HospitalityResearch
QUARTERLY UPDATE
Marcus & Millichap
National Report *Fourth Quarter 2014*

Growing Economy Raising Hotels to New Heights

A more vigorous pace of economic growth is enabling more consumers to travel and spawning additional business trips, igniting a new wave of potent room demand growth and greater gains in revenue measures. The solid contribution of consumers to the sharp upturn in hotel performance is particularly notable. Specifically, the sources of consumer spending seem more sound and durable than those prior to the downturn, when flush home equity lines of credit and stock market gains fueled consumption and travel spending. While room demand re-accelerates, construction remains a topic of discussion, but not necessarily a matter of overwhelming concern. The potential for overbuilding exists, but thus far new supply has minimally affected market-level performance. Hotel construction is occurring where there is unfulfilled demand, and not simply a suitable site. Collectively, more than two in five hotel rooms under construction nationwide are in the 26 largest markets and, generally, hotel construction remains a complicated undertaking. Financing is not universally available and securing prime development sites in urban cores is challenging due to competition from multifamily developers.

Diverse sources of equity and debt continue to rush into the hotel sector and are supporting a thriving investment market. Transaction velocity rose in the first half of 2014 from the first six months of last year, and dollar volume also climbed notably behind higher prices and additional sales of upper-end branded properties. Lenders are becoming more competitive and are introducing new debt solutions to fill out the capital stack. Mezzanine loans, for example, are selectively available for re-branding deals. Long-term interest rates remain low but are poised to rise as the Federal Reserve concludes its program of asset purchases in October. The central bank will follow an array of labor market indicators to determine when to raise its benchmark lending rate. Amid looming changes in interest rates, too few hotels are listed for sale to satisfy investor demand, creating a highly leveraged position for owners currently contemplating a sale. Top brands in primary markets remain primary targets, but debt and equity are also pursuing opportunities in secondary and even tertiary locales.

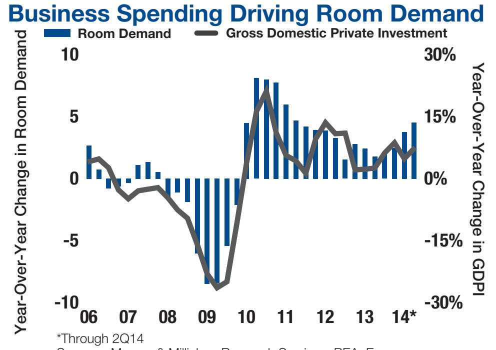
National Outlook

	2013	2014*
Occupancy	62.2%	63.7%
Demand Growth	2.2%	3.5%
Supply Growth	0.7%	1.0%
Average Daily Rate	$110.40	$115.35
Annual Change	3.9%	4.5%
RevPAR	$68.65	$73.51
Annual Change	5.4%	7.1%
Revenue Growth	6.2%	8.2%

** Forecast*
Sources: Marcus & Millichap Research Services, STR, Inc.

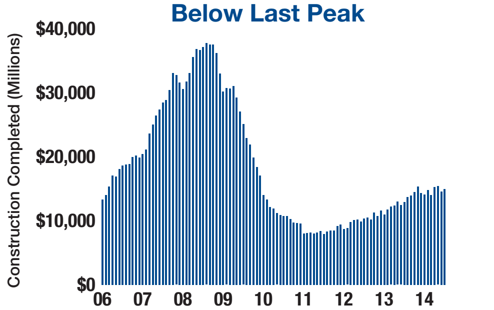
- **U.S. Payrolls Growing.** Despite sluggish job creation in August, expanding U.S. employers remain on course to add 2.7 million workers in 2014. Hiring is increasing, while a consistent rise in the number of workers purposely quitting jobs underscores a greater level of worker confidence in their ability to find employment.
- **U.S. Hotel Occupancy Rising.** Annual occupancy in the U.S. will rise 150 basis points to 63.7 percent this year, topping the pre-recession peak. Occupied rooms will rise 3.5 percent during the year, while supply growth will remain minimal. Greater pricing power will accrue to owners, driving a 7.1 percent gain in RevPAR to $73.51.
- **Airbnb Impact Examined.** Airbnb remains a hotly discussed topic in the industry. A recent study of the alternative lodging service's penetration in the San Francisco hotel market showed that weekend occupancy was impacted, growing only 0.1 percent year to date through May. Upscale and upper upscale properties are specifically slumping as visitors book elsewhere.

