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Review of Issues Affecting Hotel Values

HOSPA & ICAEW Masterclass

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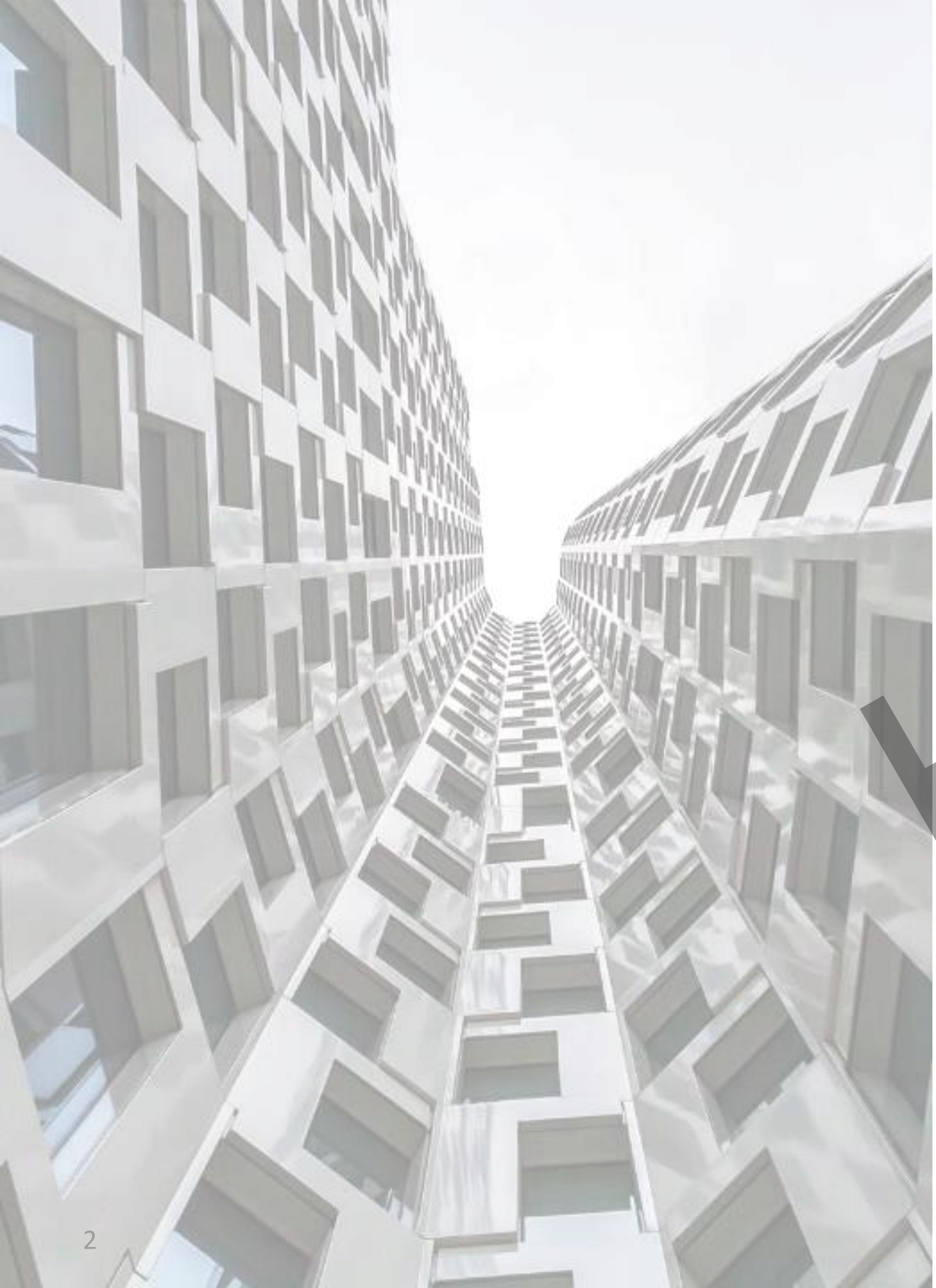
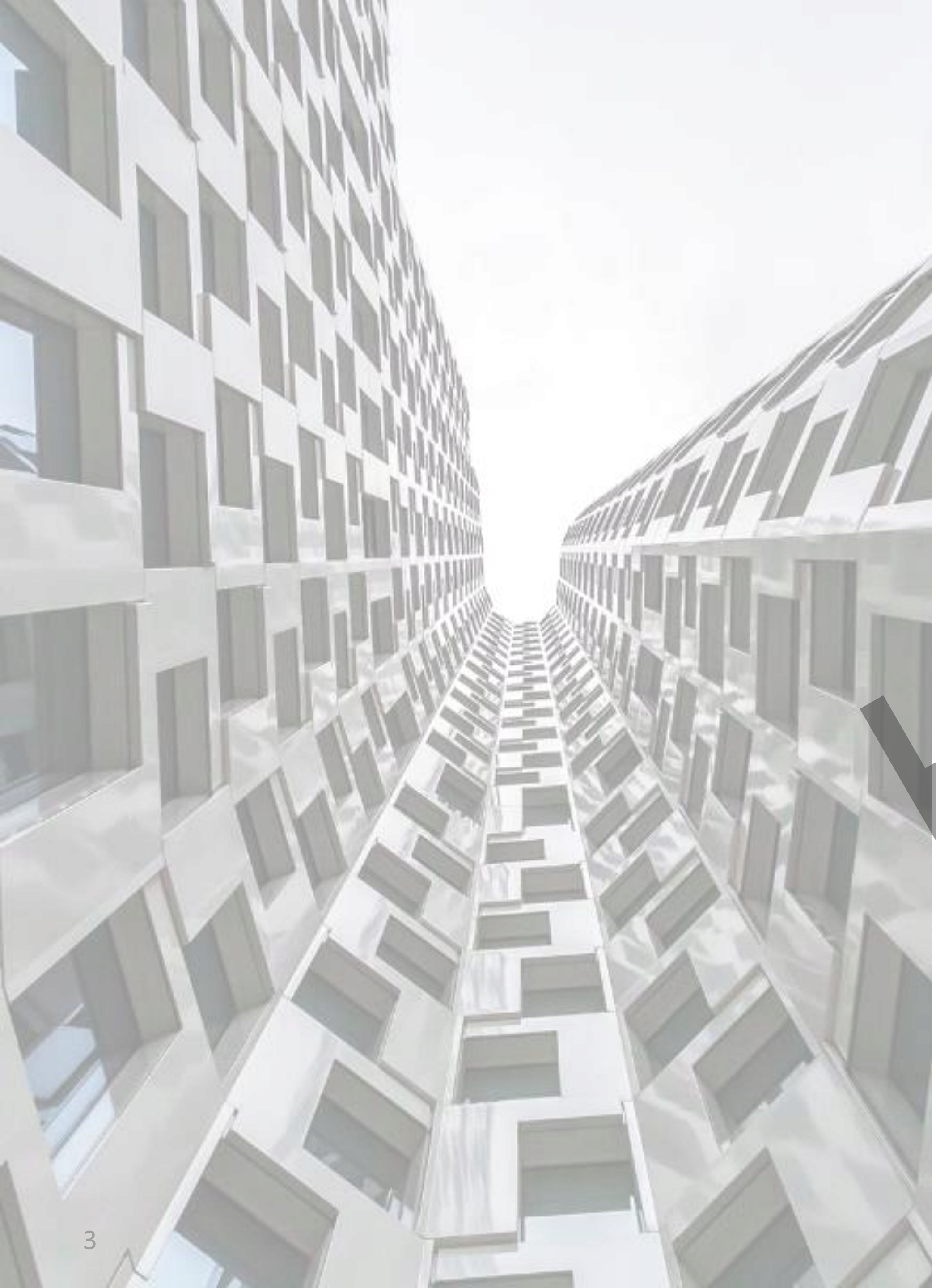


Introduction

The COVID-19 pandemic and the related restrictions on travel, business activity, and individual movement are having a significant impact on our industry. We don't know how long the pandemic will last, how long the related restrictions will be in place, or how much worse this could get for our industry. We also don't know the final, net impact on the economy.

