February 2021

Research Hotels & Hospitality

Hotel Investment Outlook 2021

A Window to Resilience and Recovery

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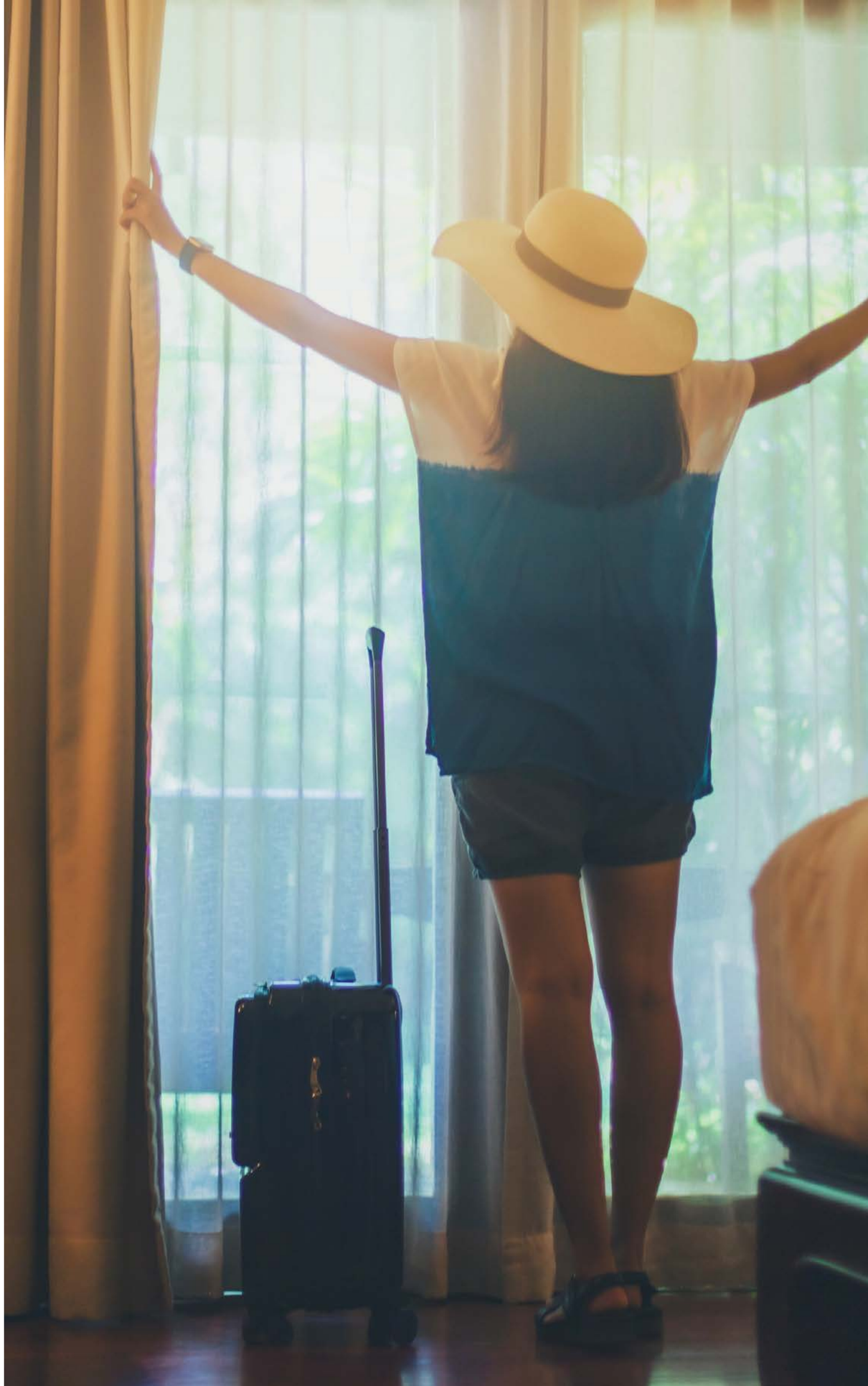


After enduring a dramatic shock to performance, the global lodging industry is eager to move forward.

The global lodging industry experienced a transformational year in 2020 following the onset of what became a global pandemic with the spread of COVID-19. The pandemic has brought havoc and devastation to every part of the world. At the time this report was written, COVID-19 has caused the deaths of two million people globally. Thousands have lost family members, jobs and a sense of purpose. Not making light of the toll on human lives, the pandemic has also taken a toll on the global economy with prognosticators expecting a decline of 4.4% in 2020. Worldwide, hotels were forced to close with lodging demand drastically retracting and bottom lines plummeting. 2020 also saw the highly anticipated Airbnb, Inc (Airbnb) IPO come to fruition. The impact of 2020 on the hotel and hospitality industry will endure for years to come and in many ways redefine the travel experience of tomorrow.

Throughout 2020, global hotel investors were plagued with uncertainty as travel restrictions and mandatory lockdowns drove down both leisure and business travel. Leisure travel proved to be a stronger segment of demand throughout the pandemic as travelers experienced lockdown fatigue and planned 'last minute' trips, escaping to drive-to destinations. With advancements being made around a vaccine, leisure demand is expected to recover more quickly, as corporate and meeting travel demand remain challenged given the rise of virtual meetings and working-from-home arrangements. Moreover, with pressure mounting for global companies to more aggressively adopt environmental, societal and governance (ESG) principles, many are expected to reduce their travel budgets to help lower their carbon footprints and reallocate funds to fullfiling ESG goals. In a post-covid-19 world, we could see the make-up of corporate demand return with a reduced number of trips but longer lengths of stays.