Business Spending Driving Room Demand



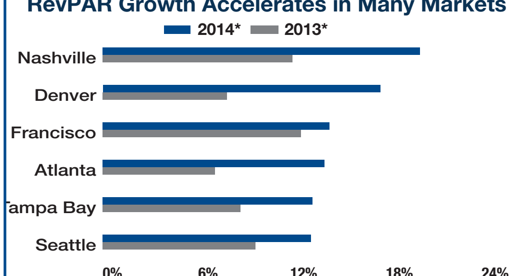
*Through 2Q14
Sources: Marcus & Millichap Research Services, BEA, Economy.com, STR, Inc.

Hotel Construction Spending Below Last Peak



*Through July
Sources: Marcus & Millichap Research Services, BOC, Economy.com

RevPAR Growth Accelerates in Many Markets



* Year to date through August
Sources: Marcus & Millichap Research Services, STR, Inc.

National Economy

A more rapid pace of economic growth is generating additional business for hotels around the country. Positive trends continue to take hold in the corporate and consumer segments. Manufacturing and service businesses are expanding, and steady growth in new orders so far this year foreshadows additional improvement in corporate performance in the near term. The normalizing of credit markets is providing a flow of capital for businesses to purchase new equipment and expand less hesitantly than a year ago. Investment in plants and equipment, a measure that closely tracks changes in hotel room demand, climbed notably over the 12 months ending at midyear. Within the consumer segment of the economy, spending is growing despite wage growth that barely exceeds inflation and lessened reliance on credit card debt to make purchases. Stung by the severity of the recession and the accompanying downturn in household wealth, consumers are displaying greater willingness to spend within means and effectively manage household finances to maximize liquidity. The recent lowering of long-term interest rates and upward pressure on home prices, for example, could encourage additional mortgage refinancing, potentially freeing up money in the monthly budget for trips and vacations.

Occupancy Trends

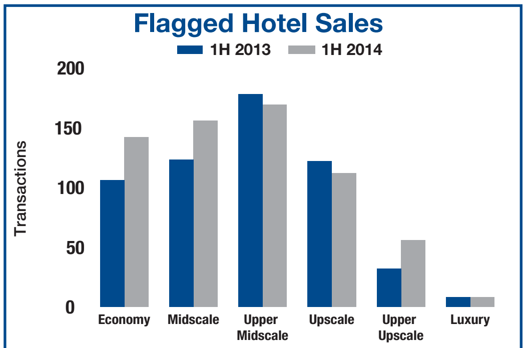
The more robust pace of expansion in the U.S. economy is triggering a second wave of significant growth in room demand. Year to date, occupancy jumped 220 basis points to 66.0 percent behind a 4.3 percent rise in room nights, nearly two times the rate of growth recorded in the corresponding period last year. Higher group demand accounts for some of the outperformance of hotels this year; through July, U.S. hotels recorded 2.1 million additional group rooms than in the first seven months of 2013. Supply growth, meanwhile, has not quite materialized as a potent threat to undercut ongoing increases in occupancy. Available rooms rose only 0.8 percent year to date, and construction is highly concentrated in large markets where demand drivers are more diverse and capable of absorbing new supply. New York, Houston, the Washington, D.C., metro, Miami-Dade County and Orange County collectively account for more than one-fourth of the rooms slated to come online around the country. An alternative perspective on hotel construction, meanwhile, reveals a rather tame trend. Spending on hotel construction has not ramped anywhere close to the level recorded during the last surge in building. Recent data on hotel construction spending, in fact, may signal a leveling of development.

