% in October, indicating a possible increase in core PCE inflation and alignment with the

Fed's goal of 2.0% through 2025. Nonetheless, the downward revision of unemployment coupled with rising core inflation rates will likely place upward strain on wages and prices. Private demand also experienced a sharp uptick in the third quarter with residential investment, equipment spending, exports, and imports all up sharply.

In summary, IHS Markit expects third quarter GDP growth to fade as infection rates rise, local authorities restrict economic activity, and both state and local governments restrain spending for their new fiscal years. GDP growth is expected to rebound to 1.9% in 2021 and 2.8% in 2022 on a fourth quarter over fourth quarter basis, reaching prior peak levels early that year.

Source: IHS Markit (forecast released November 2020); PwC

Table 1: US outlook (November 30, 2020)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Demand growth	4.6%	2.7%	1.9%	4.0%	2.5%	1.5%	2.4%	2.3%	1.8%	-35.2%	22.9%
Supply growth	0.4%	0.3%	0.5%	0.6%	0.9%	1.4%	1.7%	1.9%	2.0%	-3.6%	3.5%
Room starts, % change	57.9%	26.1%	26.6%	35.4%	14.7%	14.7%	-4.1%	8.2%	-7.1%	-53.0%	-82.2%
Occupancy	60.0%	61.4%	62.3%	64.4%	65.4%	65.4%	65.9%	66.1%	66.0%	44.4%	52.7%
% change	4.2%	2.4%	1.4%	3.4%	1.5%	0.1%	0.7%	0.4%	-0.1%	-32.8%	18.7%
Average daily rate	\$101.76	\$106.06	\$110.06	\$115.21	\$120.44	\$124.09	\$126.84	\$129.97	\$131.22	\$102.96	\$103.25
% change	3.8%	4.2%	3.8%	4.7%	4.5%	3.0%	2.2%	2.5%	1.0%	-21.5%	0.3%
RevPAR	\$61.05	\$65.14	\$68.53	\$74.16	\$78.72	\$81.18	\$83.56	\$85.96	\$86.67	\$45.70	\$54.41
% change	8.1%	6.7%	5.2%	8.2%	6.1%	3.1%	2.9%	2.9%	0.8%	-47.3%	19.1%
GDP, % change Q4/Q4	1.6%	1.5%	2.6%	2.9%	2.2%	2.1%	2.7%	2.5%	2.3%	-2.6%	1.9%
Inflation, % change	2.5%	1.9%	1.3%	1.5%	0.2%	1.0%	1.8%	2.1%	1.5%	0.9%	1.7%

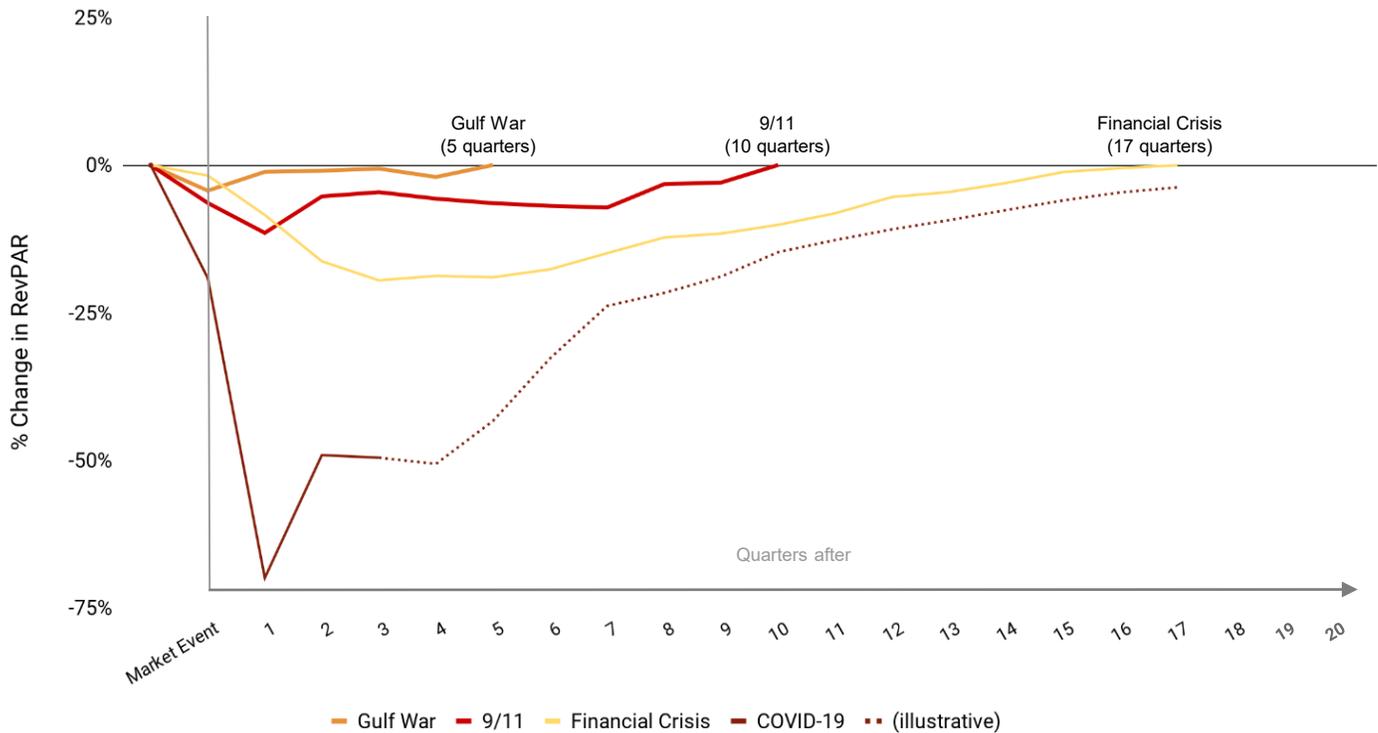
Source: STR; Bureau of Economic Analysis; IHS-Markit (forecast released November 2020); MHC Construction Analysis System; PwC