We do know that the hospitality industry is extraordinarily resilient. Past "shock" events and downturns have caused business to plummet; however, the industry performance has always recovered. Even though the pace and degree of the COVID-19 downturn is unprecedented, market participants believe that the hospitality industry will recover and, as in the past, this cycle will create the opportunity for strong returns through well-timed and well-executed investment strategies.

Owners, operators, lenders, and investors are all facing greater challenges than ever anticipated. HVS is here to help. We have a strong team of senior leaders who have been through numerous prior cycles. With the knowledge and expertise gleaned from past downturns, HVS is available to support you, your hotels, and your investors as we navigate these challenging times.



Agenda

1. How are hotels valued?
2. An unprecedented downturn
3. Looking ahead
4. Impact on hotel values
5. Conclusions

How are hotel values measured?

Simplistic…

- Present value of expected future cash flows
- Sales comparisons – amount per room
- Replacement cost

Even more simplistic…

- Multiple of profits
- Yield

What we used to do…

- Rule of a thousand

Utterly fascinating…

- Can of Coke method

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‘I think you’re meant to *multiply* by a hundred thousand – not try and *drink* a hundred thousand…’

Market Value

*"The **estimated amount** for which an asset should exchange on the **date of valuation** between a **willing buyer** and a **willing seller** in an **arm's length** transaction after proper marketing wherein the parties had each acted **knowledgeably, prudently** and **without compulsion**."*

Royal Institution of Chartered Surveyors

Hotel valuation methods

- Sales Comparison Approach
- Depreciated Replacement Cost
- Income Capitalisation Methods

Valuation methods

Method	Uses / Advantages	Limitations
Sales Comparison	▪ Provides a range of values ▪ Gives an indication of real buyers' motivations ▪ Compares sales of actual hotels	▪ No hotel is truly comparable ▪ Value is dependant on buyer's motivations ▪ Economic environment may (and most probably will) differ ▪ Reliable sales data not always available ▪ Currently very few transactions, limited transparency
Depreciated Replacement Cost	▪ Construction cost estimate at today's prices less depreciation allowance ▪ Useful for new properties	▪ Not always applicable, especially when considering 'old' hotels ▪ Doesn't reflect investor rationale ▪ Depreciation can be physical, functional, and/or external

Method	Uses / Advantages	Limitations
Income Capitalisation – Single Multiple	▪ Quick approach ▪ Commonly used and widely understood	▪ Only based on one year's net income ▪ Doesn't reflect increases/decreases in net income ▪ Not always reliable
Income Capitalisation – Future Multiple	▪ Takes some account of the impact of future cash flows ▪ Useful where assets are currently underperforming	▪ Needs skill and hotel operational knowledge ▪ Still only based on one year's net income ▪ Still doesn't reflect the fluctuations in net income
Income Capitalisation – DCF	▪ Thorough approach ▪ Reflects the rises and falls in net income ▪ Increasingly used and widely understood	▪ Based on forecasts of five/ten years' net income – not 'quick and dirty' ▪ Valuers need more exposure to and understanding of the local hotel market