These shifting demand dynamics create a sense of urgency for hotel operators to redefine today's hotel lodging experience to better fit the needs of both leisure and corporate travelers. Everything from the size of the hotel room to technological features need to be reimagined to best capture a demand base looking for a seamless and contactless experience. Individual, private and comfortable spaces that can accomodate longer stays and enhance work productivity will be preferred. Hotels are expected to be one of the fastest commercial real estate sectors to recover once a vaccine is made widely available. As such, investors who enter the market now will be best positioned to reap the benefits of the industry's recovery.

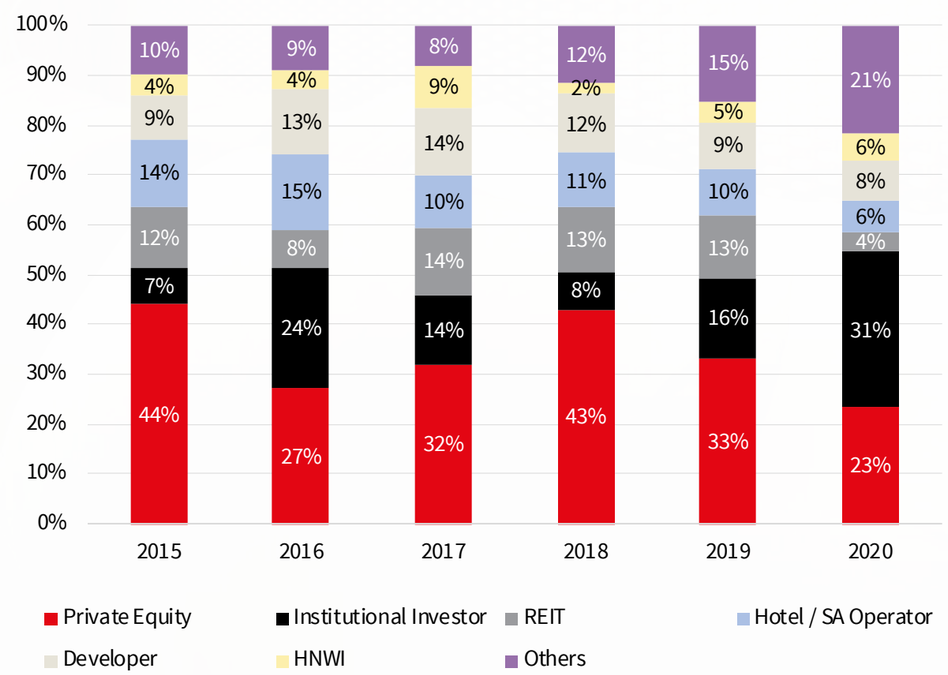
After enduring a dramatic shock to performance, the global lodging industry is eager to move forward. (continued)

At the beginning of 2020, we expected global hotel liquidity to be down 10 to 15% by year end but instead global transaction volume ended more than 60% down on 2019 levels. In a zero cash-flow environment, asset valuations became increasingly challenging, making it difficult to obtain debt financing. Nevertheless, lenders were incredibly accommodating to hotel owners by granting forbearance agreements, where possible. The more flexible operating environment deterred owners from putting their properties up for sale and as a result, acquistions were largely on hold.

The deals that did cross the finish line were well underway prior to the pandemic, with nearly 50% of all transaction closings taking place during the first three months of the year. Other hotels that traded involved the conversion of a hotel to an alternative use or the participation of a motivated seller willing to come down on pricing to strike a deal.

Private equity groups and institutional investors drove liquidity in the market and accounted for 54% of total volume for the year. These investors responded to shifts in hotel demand and leisure traveler preferences by adjusting their investment strategies to acquire assets in less dense markets and resorts. In fact, assets located in resort markets represented 21% of global hotel investment activity, two times the proportion observed in 2019. As we look at 2021, we expect investors to not only continue favoring assets in less dense and resort markets but also those assets that implemented swift changes to support changing guest expectations by focusing on technological advancements and wellness.

Global Hotel Transaction Volume by Buyer Type 2015 to 2020



Source: JLL Research
Notes: Other includes corporates, sovereign wealth funds, receiver and pub operator.

While COVID-19 will have long-term implications on the global hotel and hospitality industry, over the short-term we anticipate the following to be notable trends in 2021.

Trends

1. **Private equity groups and high-net-worth individuals (HNWI) anticipated to be active purchasers of hotel assets in 2021...**read more

2. **Hotel parent brand companies supporting the evolution of traditional management agreements via "Manchises"...**read more

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1 Private equity groups and high-net-worth individuals (HNWI) anticipated to be active purchasers of hotel assets in 2021.