Revenue Trends

Property operators across the country are employing greater pricing power, as evidenced by a 4.4 percent rise in ADR through the first eight months of 2014. By demand segment, group ADR increased at a rate in the low-3 percent range over the past 12 months, but group demand is starting to recover after lagging U.S. trends for a lengthy period. Recent gains in group room nights and positive advance booking trends will likely enable property owners to push up transient daily rates more aggressively in the near term. The increase in nationwide ADR is also the principal driver behind the 8.0 percent increase in RevPAR posted thus far in 2014. RevPAR growth is accelerating, with 11 of the nation's 25 largest markets posting double-digit gains this year, compared with only seven markets in the same period of 2013. Nashville continues to record outsized rate-driven gains, prompting a new wave of development in the downtown core. Elsewhere, elevated RevPAR growth in Atlanta and Tampa confirms that hotel recoveries in those markets are firming as local economies strengthen. The gain in RevPAR in both markets is primarily the result of occupancy growth, creating an opportunity for operators to push rate more assertively in the months ahead.

Investment Trends

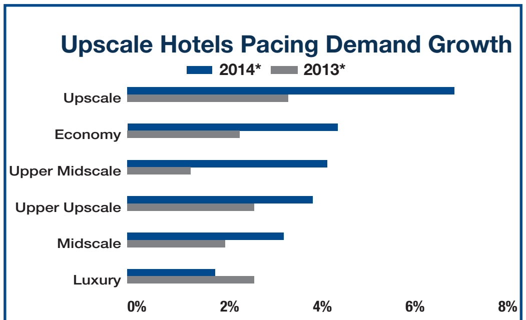
Broader access to debt and more favorable lending terms are underpinning a heightened level of hotel transactions. The hotel industry often falls out of favor with lenders, but positive industry outlooks and highly motivated capital sources will sustain favorable capital market conditions for buyers and sellers in the coming months. The more liberalized lending standards in today's investment market favor all investors but have especially lifted the ability of small private buyers to make purchases. Higher leverage has reduced equity requirements, enabling investors to make larger buys or multiple purchases. Collectively, nationally flagged economy and midscale brands represented nearly half of all flagged hotels sold in the first half of 2014, exceeding the proportion that changed hands in the corresponding period of 2013. The number of upper midscale and upscale hotels sold in one-off transactions or in small multi-property portfolios decreased slightly in the first half, primarily reflecting reduced listings and not a drop in demand. Several owners of upper midscale and upscale assets may be electing to temporarily defer listing to build up additional asset value despite the presence of a deep pool of motivated buyers seeking to make deals currently. In addition to franchised hotels, sales of independents also rose substantially in the first half as lenders were more willing to consider well-located and performing assets operating outside of a brand network.



Sources: Marcus & Millichap Research Services, CoStar Group Inc., Real Capital Analytics, STR, Inc.

Hotel Sector Spotlight: Chain Scales

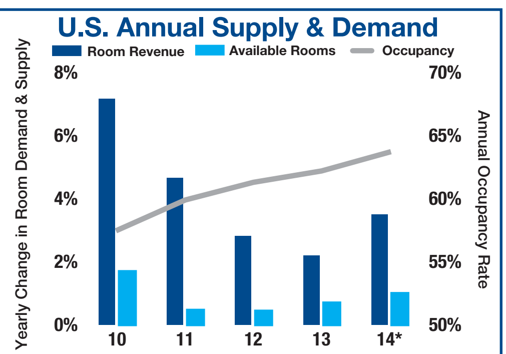
In most chain scales, room demand is growing at a faster pace than one year ago. Only luxury hotels registered a slower pace of demand growth so far this year. Through the first eight months of 2014, room nights at upscale properties grew 6.7 percent, outpacing the increase posted in the segment during the first seven months of 2013. Despite a hefty 3.5 percent jump in supply, upscale occupancy climbed 220 basis points to 75.5 percent. To date, the introduction of new stock in this segment appears to have satisfied pent-up room demand in specific markets with a sizable concentration of higher priced hotels. Upscale RevPAR rose 8.1 percent year to date, marginally more than the U.S. rate of growth. Property owners are leveraging higher demand to raise rates, and the ADR accounts for most of the gain in RevPAR across most chain scale segments. In the economy tier, for example, the increase in rate drove most of the segment's 8.6 percent rise in RevPAR, while room nights rose more than 4 percent to eclipse last year's gain. Extremely limited construction in this segment will support additional increases in excess of the U.S. rate of growth in the near term. Less than 5,000 rooms are under construction and planned in the economy tier, representing a scant 0.6 percent of existing room count.



