HVS

Conference Takeaways – The Lodging Conference 2022

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Contributions by **Kasia Russell**, **Eric Guerrero**, **Neil Flavin**, and **Emil Iskandar**.

The halls of the **JW Marriott Desert Ridge** were buzzing this week as thousands descended upon the Phoenix resort for this week's Lodging Conference. If you couldn't make it to the event, here's a quick recap of what you missed.

Rising Interest Rates Cool an Overheated Market That Offers Well-Performing Assets

Debt costs continue to rise, and the continually adjusting rates are moving some deals to the sidelines. We heard stories of rates changing multiple times during a due diligence period, and in some cases, if sellers are unwilling to adjust prices, deals are not closing. An example was a buyer we spoke to who was having to underwrite deals at current yields with premiums of up to 500 or 600 basis points, which can lead to IRRs of 10–12%, and some sellers are backing out at the resulting prices.

With another rate hike possible in November, this heightened level of debt cost (which many consider a return to normal), could persist for a while. The transactions market is falling into a less frenzied period, as deal pipelines for the remainder of the year were reported to be slim, along with available inventory. Furthermore, brokers, buyers, and sellers are reevaluating and repricing deals as the pace of interest rate hikes erodes purchasing power despite strong property-level performance. Moreover, distressed transaction volume is picking up, driven by special servicers, maturing senior loans, PIP requirements, and lagging conference/group business pickup in select markets.

Will Sellers Adjust to a New Market Reality?

In the weeks before the NYU Conference in the early summer, brokers were reporting deals going under contract above pricing guidance. The opposite is true today, as we exit the Lodging Conference. That can be a tough adjustment for sellers to make, as it was not long ago that buyers would accept low going-in yields (partly driven by abnormally low cost of debt). There are still some buyers out there with these low yield expectations, but the right story has to exist for the property and/or market.

Debt available to the hotel sector has also been curtailed by the strong performance of hospitality compared to other real estate sectors. Most lenders have balance sheet caps on hotels, and depreciation in other sectors is causing their segment of hotel debt to surpass those caps. Accordingly, lenders can be highly selective. While a 65% LTV financing package might be available, the lender might instead choose a similarly attractive 50% LTV/LTC deal. At this time, reported rates are in the 5.5–6.25% range, roughly.

Top-Line Forecasts Remain Positive

Despite a cooling transactions market, HVS, as well as its peers, expects the operating fundamentals of the industry to remain strong and the recovery to remain on course. **Kasia Russell**, Managing Director and West Region Leader for the U.S., presented our latest forecast of occupancy, ADR, and RevPAR (shown below), as well as the latest in cap rate, discount rate, and transaction trends for the industry. Despite concerns about lower levels of consumer discretionary spending caused by inflation, the industry is seeing strong post-summer forward bookings (particularly at leisure-oriented hotels).

Summary

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National Metric Forecasts as of August 2022

Year	Occupancy	ADR	% Chg	RevPAR	% Chg
2018	66.1%	$130		$86	
2019	65.9	131	0.8%	86	0.0%
2020	44.0	103	-21.4	45	-47.7
2021	57.6	125	21.0	72	60.0
2022	**63.0**	**145**	**16.6**	**92**	**27.1**
2023	**64.5**	**149**	**2.5**	**96**	**4.9**
2024	**65.5**	**155**	**4.0**	**102**	**5.7**

Source: STR (Historical), HVS (Forecast)

The return to office continues to be a sensitive topic, with prognosticators suggesting that a full recovery of office occupancy may not return until after 2030. However, the trend of extending business trips and now group stays to include additional leisure days is not cooling. The intensifying recovery in the group segment, a more gradual recovery in the business transient segment, and continued strong leisure demand all contribute to the illustrated forecast.

Lastly, new supply growth is anticipated to remain well below the industry average of 1.8% annually, with forecasters suggesting that supply will grow at only 1.0% to 1.2% in the near term. This expectation further supports the occupancy recovery and ADR growth forecast.

Other Factors to Consider

Most panelists agreed that labor challenges will remain as long as the federal government does not get a better handle on immigration policy. Technology is becoming more critical in light of these challenges, driving contactless check-ins, more specialized property-management systems, and other innovations.

Also discussed were challenges that are geopolitical in nature, mostly the war in Ukraine and how that conflict has affected inflation, supply chain problems, and a general sense of global instability.

Elements of environment, social, and governmental (ESG) policies and how they will shape the future of our industry were also top of mind.

Conversion opportunities are considered a growing option in light of heightened construction costs for new builds. The industry was highlighting recent success in economy to upscale boutique conversions, as well as select-service to extended-stay, and office to hotel, among others.

We Will See You Soon

We look forward to attending the **Latino Hotel Association**'s upcoming **conference in October** in Dallas and the **Caribbean Hotel Investment Conference & Operations Summit (CHICOS)** in November before next year's events kick off with **ALIS** in Los Angeles.

Many thanks to Harry Javer and the entire **Lodging Conference** team, as well as the operations team at the **JW Marriott Desert Ridge**, for pulling off an extraordinary event in Phoenix. The service and food were top notch, the hotel looked superb, and the event was flawless. A truly extraordinary week, and we cannot wait to return next year.

About Rod Clough, MAI, CRE, MRICS

Rod Clough, MAI, President – Americas, is in his 30th year with HVS and leads the Americas region from its headquarters office in Colorado. As President, Rod has developed the vision and strategy for the Americas and oversees its execution throughout the Americas' 40 locations. He has cultivated a firm that thrives with an extraordinary culture and remains the thought leader in the hospitality consulting space. He is proud to lead a group of 175 exceptional team members that execute thousands of engagements annually. Rod also has a passion for speaking, regularly sharing the insights and thought leadership of HVS at the nation's leading hospitality conferences. Rod is a graduate of Cornell's School of Hotel Administration, a Designated Member of the Appraisal Institute (MAI), a state-certified general appraiser, and a licensed hotel broker. Contact Rod at (214) 629-1136 or .