In 2020, USD24.5 billions in capital was raised in closed-end funds targeting hotel assets globally, matching the levels recorded in 2016. With signficant dry powder on hand, these well capitalized private equity groups are preparing to pounce on assets that become available for sale at an attractive basis and are expected to drive the bulk of liquidity in 2021. As an example, global private equity fund Blackstone, which has more than USD584 billion in assets under management as of September 2020, reportedly has USD152.4 billion in dry powder and is experiencing renewed momentum in both capital deployments and realizations.

In addition to private equity funds, HNW individuals/ family offices are also turning their attention to distressed assets in the hospitality sector, in anticipation that these will be amongst the first commerical real estate assets to recover following the wide distribution of a vaccine. Potential targets include trophy hotel assets that become available on and off the market in gateway cities, such as Hong Kong, New York and Singapore. These investors will be looking to capitalize on opportunities that rarely come to market.

While the level of distress across the lodging industry remains relatively limited, as banks and governments were generally accommodative in 2020, pressure is building as hotel owners continue to be weighed down by high carrying costs. This dynamic will result in the sale of hotel assets situated in typically tightly held markets. Price-to-market opportunities are expected to arise as owners exit out of non-core and non-strategic investments.

We anticipate opportunities for acquisition to emerge across:

- **Resort markets or urban centers largely dependent on fly-to international travel demand**
- **Primary or secondary markets with an over reliance on group and corporate demand**
- **"Big box" assets located in the major gateway markets, particularly those with high fixed costs**

As a result, in 2021 we expect global hotel investment volume to mark an increase of 35 to 40% from 2020 levels.

Note: Pertains to closed-end real estate funds raised globally. Volume of funds pertains to groups that target hotels exclusively and groups with a diversified investment strategy that includes hotels and hospitality.

Americas

All regions seeing a flurry of fundraising activity with opportunistic capital ready to capitalize on distress

With record levels of funds awaiting to enter the hotel space, not only are traditional investors keen to deploy capital but new entrants are making way into the space, including family offices, HNWIs and hedgefunds. This includes firms establishing funds for the sole purpose of acquiring distressed hotel assets. With an investment horizon of five to seven years, these investors find the current trading environment appealing as they see prospects for capital appreciation once the travel industry recovers. As an example, Monarch Alternative Capital announced that it has raised approximately USD3 billion of capital to capitalize on distressed opportunities emerging due to COVID-19. Real estate is a vertical that the investment firm is looking to focus on.

In April 2020, Florida-based firm Kayne Anderson raised USD1.3 billion for a distressed debt fund in two weeks amidst the global pandemic, which would have otherwise taken between a year and 18 months. This further exemplifies how investors are capitalizing on opportunities during the pandemic to pick up real estate debt made available in the market by troubled real estate lenders.

Asia-Pacific

Private equity funds and HNWIs will be key buyers to watch in the region in 2021 as evidenced by recent transaction activity. In November 2020, private equity fund, Iris Capital, acquired a 17-hotel portfolio located across Sydney, Melbourne, Canberra and Brisbane from AccorInvest for more than USD130 million. The sale comprises four ibis hotels and 13 ibis Budget hotels, marking the largest hotel sale in Australasia during the year. The fact that a sale of this scale consummated amidst the global pandemic signals private equity groups' increasing appetite to invest in the hotel space.

In October 2020, Hong Kong-based private equity fund, Alta Capital Real Estate, launched its new fund aimed at investing in undervalued sutainable and wellness oriented hospitality assets across Asia Pacific. Its target assets include those located in key urban and resort locations such as Indonesia, Japan, Korea, Malaysia, Sri Lanka, Thailand and Vietnam. The fund hopes to reposition, rebrand and redevelop these assets to welcome guests in a post-COVID-19 environment.

Earlier in June 2020, Allen Law of Singapore based Park Hotel Group and Kishin RK of Singapore-based RB Capital co-founded and seeded HotCap Asset Management, also with the aim to invest opportunistically in distressed and undervalued assets. Similarly in April 2020, one of Asia's leading investment managers, PAG, announced that it had raised USD2.75 billion in investor commitments via its Secured Capital Real Estate Partners (SCREP) VII fund, which will focus on distressed debt and property investments in Japan, as well as real estate assets in China, Australia, Korea and other selected markets.

EMEA

In December 2020, the U.K. announced the extention of rent protection to March 31, 2021, which bans landlords from evicting tenants and other business owners from their premises, including hotels. This scheme will likely limit the level of hotel distress anticipated to emerge across Europe in 2021.

Global private equity groups are keeping a watchful eye on opportunities that emerge in the region, as evidenced by Blackstone closing its largest-ever European dedicated real estate fund in April 2020 worth USD10.7 billion.

Further, in July 2020, private equity fund Schroders Real Estate Hotels raised approximately USD515 million of equity commitments for its debut hotel fund, with a target of eventually raising more than USD600 million. The fund will aim to create a diversified portfolio of hotels across Western Europe by focusing on acquiring and operating hotels independently or under a franchise or hotel management agreement rather than acquiring assets that are leased to a brand hotel operator.

2 Hotel parent brand companies supporting the evolution of traditional management agreements via “Manchises”.

Hotel investors have a choice when selecting a brand or manager for their hotels: either hire a hotel parent brand company to manage the hotel under a management agreement or hire a third-party management company under a franchise agreement. Recently, hotel parent brand companies have responded to the changing needs of hotel owners and evolving markets to make management agreements more versatile and flexible. These changes, in part, were triggered by the rapid rise of third-party or white-label management companies over the last decade that operate hotels on behalf of owners.