* Year to date through August
Sources: Marcus & Millichap Research Services, STR, Inc.

2014 National Forecast

Rising travel volume will support gains in all key measures of U.S. hotel performance during 2014 and extend the hotel sector's run of strong performance into next year. Supply will rise 1 percent during 2014, surpassing last year's rate of growth but a level well below historical norms. Securing financing for construction remains an imposing hurdle for many prospective developers to clear, while construction labor and material costs are rising in some markets. Room nights, however, will increase 3.5 percent this year and generate a 150-basis point jump in occupancy to 63.7 percent. With no government shutdown looming to alter trip plans, travel to national parks and the Washington, D.C., metro is poised to recover from last year's lackluster showing. ADR will further emerge as the main factor driving RevPAR growth and as a means for property owners to offset the higher expenses that accompany higher occupancy. Accordingly, the nationwide ADR will rise 4.5 percent in 2014, surpassing last year's sub-4 percent gain, and will be fuel a 7.1 percent jump in RevPAR to $73.51.



*Forecast
Sources: Marcus & Millichap Research Services, STR, Inc.

Capital Markets

By WILLIAM E. HUGHES, Senior Vice President, Marcus & Millichap Capital Corporation

- CMBS lenders continue to wage a pitched competition with local, regional and large national banks to finance hotel acquisitions. For loans starting at $5 million, spreads are roughly 200 basis points above the 10-year U.S. Treasury swaps for top brands in the largest markets. Well-sponsored deals involving preferred flags in secondary and tertiary markets are also viewed favorably. Leverage averages in the low-70 percent range, but conduits will stretch to 75 percent for the best transactions. Conduits require minimum debt yields of approximately 11 percent; non-recourse financing is available for qualified borrowers and in select circumstances.
- Local and regional banks will loan a maximum of $15 million, while large national banks typically have capacity up to $50 million. Leverage is typically around 70 percent for the best transactions, though LTVs can reach 75 percent for best-in-class assets and top sponsorships. Cash-flowing assets are favored, while loan terms vary from three to seven years at rates generally ranging from 200 to 300 basis points above the corresponding U.S. Treasury swaps. Outside of the conduits and banks, a number of mezzanine lenders and private equity sources are emerging to fill gaps in the capital stack.
- For first-time buyers of hotels and purchasers of transitional assets, the Small Business Administration's 7A and 504 programs remain commonly employed funding options. The SBA programs are a valuable alternative source for loans as high as $15 million, with terms of up to 25 years for the 7A and 20 years in the 504 program. Blended rates on the latter are currently in the mid-5 percent range.

Recent Marcus & Millichap Transactions

Hotel Name	State	Rooms
La Quinta portfolio (four properties)	FL, MO, TN	504
Dells Island Resort & Conference Ctr.	WI	228
Royal Celebration Inn	FL	222
Ramada Conference Altoona	PA	216
Best Inn & Suites	CO	194
Stratford Inn Extended Stay	GA	185
Ambassador Hotel & Conference Ctr.	CA	162
Baymont Inn & Suites	FL	162
Clarion Inn and Conference Center	OH	157
Quality Inn	FL	152
Baymont Inn & Suites	LA	142
Hampton Inn	FL	128
Hilton Garden Inn	IN	122
Courtyard by Marriott	AR	114
Holiday Inn	TX	109
Holiday Inn	TX	101
Holiday Inn	LA	97
La Fuente Inn & Suites	AZ	96
Courtyard by Marriott	AL	90
Ramada Inn West	AZ	89
Holiday Inn Columbus	OH	81
Hampton Inn Sulphur/Lake Charles	LA	79
Comfort Inn & Suites	UT	78
Holiday Inn Express	TX	68

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