The Future of the Hospitality Market

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Abstract

In this white paper, Cumming Vice Presidents Dan Pomfrett and Graham Flight take a detailed look at how various aspects of the hospitality market have been impacted by the COVID-19 pandemic, and what the future may hold.

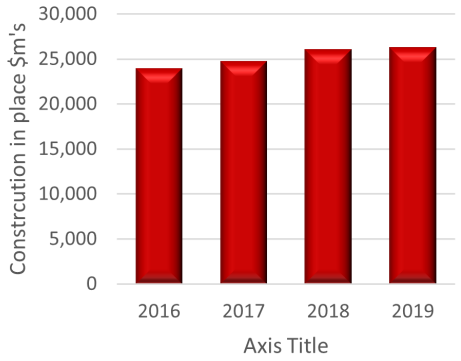
Summary

Nationwide, no industry has been hit as hard by the COVID-19 pandemic as the hospitality sector. While the service industry as a whole has struggled through varying state and local edicts — including social distancing guidelines, capacity limitations, and other requirements — hotels in particular have seen dramatic drops in their revenue streams and construction projects as a result of sharply reduced demand. The good news is that the worst should nearly be over. Challenges will remain for some time, of course, but with the recent news that vaccines are nearing distribution, hope is starting to build for the industry.

The Current Market

As we discuss the current state of the market, it is important to first understand how we got to where we are now. Everyone has heard anecdotes about how COVID-19 has impacted the hospitality industry, but for a more accurate and objective understanding, we should look closely at some key facts and figures.

- In 2019, the hotel sector saw historic highs across all brands, flags, and stars, with construction volume totaling more than $26.3 billion. A plateau in that figure was always expected, with pre-pandemic projections forecasting a leveling out in 2020 followed by a small contraction in subsequent years. Because of the pandemic, these figures have been updated with 2020 currently projected to see a 24.6% drop in activity.



- recent survey by the American Hotel and Lodging Association shows that there were approximately 2.3 million direct hotel jobs before the pandemic; as of September 2020, this number has dropped by nearly 900,000.

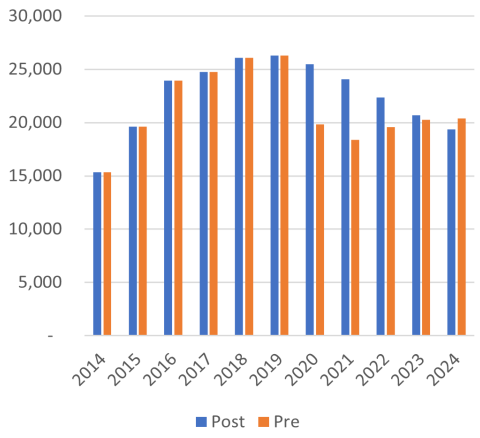
- The same survey showed total employment (direct and indirect) at 8.3 million pre-COVID, with a loss to date of almost 2 million.
- Pre-COVID, the average daily hotel room rate was approximately $130; the average has dropped steeply and is now approximately $80, although it should level out at around $100 by the end of the year.
- Occupancy rates in September 2020 were reportedly at 48.3% — a 31.7% decline from the same time last year.
- Luxury properties have fared worse under the pandemic than mid-tier and lower end properties. This dynamic is expected to flip towards the middle of 2021, as the luxury market starts to regain traction.
- On average, 1.3 billion guests stay in hotels within the U.S. each year.
- Pre-COIVD, there were an estimated 5.3 million guest rooms in the U.S., distributed across approximately 56,000 properties nationwide.
- RevPAR (revenue per available room) projections from analytics firm STR note a drop from $87 in 2019 to a projected $44 in 2020 and $57 in 2021. This accounts for a 34.2% drop between 2019 and 2021.
- At this time of this writing, there are 1,771 hotel projects (encompassing 235,467 rooms) reported as being under construction.
- During the first half of 2020, 313 new hotels opened, encompassing 36,992 rooms.
- The second quarter of 2020 saw a 53% decrease in new project announcements compared to the second quarter of 2019.
- A recent reported issued by STR reported that the U.S. opened more hotel rooms between the beginning of March and end of September than any other country:

    1. U.S. (55,395 rooms)
    2. China (23,470 rooms)
    3. Japan (16,304 rooms)
    4. Germany (9,027 rooms)
    5. Canada (2,748 rooms)
    6. United Kingdom (2,481 rooms)

Is the Hospitality Sector Heading for a Renaissance?