Third-party management companies tend to offer shorter term contracts and can more easily be terminated if the owner feels that the asset is underperforming or would like to sell it unencumbered. By exiting the investment and selling the asset unencumbered, hotel owners have the potential of attracting a wider investor pool, which can result in enhanced pricing and returns.

Nevertheless, through traditional management agreements, which can range from 10 to 15 years, hotel owners can avoid franchise fees and reap the benefits of being part of a large platform that is skilled in hiring and training and that can offer brand resources coupled with robust distrubtion channels. Hotel parent brand companies have focused on expanding their management agreements as a way to limit volatility in brand distribution and satisfy shareholders eager for lengthy fee annuities.

These objectives are often at odds with hotel owners as they limit their control over the asset and result in costly management fees – sometimes up to 15% of monthly profit. These dynamics coupled with increasing competition from third-party managers have motivated hotel parent brand companies to formulate more creative agreements.

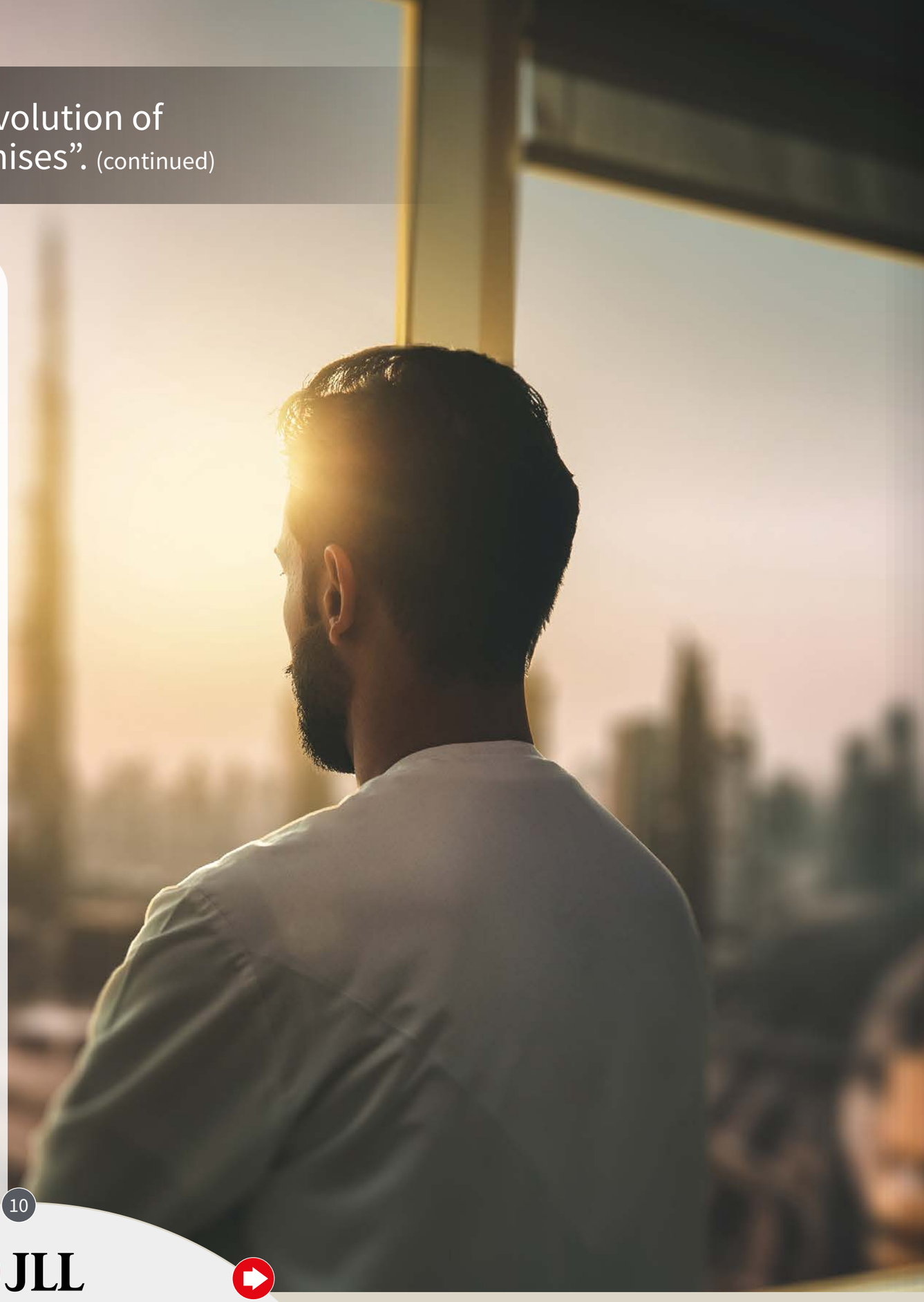
Hotel parent brand companies have responded to the changing needs of hotel owners and evolving markets to make management agreements more versatile and flexible.