Table 2: Chain scale outlook, percentage change from prior year

Chain scale	2020					2021				
	Demand	Supply	Occupancy	ADR	RevPAR	Demand	Supply	Occupancy	ADR	RevPAR
Luxury	(70.4)	(24.0)	(61.0)	(12.0)	(65.7)	88.6	21.7	55.0	(5.0)	47.2
Upper upscale	(63.7)	(14.5)	(57.5)	(23.0)	(67.3)	63.1	12.5	45.0	(7.0)	34.9
Upscale	(40.7)	(1.1)	(40.0)	(22.5)	(53.5)	26.8	1.5	25.0	1.0	26.2
Upper midscale	(29.8)	0.8	(30.3)	(15.5)	(41.1)	35.7	0.5	35.0	2.0	37.7
Midscale	(18.3)	0.9	(19.0)	(8.5)	(25.9)	6.6	0.5	6.0	1.0	7.1
Economy	(12.7)	(0.1)	(12.6)	(8.3)	(19.8)	5.4	0.4	5.0	1.0	6.1
Independent hotels	(33.7)	(4.9)	(30.3)	(9.3)	(36.8)	12.4	4.9	7.1	(7.8)	(1.3)
US total	(35.2)	(3.6)	(32.8)	(21.5)	(47.3)	22.9	3.5	18.7	0.3	19.1

Source: PwC, based on STR data

Figure 3: Year-over-year RevPAR change after Market Event



	S&L Crisis / Gulf War	9/11	Financial Crisis
Market Event / Month	S&L Crisis / Gulf War (Aug. 1990)	Terrorist Attacks (Sep. 2001)	Lehman Bankruptcy (Sep. 2008)
Economic Conditions	<ul style="list-style-type: none"> Decelerating GDP growth Recession Peaking savings and loan crisis 	<ul style="list-style-type: none"> Bursting of dot-com bubble Decelerating GDP growth Recession 	<ul style="list-style-type: none"> Decelerating GDP growth Recession Historically low CRE risk premium Ubiquity of CMBS
Prior Lodging Industry Conditions	<ul style="list-style-type: none"> Flat RevPAR prior to onset of the crisis "Non-economic" hotel development Significant lodging oversupply 	<ul style="list-style-type: none"> RevPAR declines prior to the terrorist attacks Above-average quarterly supply growth 	<ul style="list-style-type: none"> RevPAR declines prior to the onset of the financial crisis Frothy valuations Above-average quarterly supply growth Previously decelerating performance
Recovery & Key Impact	<ul style="list-style-type: none"> Five quarters to recover to pre-market event RevPAR levels Emergence of REITs, fundamentally changing the lodging landscape 	<ul style="list-style-type: none"> 10 quarters to recover to pre-market event RevPAR levels Subsequent US intervention in Iraq significantly prolonged the recovery 	<ul style="list-style-type: none"> 17 quarters to recover to pre-market event RevPAR levels Lenders amended and extended loans instead of foreclosing Accelerated pace of sector consolidation

Forecasting in Unprecedented Times (1 of 2)

The concurrent health and economic crises caused by COVID-19 continue to dramatically challenge hotel owners, lenders, brands, and operators. As the recent exponential growth in infections in the US illustrates, forecasting in this context of unprecedented uncertainty presents considerable complexity. Even though copious considerations have been factored into PwC's outlook, important variables continue to evolve. The following points summarize factors that could influence the hotel industry's recovery in a meaningful, but unpredictable way.