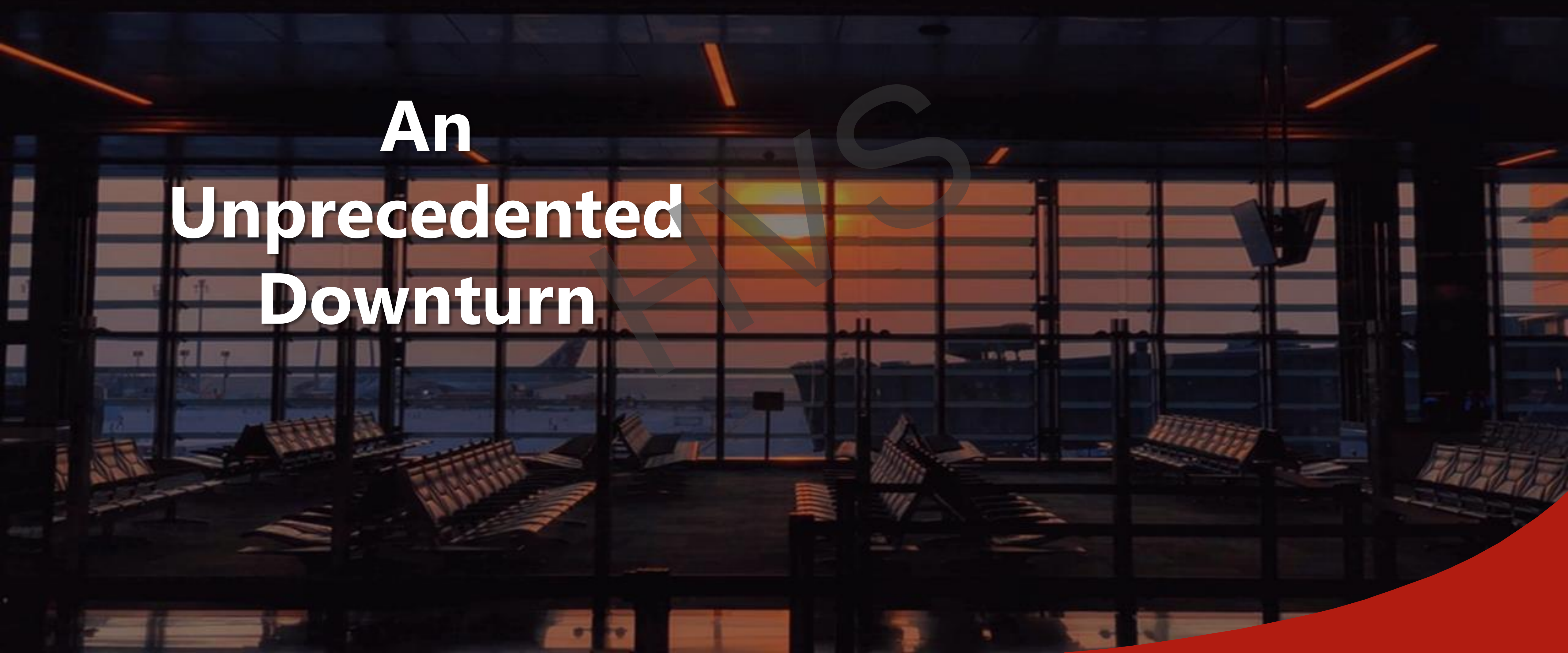
HVS Valuation Methodology

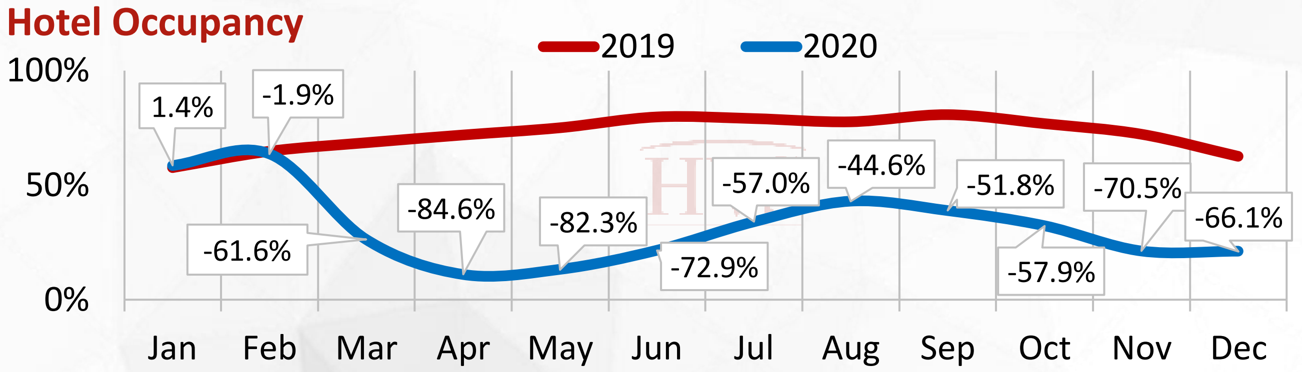
- Market study
- Derivation of occupancy, room rate
- Projection of income and expense
- Sensitivity analysis
- Application of valuation parameters
- Cross-check with market evidence
- Can be applied to existing hotels and proposed developments

HVS Valuation Methodology (cont'd)

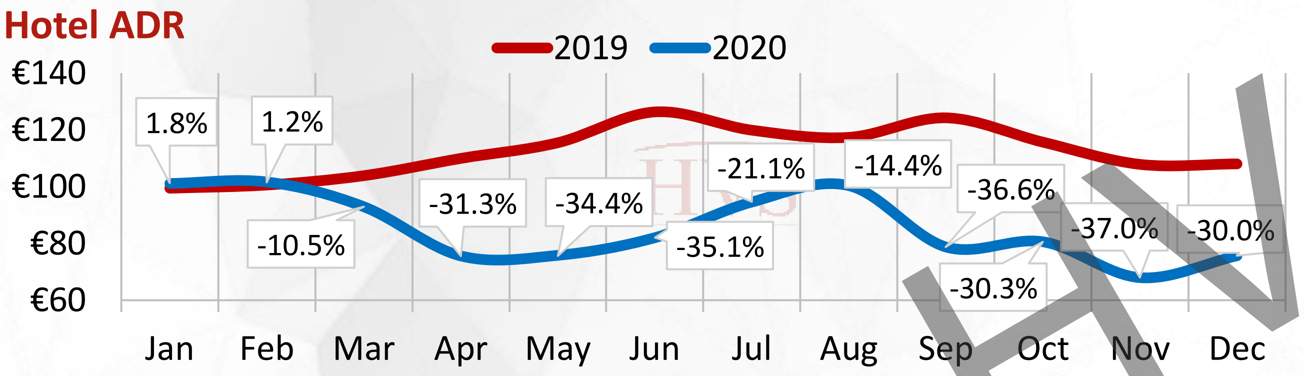
- Ten-year holding period assumed
- Assumed sale at end of year 10
- Investment is assumed to be leveraged
- Appropriate market lending parameters adopted
- Net cash flows split between debt and equity components
- Each component discounted at market rates
- Value calculation performed using the Simultaneous Valuation Formula
- Cross checks – comp. sales and replacement cost