Hotel parent brand companies supporting the evolution of traditional management agreements via “Manchises”. (continued)

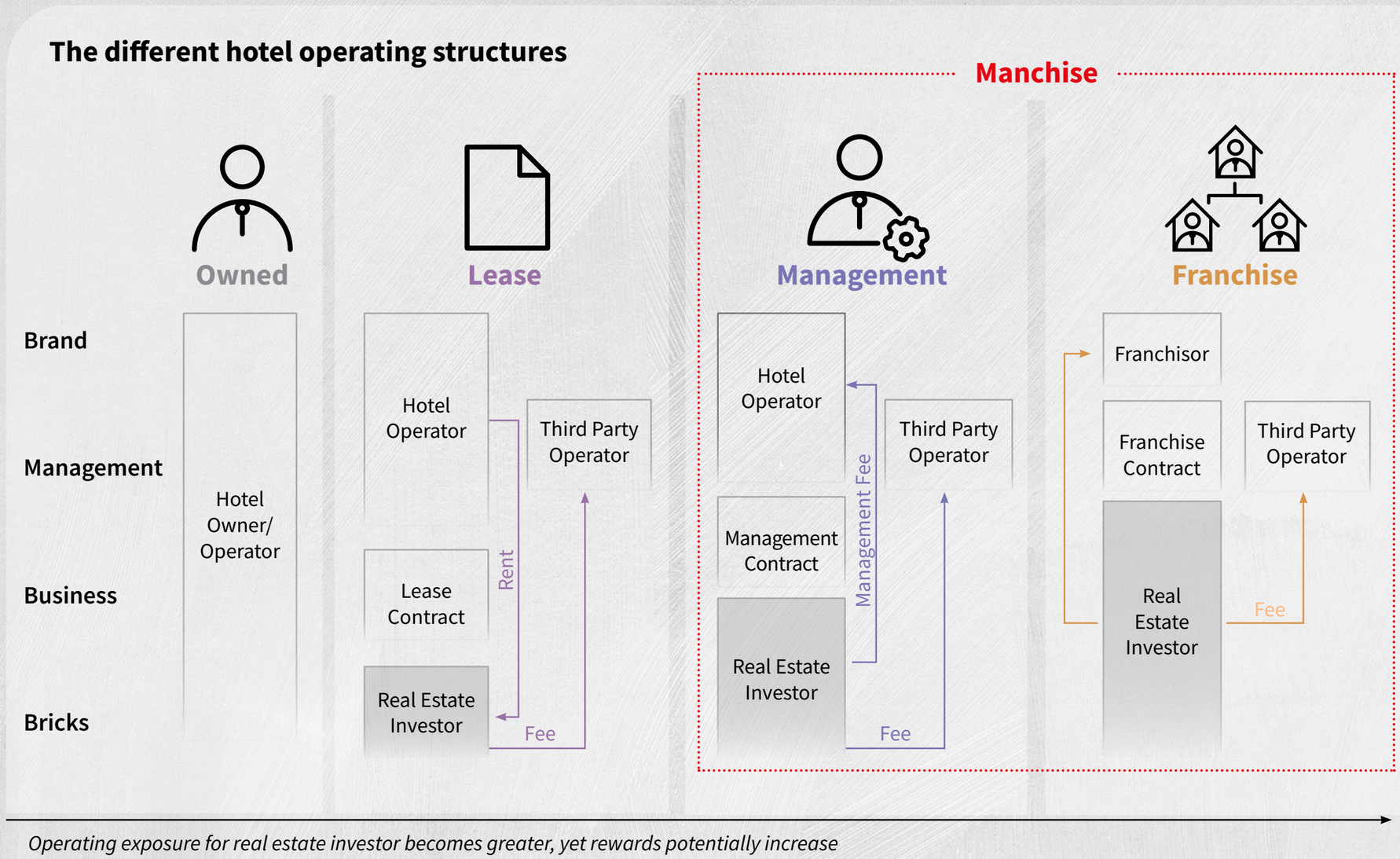
Manchise agreements offer benefits to both hotel parent brand companies and hotel owners.

Manchise is a term that refers to a brand management contract that can be converted to a franchise agreement. The duration of the agreement typically is consistent with that of a traditional franchise agreement, which is shorter in length than a management agreement. Manchises offer owners more flexibility when selecting a hotel brand to manage their property and can potentially lower fees, while also making hotel parent brand companies more compeititve versus third-party managers. Highlighting the growing prominence of manchise agreements is the arrangement that occurred between Marriott and Diamond Rock, a U.S. public REIT.

In 2020, in exchange for management to franchise contract conversions, DiamondRock and Marriott agreed to renovations at three properties, extended the term for three other franchise agreements and confirmed a new franchise for Vail, which is moving from a Marriott branded hotel to a Luxury Collection hotel. As hotel parent brand companies launch new brands to expand their geographic footprint, it is likely we will see manchise agreements become more popular, where hotel brand companies will retain control for the initial years of hotel trading, then convert to a franchise agreement.



The different types of hotel operating structures and how third-party managers fit in to the relationship are highlighted in the graphic.



COVID-19 has enhanced the competitiveness and challenges of operating a hotel. Moving forward, hotel parent brand companies and owners need to work together to find the most appropriate structure to meet investor objectives and brand goals. Manchise agreements may be just the solution.