It's perhaps an understatement to say that significant challenges lay ahead for the construction industry, but in no market is this truer than in the hospitality sector. Still, there are encouraging signs of light at the end of the tunnel. In addition to all the recent positive vaccine news, the industry was already engaging in significant change to meet transforming customer needs and trends; the pandemic has helped accelerate this change. Once the pandemic is over, there will be a lot of opportunity for the industry to grow and for new business models to make their way forward.

- As we near the end of 2020, it is expected that the hospitality construction market will slowly start to rebound, picking up pace by the end of 2021.



- Between 2021 and 2022, we are expecting to see a 7% increase in hospitality construction. The following two years (2023 and 2024) are expected to see growth of between 1% and 3% year-on-year.
- 5,582 projects and 687,801 rooms are in the U.S. hotel pipeline for Q2 2021, which represents a drop of 1% year-on-year.
- California is expected to have the highest volume of construction put in place in 2021, with Texas a close second and Florida and New York in third and fourth, respectively (see top right chart).
- The aviation industry is intrinsically linked with the hospitality market, from revenue driven by business travelers and vacationing families to the movement of construction materials and products.
- Demand for rooms is expected to return to pre-pandemic levels by 2023.

2021 TOP 10	2021	2022	2023	2024
California	2,895	2,686	2,480	2,321
Texas	2,127	1,978	1,832	1,722
Florida	1,746	1,630	1,510	1,415
New York	1,331	1,231	1,132	1,055
Illinois	906	839	771	718
Ohio	825	762	700	651
Pennsylvania	814	750	688	639
Georgia	785	736	682	640
North Carolina	769	719	667	627
Michigan	650	599	550	511

Numbers are "real" numbers in million of dollars, with a baseline of 2012; figures from IHS Insights

Escalation and Costs

Despite the reduction in sector activity, the market is not expected to go into negative escalation as seen in 2008, owing mainly to those involved in the industry pivoting to other sectors. A good example of this is the combination the healthcare and hospitality markets, where we have seen a healthy spike in activity for senior living facilities and hotels being considered for purchase to assist convalescing patients.

Escalation projections have changed significantly due to the pandemic, and while the data indicates a buyer's market, there is potentially a sting in the tail: even as volume returns, there is a risk that skilled workers who left the sector (or even the industry altogether) may not come back. This could ultimately lead to an above-average spike in escalation.

	2020	2021	2022	2023
Pre-COVID	1.27%	3.16%	4.07%	3.82%
Post-COVID	2.11%	3.17%	3.13%	3.13%

		$/KEY (CONSTRUCTION COSTS)	$/KEY (PROJECT COSTS)	$/KEY FULL PROJECT
New York	High End Luxury	$340k to $400K	$150k to $225k	$490k to $625k
	Luxury	$270k to $370K	$130k to $185k	$400k to $555k
California	High End Luxury	$300k to $355K	$135k to $170k	$435k to $525k
	Luxury	$240k to $330K	$120k to $165k	$360k to $495k
Illinois	High End Luxury	$300k to $350K	$135k to $175k	$435k to $525k
	Luxury	$245k to $330K	$120k to $165k	$365k to $495k
Miami	High End Luxury	$245k to $295K	$125k to $145k	$370k to $440k
	Luxury	$200k to $265K	$110k to $135k	$310k to $400k

Note that the above costs are subject to variation between each property. For example, the level of amenities will affect cost per key.