An Unprecedented Downturn

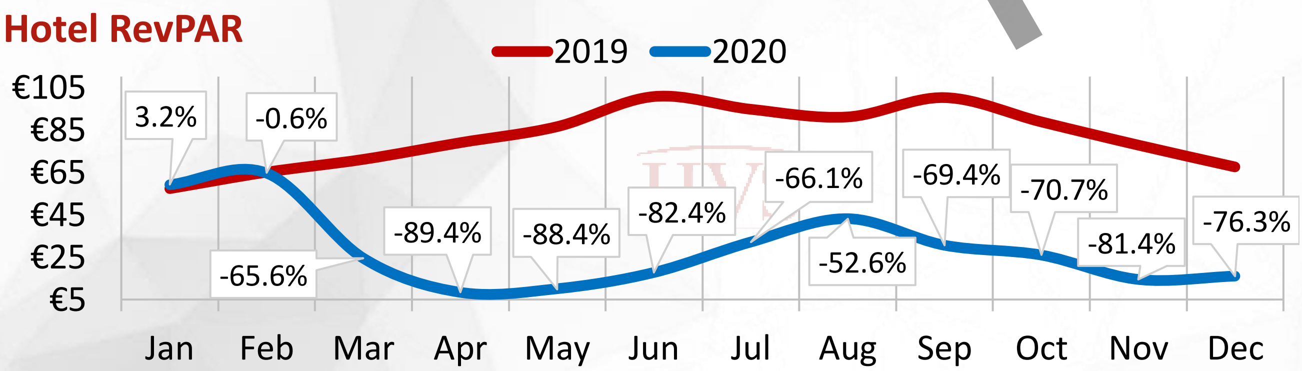




FY20 VS 19
-54.4%
-63.2%*
*Including Closed Hotels



FY20 VS 19
-19.4%
-17.2%*
*Including Closed Hotels



FY20 VS 19
-63.1%
-69.5%*
*Including Closed Hotels

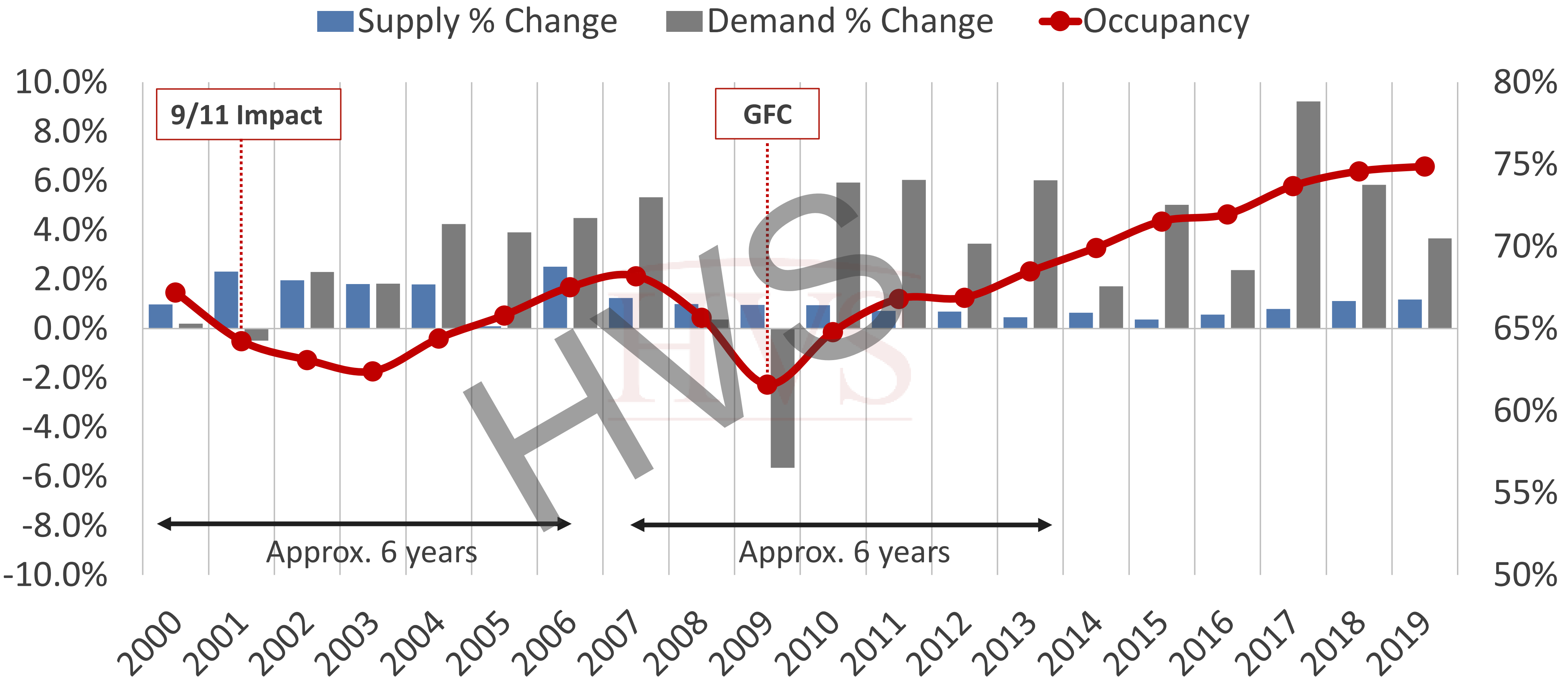
Data for Europe show substantial Y-o-Y declines – partial summer improvement followed by renewed winter declines

Monthly data exclude hotels that were closed

Data Source: STR

Demand proved resilient to previous shocks

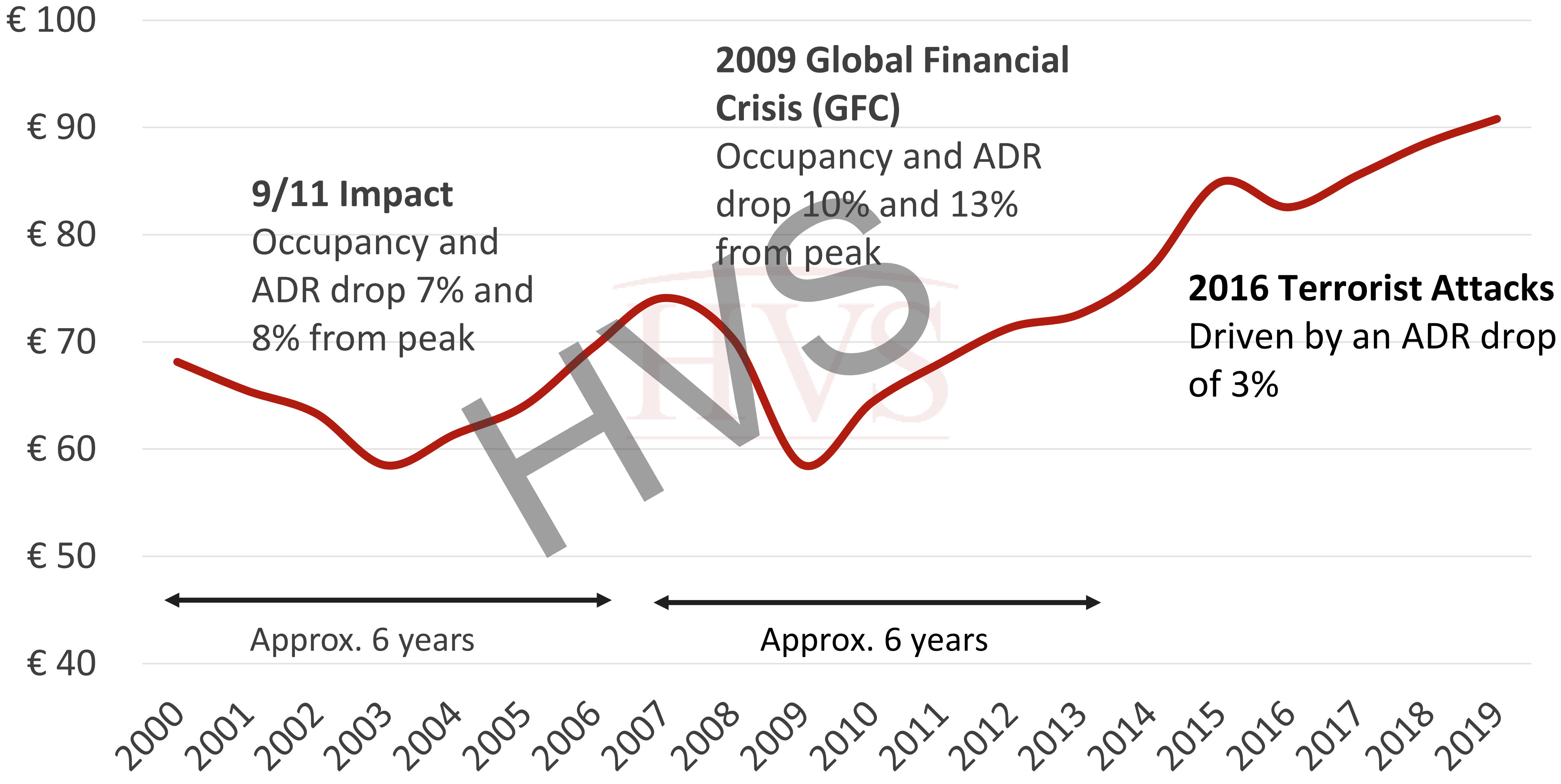
Europe Overall



Sources: Eurostat; UNWTO; STR

RevPAR recovery averaged 6 years

Europe Overall



Source: STR

Looking Ahead

Winners and losers in the recovery

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More Vulnerable

- Full-service hotels, dependent on groups and/or MICE business
- Hostels with dorms
- Luxury hotels
- Gateway markets that depend on international travel
- "Fly to" markets that depend on air travel
- Airport hotels
- Independent properties
- Markets influenced by the energy sector

Secondary and tertiary markets
↓
hold up better & trade at a smaller discount to 2019 prices

Gateway and primary markets
↓
more volatile, larger value declines in the near term, with greater potential for accelerated appreciation thereafter

Less Vulnerable

- Hotels that primarily rely on transient segments
- Markets accessible by car should recover faster than those dependent on air travel
- Suburban, smaller properties
- Extended-stay hotels /apart-hotels / serviced apartments with self-contained units
- Properties affiliated with strong brands
- Economy / midscale properties