3 Changing consumer preferences and Airbnb IPO underscore need for hotel room redesign and advancements in technology.

To better accommodate travelers in a post COVID-19 world, hotels to feature larger, more private accommodations.

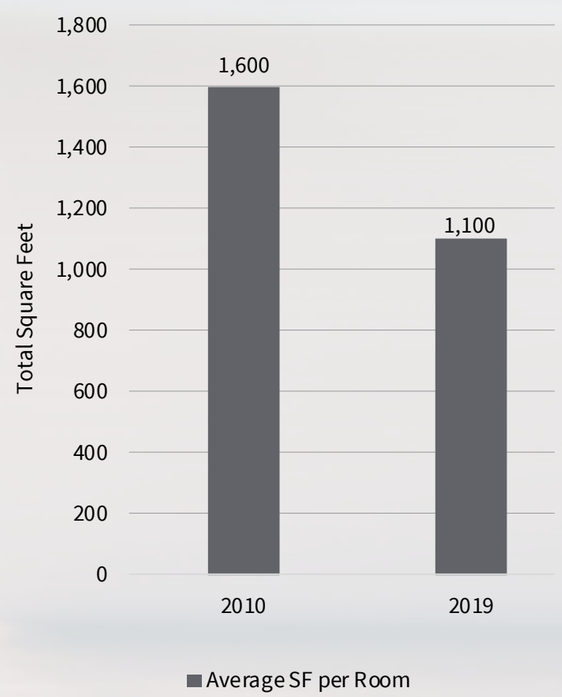
Over the past decade, hotels evolved to feature smaller-sized rooms as a way to optimize revenue per square foot, and reconfigured hotel spaces to have expansive lobbies and more flexible common areas to meet traveler needs. At the same time, Airbnb, Inc. (Airbnb) disrupted the traditional accommodation space by allowing consumers to book entire homes at the click of a finger via a mobile app.

When consumers slowly started traveling during the pandemic, it became clear that they favored larger, individual and private accommodations to comfortably stay for longer periods of time and work productively. As evidence, across the U.S. during Q3 2020, extended-stay hotels recorded an occupancy of 65.8% down only 0.8 % when compared to the same period in 2019, while the overall hotel industry logged an occupancy of 48%.

As lockdowns eased, more travelers also opted to book homes, helping Airbnb post a surprise profit in Q3. After a dismal Q2, Airbnb's remarkeable recovery helped boost its' IPO valuation, which surged past USD100 billion, marking the largest IPO in the U.S. in 2020.

The market's response to the 13-year old company was not only a testament of investor's insatiable appetite for tech stocks but also a sign of confidence in the hospitality industry's recovery. The outperformance of extended-stay product during the pandemic coupled with Airbnb's strong performance suggest that guest preferences are shifting to larger rooms and residential-style accommodations as they seek to mitigate the risk of COVID-19 infection.

Full-Service Hotel Room Size Trend from 2010 to 2019



Average SF per Room % Change : -31.0%

Source: JLL Research
Note: analysis is based on gross building square footage and pertains to a sample of full-service hotels that opened across the U.S. in each year.

Changing consumer preferences and Airbnb IPO underscore need for hotel room redesign and advancements in technology. (continued)

Major hotel brands have started responding to the shift in guest preferences by moving forward with branded residential developments announced pre-COVID-19 or launching new projects with a branded-hotel component. Examples of these include:

- **Four Seasons Resort and Residences Napa Valley** (opening spring 2021) - The Resort features 85 guest rooms, one-bedroom suites and the three-bedroom The Estate Villa.

- **Conrad Residences Bahrain Financial Harbour** (opening 2022) – The first fully residential luxury Conrad development in the Middle East will be part of a mixed-use development, Bahrain Financial Harbour. The property will feature 98 serviced apartments.

- **Evermore Orlando Resort** (opening 2023) – a comprehensive redevelopment of an existing complex near Disney World. The 1,100-acre resort development will feature nearly 1,500 bedrooms spread across 69 houses, 76 four-bedroom flats, 41 villas and a luxury 433-room Conrad hotel in its initial opening phase alone.

- **JW Marriott and Marriott Hotel Residences Ho Chin Minh City** (opening 2024) – The dual-branded residential and officetel project in Ho Chin Minh City will feature nearly 4,200 residential and officetel units. Anticipated to be the largest hotel-branded residential project announced to date worldwide.

- **Aman New York** – the first urban "retreat" property for the brand, including 83 guest rooms, 22 branded residences and a premier spa. Guest rooms will be larger in size and average approximately 940 square feet.

Four Seasons Resort and Residences Napa Valley

Changing consumer preferences and Airbnb IPO underscore need for hotel room redesign and advancements in technology. (continued)

The pandemic hastened technology's impact on how we use, manage and experience real estate

Without overlooking the great devastation COVID-19 has caused, the pandemic has catalyzed our dependence on technology in every aspect of our lives, including how we use, manage and experience real estate. This couldn't be truer for the hotel and hospitality industry. Over the last cycle, smart capabilities in the hotel experience were gradually introduced as a way to personalize and elevate a loyal guests' stay. During COVID-19, hoteliers made advancements to mobile applications and integrated booking and check-in technology to deliver a contactless environment. Features that would have taken years to roll-out became stables of the hotel experience in less than 12 months. Guests are now able to check-in/check-out, order room service and reserve a treadmill at the gym with the touch of a button.