One important note to keep in mind is that costs are being impacted across all aspects of the project budget, and consideration should be given to project costs which can be up to 50% of the total project budget.

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How has the Contracting Community Been Affected?

- Across the U.S., the number of workers employed in the construction industry has remained relatively consistent throughout the total period.
- While the reduction in volume has offered some respite, labor shortages remain; as markets return, this could lead to further shortages across all sectors.
- Labor pricing has increased despite the pandemic, and is up 3% year-on-year, on average.
- Unemployment in the construction industry peaked at almost 17% in April but has since declined to 6.9%.
- Price reductions are primarily being driven by the desire of the contracting and subcontracting community to secure backlog.
- As mentioned previously in this report, contractors are pivoting to new sectors.
- Material prices that bottomed out are now plateauing before an expected rise in early 2021.

How Has Design Been Affected?

Technology has been used ever-more impactfully over the last few years, but the necessities forced by the pandemic have accelerated this trend. Remote check-in and virtual room keys, for example, are becoming more and more common and are here to stay. Hotel design has changed in other ways, including:

- Food outlets, particularly buffets, are being replaced and redesigned to adhere to social distancing and hygiene requirements.
- Along with contactless check-in, the physical aspects of hotel design are also changing. Examples include contactless entry doors, in-app payment systems, and facial recognition for elevators.
- Outdoor space is at more of a premium than ever, and so utilizing designs that can open the inside to the outside — such as folding walls — has been a key change, especially in milder climates.
- Hotels are increasingly introducing new processes and procedures designed to protect the health and safety of each guest. Room seals, for instance, work like the plastic seal on a bottle cap — they show if the seal on a room has been broken, thus indicating that someone has been in the room.
- Layout modifications and adjustments will be made to public areas to facilitate social distancing, particularly in densely populated spaces.
- Health and wellness standards have increased with the introduction of germicidal lighting and state-of-the-art air filtration systems.

Future Challenges and Considerations

Despite the progress being made on multiple fronts, the hospitality sector will continue to face significant challenges, some of which are described below.

- Large-scale projects that are in the works are spread across multiple locations, with only a small number of locations repeating.
- Shipping has seen low order book levels of around 10%, compared to 60% in 2007.
- Shipping capacity has reduced by approximately 13% worldwide.
- Prices in Europe have been driven up by 6%.
- Airfreights from China to the U.S. were below $4 per kilogram at the beginning of the year, before peaking in June to more than $10. Current prices are at just above $47 per kilogram.
- Although products will be available, the mass reduction in flights, along with container movement restrictions, point to potential increases in freight costs. The extent of this increase is unknown, but as a comparison, freight prices tripled during the recent tariff negotiations between the U.S. and China.
- There will be some expected delays as facilities get through the accumulated backlog, but that should be cleared in short order. Imported materials and supply restrictions are already starting to ease as China gets back to full production.
- High-rise developments will continue to see challenges with construction means and methods.
- Timber and lumber costs are increasing more than 26% year-on-year as the demand outpaces the supply chain. This has already had an impact on high-rise construction
- Planning ahead will be key. Despite the opening up of trade routes, there are still potential closures and restrictions that may come into play.
- We have seen more and more furniture being purchased from neighboring countries to facilitate project schedules, but this workaround can come with its own challenges due to COVID-related restrictions and delays.
- New-build construction is expected to drop significantly; however, renovations and rebranding efforts are expected to mostly continue, albeit at a slower pace. The limited number of guests has opened up opportunities to commence those works with reduced interruptions and cost.
- The rebound will be sector- and location-specific, with the southern U.S. expected to rebound the quickest in terms of both volume and labor.

Conclusion

While this year has been an exceedingly difficult one for the hospitality industry, there are positive signs in the market that construction will return. The timing, cost, and design of a given project will all be subject to the type and quality of the project being undertaken, but the good news is that the worst is nearly over and full sector recovery should begin soon.

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