Key trigger points to revive hotel demand

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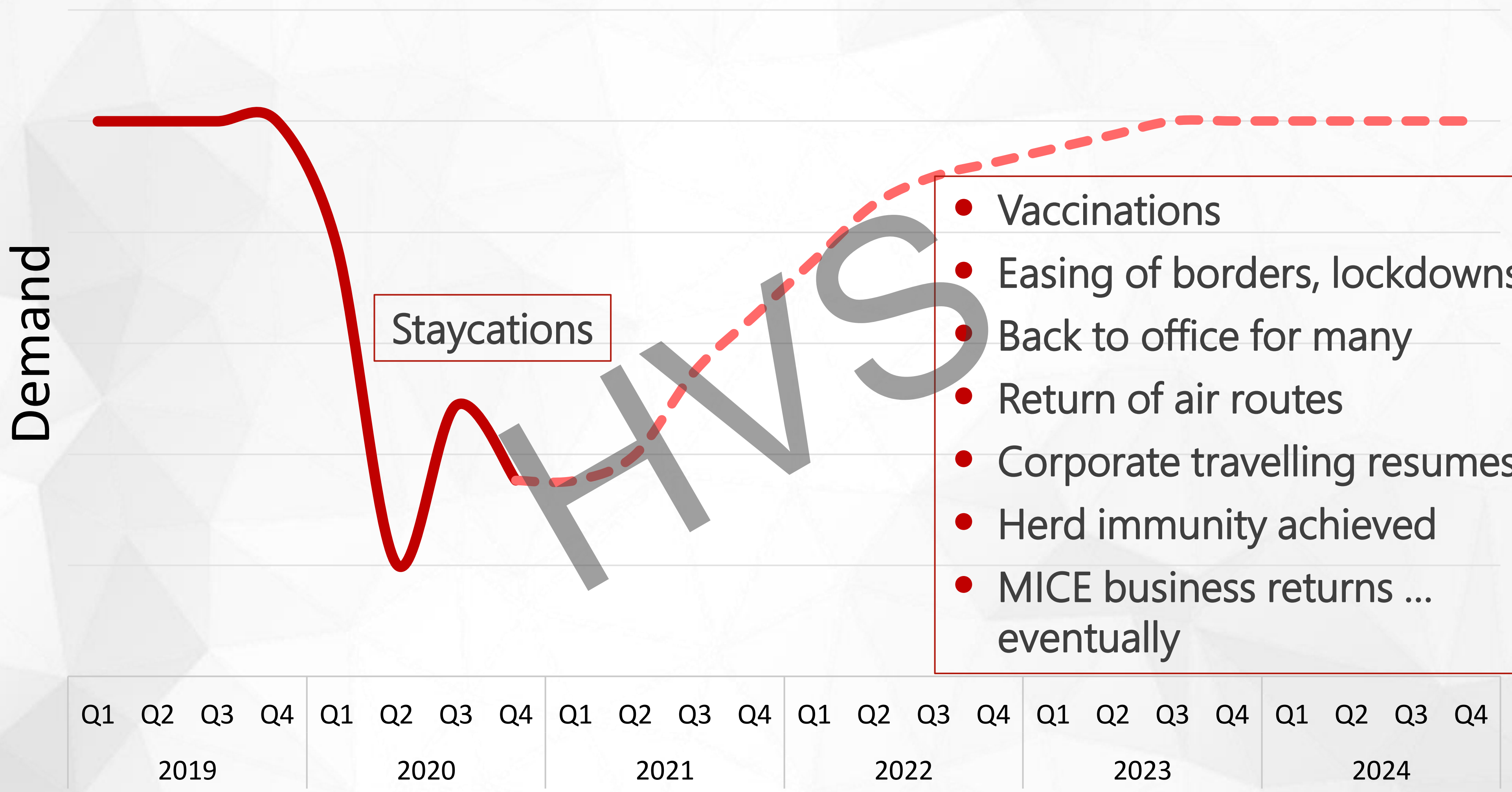


- Vaccinations
- Easing of borders, lockdowns
- Back to office for many
- Return of air routes
- Corporate travelling resumes
- Herd immunity achieved
- MICE business returns … eventually

Meaningful hotel recovery anticipated from 2022

	Historical			Forecast			
	2018	2019	2020	2021	2022	2023	2024
Occupancy	72%	72%	27%	45%	63%	70%	72%
Percent Change		*0.3%*	*-63.2%*	*69.9%*	*40.2%*	*10.5%*	*2.9%*
Change vs. 2019			*-63.2%*	*-37.4%*	*-12.2%*	*-3.0%*	*0.0%*
Average Rate in €	113	111	92	97	105	111	116
Percent Change		*-2.1%*	*-17.2%*	*5.7%*	*7.8%*	*5.8%*	*5.0%*
Change vs. 2019			*-17.2%*	*-12.4%*	*-5.6%*	*-0.2%*	*4.8%*
RevPAR	82	80	24	44	66	78	84
Percent Change		*-1.8%*	*-69.5%*	*79.6%*	*51.1%*	*16.8%*	*8.0%*
Change vs. 2019			*-69.5%*	*-45.2%*	*-17.2%*	*-3.2%*	*4.5%*

Source: STR (Historics) and HVS (Projections)

