EXPERT Q&A

Demand for certain segments of hospitality is back, and lenders with appetite to provide debt liquidity in the sector stand to benefit from this, argue MetLife Investment Management's Bill Webster, head of hotel asset management, and William Pattison, head of real estate research and strategy

The hotel revival

After last year's annus horribilis, rising hotel demand in certain parts of the hospitality sector is keeping hotel investors optimistic. One such player is MetLife Investment Management. The institutional asset management business of life insurer MetLife has a positive outlook for the hotel sector in the US. "Our most real-time information suggests that hotel fundamentals are recovering very quickly as the US population gets vaccinated," says William Pattison, head of real estate research and strategy. Meanwhile, opportunities resulting from market turbulence may benefit investors who can provide liquidity to the sector, adds head of hotel asset management Bill Webster.

Q How has the US hotel sector been impacted by the covid-19 pandemic since it started more than a year ago?

Bill Webster: In 2020, the US hotel occupancy rate was at 42 percent on average, according to CBRE's State of US Lodging Industry report for March 2021, which is the lowest since the Great Depression in the 1930s. Luxury hotels were more impacted, with occupancy down 57 percent from the prior year, according to the Monthly Hotel Review by Smith Travel Research.

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According to CBRE data, occupancy declines coupled with depressed ADR's [average daily rate] resulted in a 2020 revenue per available room decline of 52 percent from 2019. Convention and luxury hotels have been some of the hardest hit; particularly, convention hotels, given group and business travel has been materially cut back or cancelled. The impact was amplified at convention hotels located in urban markets. We've also seen several hotels permanently close and be repurposed to other uses, like multifamily or office. So, it was a tough year. We laid off thousands and thousands of associates in our hotel portfolio as we were forced to shut hotels down. We have seen the worst, but we are starting to see the recovery now.

William Pattison: The hotel sector is the only real estate sector – and more broadly, one of the only institutional investment sectors – that is going through a capital markets and liquidity crisis. That's important to recognise, and one of the reasons we have a positive outlook on hotel investments today.

Q How do you expect market conditions to change going forward?

BW: In terms of headwinds, the corporate group client is really going to be the challenge. In urban centres like Chicago, we are seeing a very difficult group rebound and a lot of these groups have cancelled or moved to venues outside the city with less onerous covid-19 restrictions. A lot of companies are no longer holding those meetings or they're thinking about the future of meetings differently for the time being, so that's going to be a longer recovery period.

But we're seeing great recovery in the resort locations and drive-to markets, where many assets are performing at pre-covid levels already. That's not across the board, there's still a recovery in place today, but demand in certain sectors is back. We have equity holdings in a property located at Disney World [in Florida], and we are seeing demand slowed down by park capacity. So, the hotel's velocity of recovery is somewhat moderated by the park itself. With all that being said, we feel the consumer leisure traveller demand is absolutely there.

WP: Taking a step back, 50 years ago, the average US household spent about

Q Could remote working 'digital nomads' also boost hotel demand?

William Pattison: We do expect some segments of the workforce to become mostly remote coming out of this pandemic. We don't believe that will be a large percentage of office workers overall, but even only a 1 or 2 percent increase in office workers represents millions of people in the US. Before the pandemic there was already a small but growing 'digital nomad' workforce, who often live in three or four places per year, and we think this could grow and increase demand for hotels. Even for people who are primarily in the office, today's more flexible working environment could turn one-week vacations into two weeks at the destination, with one week of remote working.

Additionally, we think companies that have fully remote workforces will probably have more get-togethers or internal conferences, which could increase demand for hotels.

This is something that we had also observed before the pandemic. There were only a small number of firms that were fully remote before covid, and one constant we noticed among those firms is that they have occasional all-employee meetings, where their whole workforce essentially travels into the same city and stays at hotels while meeting.

three nights per year in a hotel and in recent decades that's grown to seven or eight nights per year, show US data from the Bureau of Economic Analysis. The remarkable thing about that trend is not the rate of growth, but how steady the growth has been year over year going back 50 years. We think this long-term structural change will continue and for that reason we think overall demand – at least for the leisure component of hotels – will continue growing not only at the US population growth rate, but also as a result of consumers increasingly using hotels.

Q How active are the equity and debt markets in the US hotel sector at this point in the pandemic?

BW: There's this whole theory that there was going to be distressed asset sales, but the bid/ask between owners' perceived value and what the market was willing to pay are pretty disparate. While there's been some activity, on the whole transaction volume in 2020 was very muted as compared to prior years.

In 2020 there was the Paycheck Protection Program, which provided some shots of liquidity to help owners. In conjunction with that were the forbearance agreements that many lenders gave, which allowed the owner to hold onto the asset for longer. Today, however, there's a sense of fatigue by owners and lenders. Now that their forbearance periods have ended, business is returning, and they are trying to meet the new lender obligations

and repayments. Because of the lack of owners' willingness or ability to find capital, we're starting to see more assets on the market. From a disposition perspective, there's quite a bit of activity.

From the lending side, there's quite a bit of activity as well. Again, from that same fatigue, owners need to go out and refinance. There's a great interest there, but some traditional lenders, such as large banks, are not back into that space today.

One of the segments where we are seeing a lot of this activity is in limited-service hotels. Because of the nimbleness of that product type, the ability to not be constrained by corporate groups and their capability to execute with a lean workforce – without significant food and beverage operations – we feel it could be a very attractive investment. Historically, these assets drop like the rest of the industry does, but they haven't dropped as hard, and they have generally recovered faster. So, there's some of that coming into the market today, especially from a lending perspective.

WP: As Bill alluded to, we have seen a stark divide between full-service and limited-service hotels. In the US, full-service hotels transaction volume is down about 70 percent as compared to 2019, and limited-service hotel transaction volume is down about 30 percent, according to Real Capital Analytics data from April 2021.

Q How is distress in the market impacting your lending strategy?

WP: The primary impact to our hotel lending has been a little bit more focus on limited and select service hotel assets. We are considering the relative value of full-service assets as well, but more recently our focus has been on limited and select service. Looking ahead, Trepp data show around 15 percent of hotels in CMBS are delinquent or in special servicing and it's still unclear how those will be resolved, but that's a pretty large pool of loans that we view as a potential opportunity for distressed refinancing.

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BILL WEBSTER

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WILLIAM PATTISON

BW: There's going to be an influx of debt coming to the marketplace from CMBS – there's about $20 billion maturing by the end of 2021, according to Newmark's Lodging Year End Summary published in January – and we're going to see this day of reckoning of how lenders are going to approach the assets, which, in my opinion, will be based on sponsorship, cashflow and recovery of the asset.

Q Which future lending opportunities do you expect in the hotel sector?

BW: We feel there is going to be increased competition on the lender side for resort products and select limited-service opportunities. Until the asset class recovers, lenders will likely be able to earn a wider spread on an asset that has a clearer path to recovery, making for an attractive risk-adjusted opportunity in our view. Especially in light of what's coming out of the CMBS world. We feel there's a near-term opportunity in this space.

WP: We believe the opportunities will be fairly long lasting, or at least longer lasting than would be the case in a more efficient sector. And the reason for that is you need specialisation and expertise to invest in hotels. Many lenders and real estate investors have been closed to hotels in the past, and those which have been open to hotels have generally been struggling over the last year and may not be looking to increase their exposure today. We've seen an increase in alternative lenders in the hotel space and those lenders are generally less experienced and are looking for yield opportunities. But overall, this is a slow-moving sector, in terms of nimbleness of capital, and we think the opportunities will remain attractive for a fairly extended period of time. ■

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