The advancements in technology are not limited to rooms and hotel amenities but also apply to meeting and event spaces. The notion of a hybrid conference emerged in 2020 as hoteliers creatively crafted solutions to stimulate meetings and events demand. As an example, Hilton announced EventReady Hybrid Solutions, a program aimed at event planners looking to host a hybrid conference. The program promises event planners pre-built presentation stages to produce high-quality online programming and appropriate technology solutions to optimize the viewership of virtual attendees.

EventReady Hybrid solutions also offers hoteliers at the ground level the appropriate training and resources to develop their knowledge on hybrid events. Hand sanitizer stations and socially distanced seating and table arrangements are also an integral part of these hybrid meetings. Marina Bay Sands in Singapore added mixed-reality capabilities to its hybrid events programming.

The new technology will allow meeting planners to host events with hologram functionalities and three-dimensional renderings of items to include as part of their presentations. We expect these technological enhancements to become a permanent fixture of the meetings and events space, with a completely new experience reimagined to allow for both in-person and virtual attendees.

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4 Pressure is mounting to prioritize investing in real estate grounded in ESG principles at the global stage.

From increasing regulation at the country level to lenders and investors demanding that the footprint of their investment portfolios be more sustainable, environmental commitments are being made at every entity level. Our planet is also signaling that something needs to change. Extreme weather events continue to rise, creating a trillion dollars of damage in the last decade in the U.S. alone.

Furthermore, recent racial tensions have also renewed the focus on advancing diversity and inclusion initiatives across all industries, particularly at the upper management level. With information readily available at our fingertips, consumers are becoming more aware of the values that guide how companies are conducting business and using their purchasing power to effect change.

Globally, the commercial real estate sector has a notable role to play in promoting ESG principles as the built environment represents 39% of total CO2 emissions and employs over 13 million people. As part of the commercial real estate sector, the lodging industry has the opportunity to meaningfully accelerate ESG principles.

ESG principles are gradually being adopted at the ownership, hotel parent brand and destination level

- **Ownership**
  Host Hotels & Resorts (Host) – a U.S. public REIT, with over 46,000 hotels rooms under ownership, has invested over USD210 million in engineering projects with sustainability attributes and energy and water saving ROI projects. Host expects annual savings of approximately USD30 million, equating to a 14% cash-on-cash return and approximately USD320 million in enterprise value.

- **Hotel Parent Brand Companies**
  Wyndham – According to its 2020 Social Responsibility Report, the company has achieved 100% gender pay equity when comparing the median compensation of women versus men at the executive level and for employees below the executive management level globally.

- **Destinations**
  Costa Rica – Beyond ranking #1 in New Economics Foundation's Happy Planet Index, the Central American country represents a popular meetings and events destination. According to the International Congress and Convention Association, in 2019, the country ranked ninth most frequently chosen country in Latin America to host meetings, influenced by its health and wellness offerings, sustainability initiatives and eco-conscious attractions.

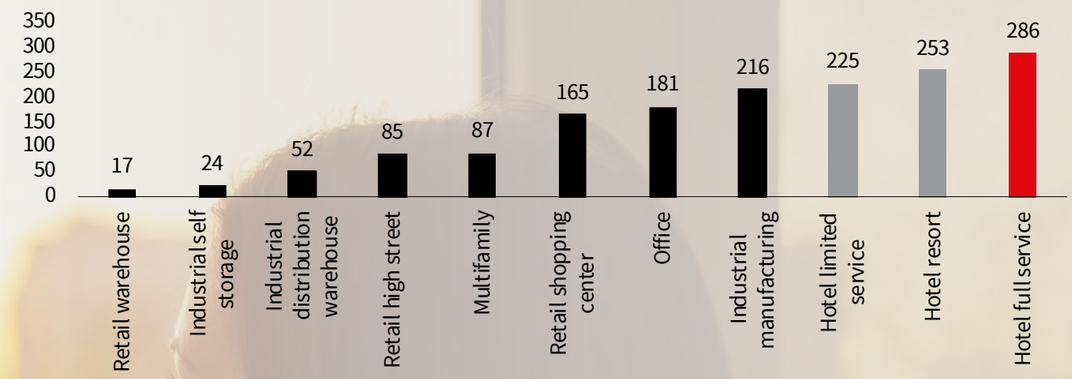
Pressure is mounting to prioritize investing in real estate grounded in ESG principles at the global stage. (continued)