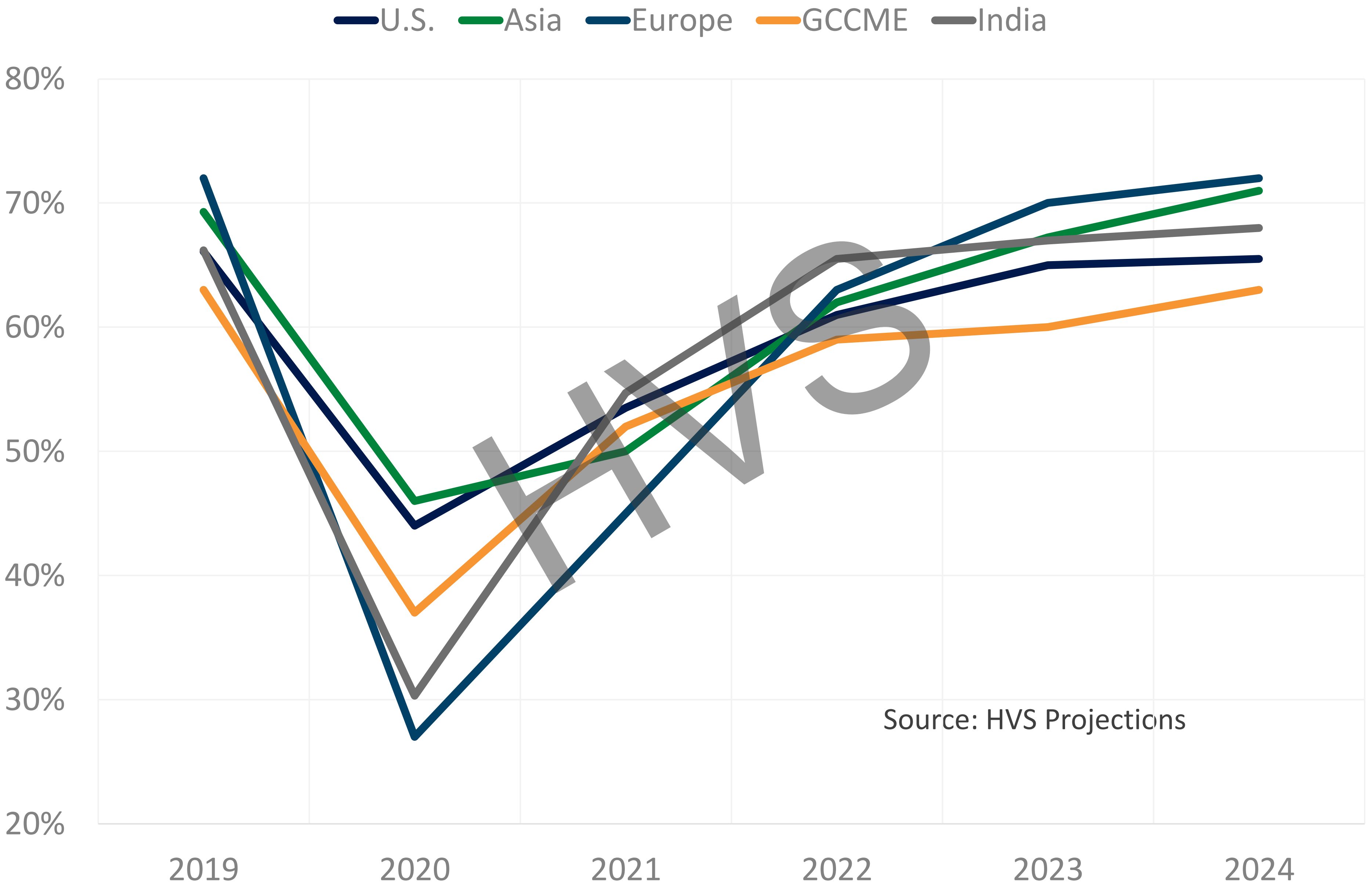
Assumptions

2021 – continuing suppressed RevPAR in H1; we project occupancy to build up from H2 and recover by 2024, i.e. within 4 years

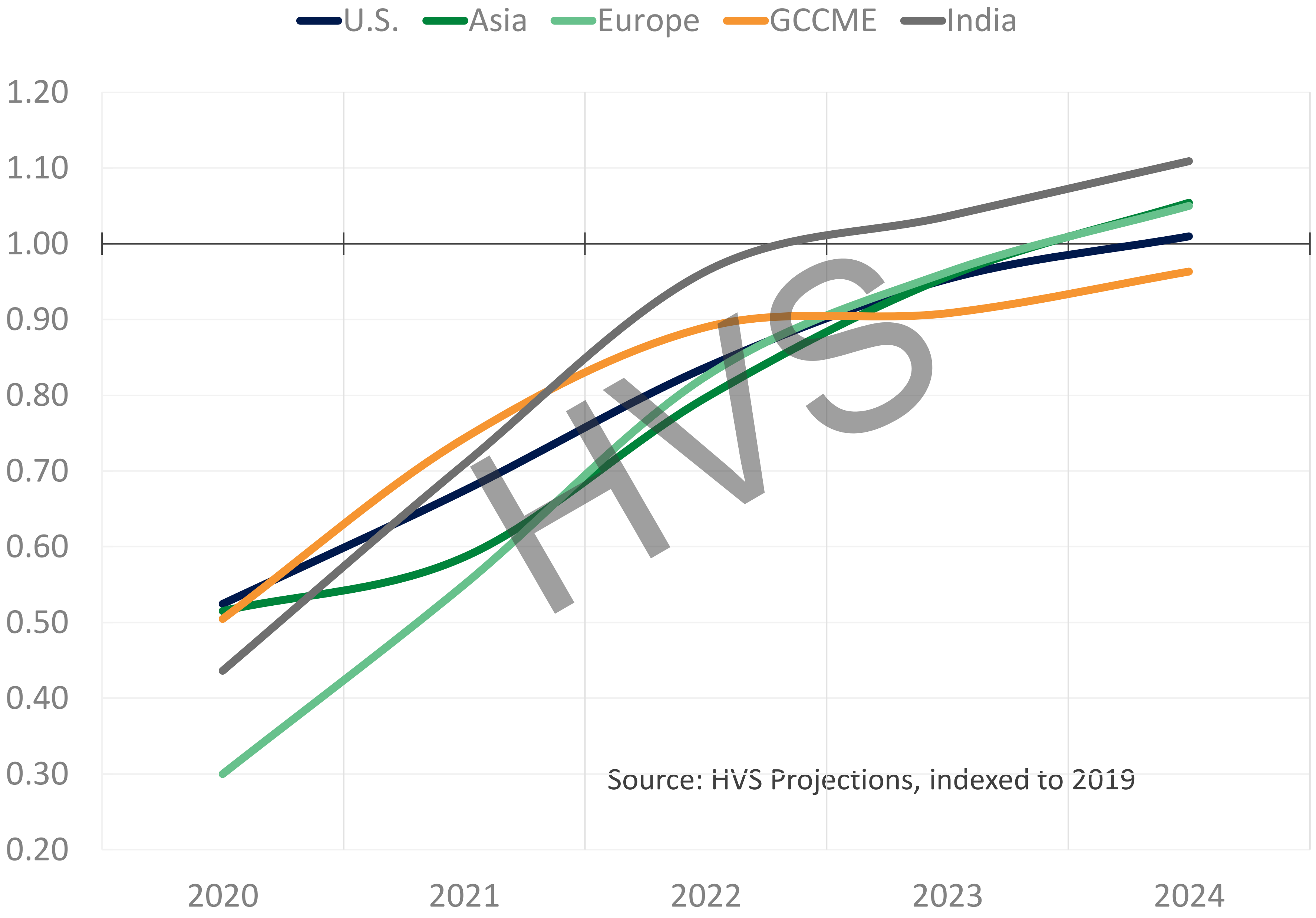
Average rate – expected to lag behind, but a narrowing of the gap by 2024 (deflated to 2019 levels)

Differences in recovery times between markets and individual properties are expected

GLOBAL occupancy levels return by around 2023-24



GLOBAL RevPAR returns by around 2024



We expect the wider supply pipeline to shrink

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Given recent events, supply growth now expected to be reduced, at a slower pace, than previously anticipated

Under-construction projects may face **delays with materials/FF&E**, pushing back opening dates

Market conditions will likely lead to delayed openings. Some projects may be placed **on hold** indefinitely

Financing challenges will delay construction start dates

Changes in market conditions may render proposed projects unfeasible; some projects may be **postponed or cancelled**

Some **properties may close and not re-open**, resulting in negative supply growth

- Operating costs cut to the bone, minimize expense levels, opportunity to rethink policies, procedures and service standards from top to bottom
- Limiting "touchpoints," supplemented by increased reliance on technology, supports reductions in staffing and service costs
- Food and beverage service curtailed, reduced or re-engineered
- New cleanliness & safety protocols produce additional operating costs but can be mitigated by other operational savings (e.g. payroll)
- Retaining these savings will enhance operating leverage as demand and revenue recovers
- Owners and operators reporting lower break-even occupancy levels: e.g. 25%-35% limited-service hotels, 40%-45% full-service hotels

Positive operating leverage and enhanced operating efficiency will support EBITDA recovery

Hotel Values

Values declined substantially in 2020, mainly because of...