THE VIRUS

- COVID-19 infections in the US have recently averaged over 170,000 new reported cases per day¹. This spike is likely attributable to multiple factors, including reopening of businesses, colder weather (which drives people to cluster indoors), and general “pandemic fatigue”. **New measures to contain the spread are likely**, with potential effects on the travel sector.
- Globally, an inconsistent pattern has emerged. While some countries in Asia appear to be effectively containing the virus, most of Europe is currently experiencing dramatic growth in infections. **A recovery of international visitation to the US is not yet foreseeable.**
- Concern over these developments was buffered recently by announcements from Pfizer Inc. and BioNTech SE, as well as Moderna, Inc. that their respective **vaccine candidates appear to have efficacy rates at or above 90%**².
- Other encouraging considerations include **additional ongoing vaccine trials**, continuously **improving therapeutics**, further development and deployment of low-cost **rapid testing**, and **an incoming administration with a defined COVID-19 response plan**.
- Nonetheless, **mass production and distribution of vaccines may not occur before mid 2021.**



THE TRAVELER

- As expected, leisure travel to drive-to destinations was key to restarting the US hotel industry in Q2 of 2020.
- However, despite consumers' improved understanding of infection risks and growing trust in therapeutics, **the rate of travel's recovery decelerated somewhat after July 4, 2020** (based on average hotel occupancies and TSA checkpoint statistics).
- Recently-published research substantiates **correlations between local spikes in COVID-19 case numbers and the reopening of hotels**, restaurants, and other businesses³. Detrimental findings like these, a **probable surge in virus-related fatalities** in the coming weeks, and individual well-publicized **setbacks in the travel industry's efforts to restart** could further dampen both leisure and corporate lodging demand.
- Rapidly evolving testing, quarantining, and insurance requirements, ongoing lockdowns of varying degrees, as well as full border closures continue to create **uncertainty among willing travelers.**
- Companies –including many outside the tech sector– are now **delaying the reopening of offices into mid 2021**, with obvious negative repercussions for corporate air, hotel, and event bookings. Amazon's recently reported year-to-date savings of nearly \$1 billion in travel-related expenses⁴ illustrate the **severe impact on the sector.**
- Even when work-from-home mandates are scaled back, web-based collaboration and conferencing technologies will likely stay. Their adoption, combined with companies' growing fiscal and environmental accountability, implies that a **share of corporate travel may not return.**

Notes:

- 1) https://covid.cdc.gov/covid-data-tracker/#trends_dailytrendscases (11.24.2020)
- 2) www.pfizer.com/news/press-release/press-release-detail/pfizer-and-biontech-announce-vaccine-candidate-against
<https://investors.modernatx.com/news-releases/news-release-details/modernas-covid-19-vaccine-candidate-meets-its-primary-efficacy>
- 3) <https://news.northwestern.edu/stories/2020/11/computer-model-can-predict-how-covid-19-spreads-in-cities/&fj=1>
www.bloombergquint.com/business/covid-superspreader-risk-is-linked-to-restaurants-gyms-hotels
- 4) Amazon.com, Inc. Q3 2020 earnings webcast; min. 28:25 (<https://ir.aboutamazon.com/quarterly-results/default.aspx>)

Forecasting in Unprecedented Times (2 of 2)



THE INDUSTRY

- The CARES Act and Paycheck Protection Program, combined with loan modifications and forbearance agreements, gave many hotel owners a crucial **respite over the summer**, despite abysmal operating results.
- However, because the fall/winter months will likely be particularly challenging and lenders are expected to be less flexible, industry **stakeholders fear a liquidity crisis and a surge in foreclosures**, especially among non-institutional hotel owners.
- Therefore, **an additional stimulus package is urgently needed**, but disagreements between the House and Senate majorities may delay a bill until after inauguration of the next president.
- **Investors' commitment to the sector persists**, but it's contingent on achieving sustainable control of the virus. That manifested itself when the aforementioned announcement from Pfizer Inc. and BioNTech SE triggered immediate and **significant price increases** in the stock of hotel companies, lodging REITs, airlines, and other travel-related entities.
- Throughout the crisis, hotel owners and operators have been versatile in finding alternate revenue sources and incremental operating efficiencies. The intention now is to **bring the top-line back to pre-pandemic levels, while simultaneously maintaining those lower cost structures**.
- To accomplish that goal, **owners will likely lean more on brands** for elastic standards, value-driven distribution, as well as innovative fee structures.
- In the meantime, the developing shift in public discourse from the risk of surface-based transmission to the effectiveness of **face masks could improve the perception of safe hotel stays** (and gradually reduce the need for visible, staff-intensive cleaning protocols).

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Definitions

Abbreviated terms include average daily rate (“ADR”), revenue per available rooms (“RevPAR”), and real gross domestic product (“GDP”). Growth rates are percentage change in annual averages.

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