But more can be done across all three principles

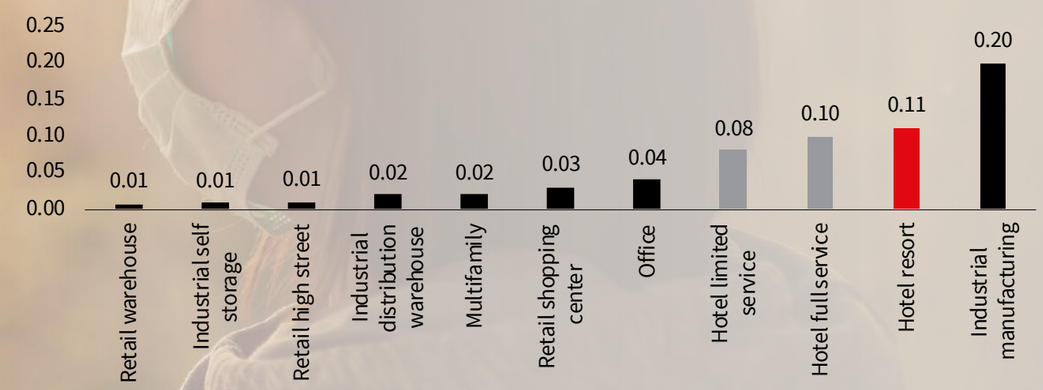
In the most recent ULI Hotel Sustainability Report, among all commercial buildings, in 2019, hotels on a global scale recorded the highest per square meter energy and water usage, making them the highest-energy and water intensive properties. As it relates to carbon emissions, hotels also show one of the highest carbon emission intensities when compared to other property types. This is influenced by the fact that hotels are a 24-hour, 365-day operational business. While hotels have taken steps in the right direction to become more sustainable by implementing programs that allow guests to forgo daily towel and linen changes, thereby reducing energy and water consumption, more can be done from a development perspective.

Similarly, as it relates to societal principles the lodging industry lags. According to the U.S. Bureau of Labor Statistics 2020 Current Population Survey, nearly 81% of hospitality management positions are held by White workers, compared with the 7% held by Black or African American workers. And while it is true that all global hotel parent brand companies have strong positions on diversity and inclusion and offer employee networks for minorities across the spectrum, these initiatives are not materializing at the most senior level.

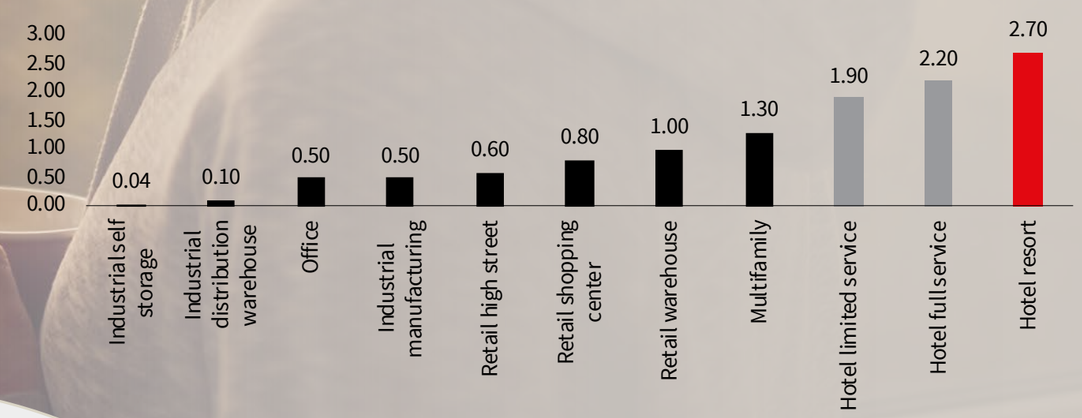
2019 Energy Use Intensity by Property Type (kWh/M2)



2019 Carbon Emissions by Property Type (CO2E/M2)



2019 Water Use Intensity by Property Type (KL/M2)



Source: ULI GreenPrint Report 2019, Cornell Hotel Sustainability Benchmarking index 2018

Pressure is mounting to prioritize investing in real estate grounded in ESG principles at the global stage. (continued)

Long-term benefits of adopting ESG principles outweigh short-term costs for the lodging industry

We believe the lodging industry has a lot to gain from grounding itself in ESG principles.

Some of which include:

- With significant operational pressures and rising expenses due to COVID-19 and extreme weather damages, ESG principles provide an avenue for potential cost savings
- Attract sophisticated, institutional capital that is increasingly prioritizing investing in real estate grounded in ESG principles
- Become brand of choice for work and consumption among the growing Generation Z demographic, which represents the most racially and ethnically diverse generation and whose buying power is worth an estimated USD143 billion in the U.S. alone. This segment of the population was born after 1997 and is keen on consuming products and working at companies that match their values

Final Thoughts

The global lodging industry will continue to be tested in ways it never has, but its resilience will not waver. Hotels that can swiftly reimagine the hotel experience to better accommodate leisure travelers and curate thoughtful stays with a sharpened focus on design, technology, sustainability, guest safety and wellness will be highly coveted by institutional hotel investors.

Assets that fail to embrace the changes brought on by the transformative events of 2020 will see their value soften. Moreover, with a current market capitalization of nearly USD90 billion – more than Marriott International Inc.(Marriott) and Hilton Worldwide Holdings Inc. (Hilton) combined – Airbnb's IPO forces traditional brands to reexamine their product offering so that they can better compete in capturing a demand with changing needs and wants.

Emerging concepts, such as Selina, are also placing pressure on traditional hotels to craft a new vision for the hotel experience of tomorrow. Selina defines its self as a lifestyle, travel and hospitality platform that aims to capture the digital nomad seeking an affordable, holistic travel experience, not only a room to stay.

The road to recovery will be long but there is optimism that pent-up demand to reexperience the world will gradually boost hotel performance across most markets. Once recovered, hotels should look and feel much different than they did at the beginning of 2020.

Thank you.

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