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Loss of income

Sharp revenue declines → more significant decreases in EBITDA (in many cases, negative)

Debt

Market has pulled back from the hotel sector. Lower LTV ratios and/or higher spreads could result in higher interest rates, despite continuing low rates imposed by central banks

Bid-Ask gap between buyers and sellers

Currently hampering transactions but is expected to narrow with ongoing financial pressure

Market value: willing buyer and willing seller

Downward Pressure

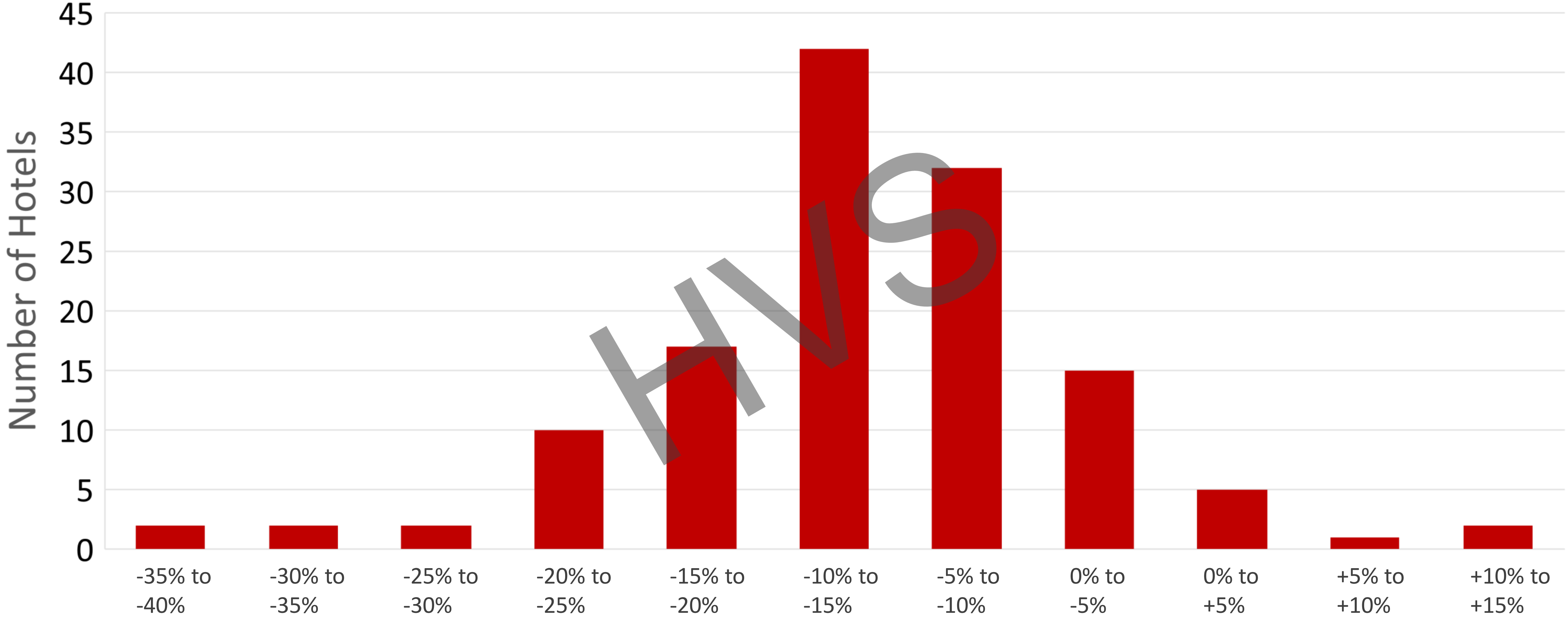
- Unprecedented revenue and EBITDA decline
- Economic recession
- Longer recovery of MICE business
- Uncertainty regarding return of normalised travel patterns
- Potential for prolonged recovery, re-infection
- Cash drain may force owners to sell

Upward Pressure

- Improved business operating model
- Return of positive operating leverage
- Yield-hungry funds lining up capital should create competition and help to sustain values
- Low cost of capital likely to continue
- Some lenders will wait for values to rise before losses are recognised

European hotel values declined mainly between 5% and 15%

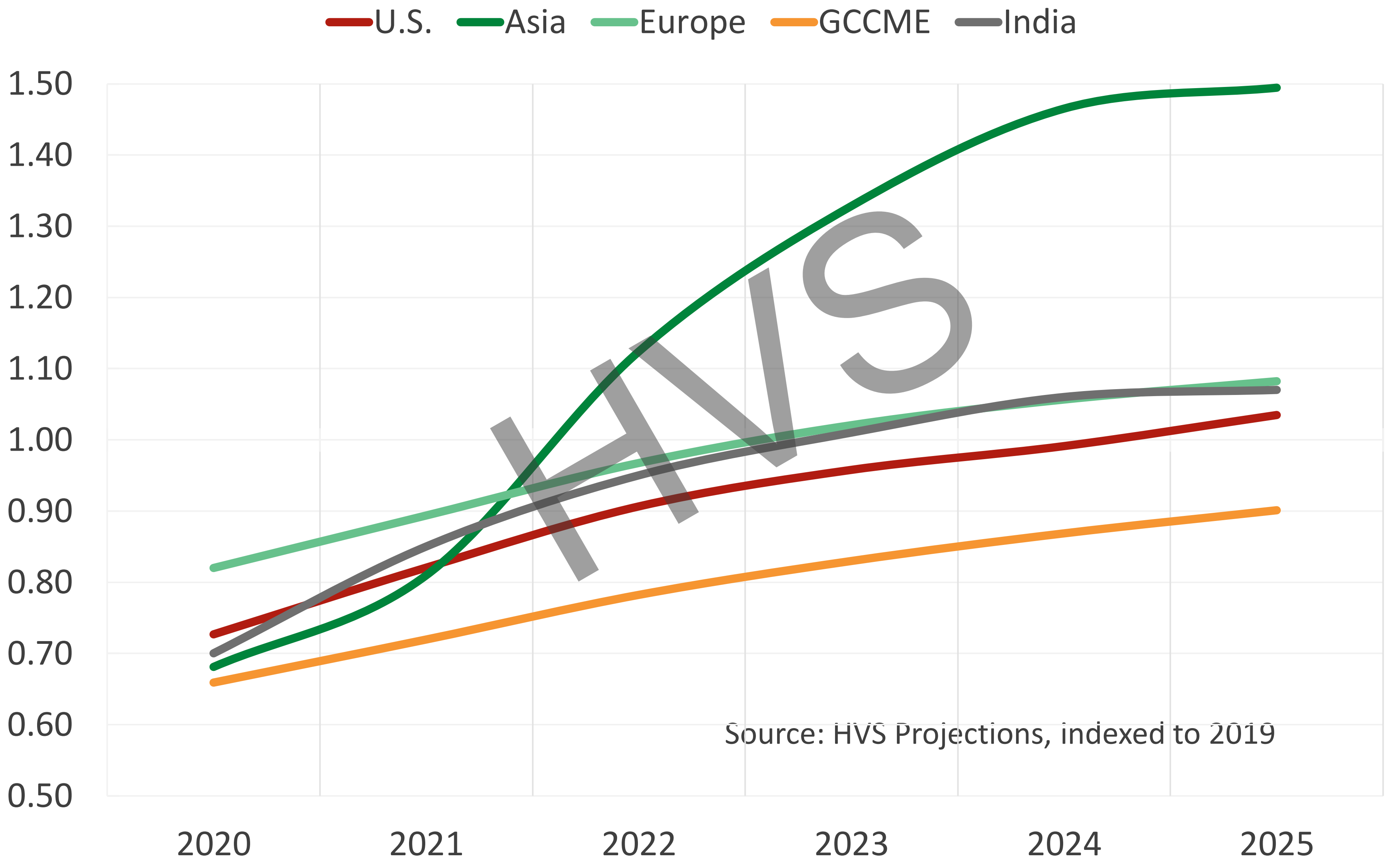
HVS 2020 valuations vs. same hotels in 2019



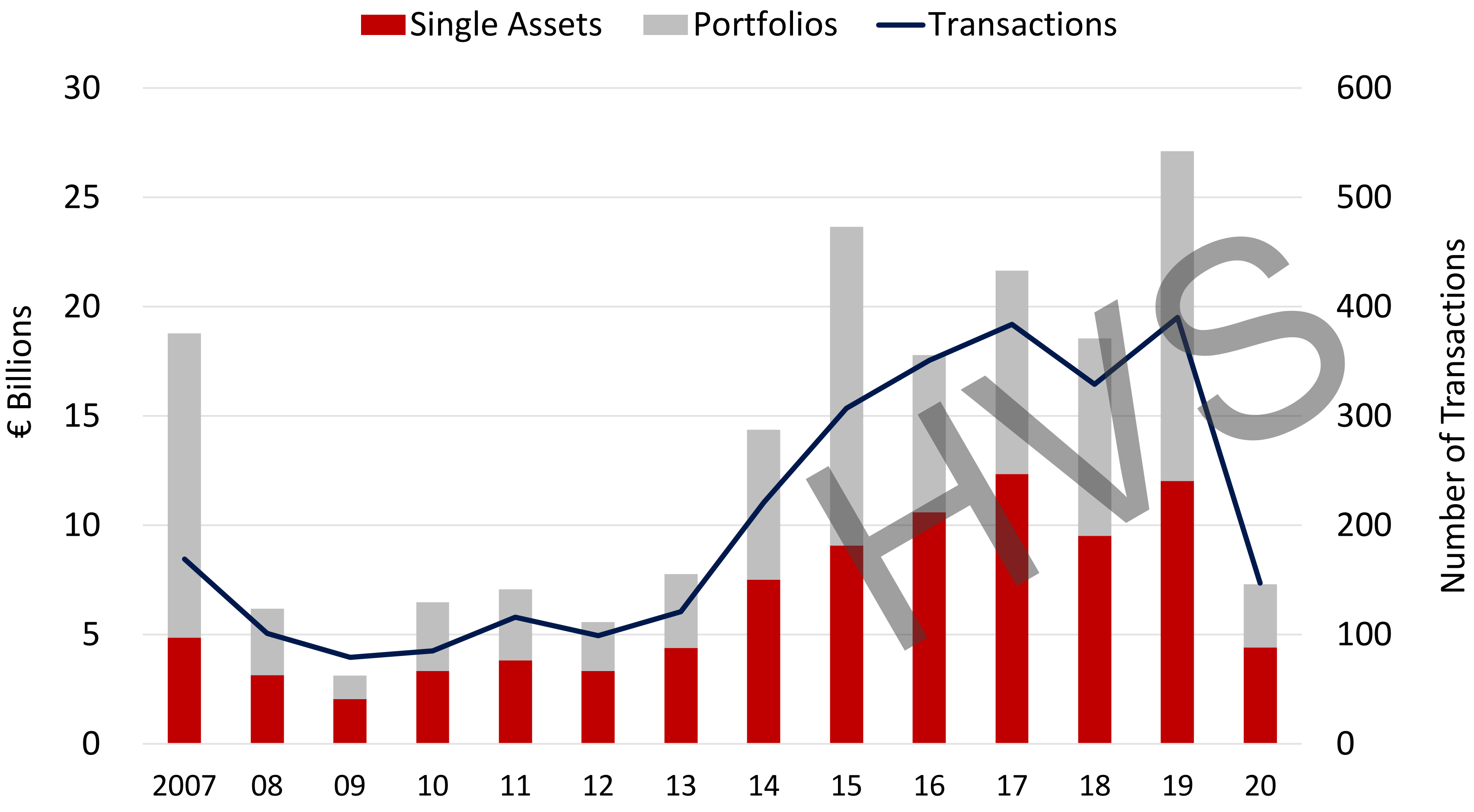
Sample Size: 130 properties across Europe

Source: HVS

GLOBAL values to return *mainly* by around 2024-25



What about the Transactions market?



Source: HVS Research

- Transaction volume declined 70% in 2020 – remained well above 2009 low
- Significant equity raised to invest in hotel assets
- Competition limiting discounts from pre-COVID levels
- Debt markets have opened to hospitality again – primarily private debt funds

Conclusions

Conclusions

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RevPAR levels depressed until travel and other restrictions lifted, individuals comfortable travelling again and staying at hotels (vaccine will help)

Occupancy should recover faster than average rate – hotels use price to stimulate demand recovery

Supply growth slows – projects under construction delayed, new projects postponed or abandoned

Hotel operations suspended / many hotels closed – helps to minimise EBITDA losses

Hotel values decline – to remain depressed until EBITDAs "hit bottom" and there is evidence of recovery

Hotel discount rates elevated in the near term – location, market and property specifics help determine the degree of elevation

Weight of capital might limit price discounting for hotel assets → most specialist hotel investors have not changed their investment strategy

Over the longer term, hotel values will recover as cash flows improve and capital markets return to more traditional parameters

Opportunity for high returns – for well-capitalised buyers to acquire hotels at prices below replacement cost and recent norms … 'soon'

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Thank you!

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Superior Results Through Unrivalled Hospitality Intelligence. *Everywhere.*

HVS has been supporting the hospitality industry in Europe and around the world for more than 40 years. Our senior staff represents a collective 300+ years of experience advising our industry, including through multiple prior cycles and events.

With an office in London since 1990, **HVS LONDON** serves clients with interests in the UK, Europe, the Middle East and Africa (EMEA). We have appraised some 4,000 hotels and serviced apartments in 50 countries in all major markets within the EMEA region for leading hotel and serviced apartments companies, owners and developers, investment groups and banks.

This knowledge and experience is available to support you as you navigate these challenging times. Our platform is fully functional on a remote basis, so even though we are not currently travelling, our staff can access the full resources of HVS on your behalf.

Let us know how we can assist you.

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Market Study
Investment Search
Product Recommendation
Financial Projections
Financial Feasibility Analysis
Economic Impact Analysis
Architectural Concept Design
Construction Costs Estimates

ACQUISITION & DEVELOPMENT

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Appraisal for Financing
Debt & Equity Financing
Due Diligence Coordination
Brand Selection & Contract Negotiations
Operator Selection & Contract Negotiations
Interior Design & Project Management
Executive Search
Pre-Opening Oversight

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Management Agreement Analysis & Negotiation
Hotel Management
Appraisal for Refinancing
Operation Performance Analysis
Repositioning Study & Valuation
Repositioning Design & Budgeting
Timeshare Conversion Review
Capital Improvement Financing

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