August Lodging RevPAR Monitor—Analyzing the Unusually Unvolatile Future Trends

The "wait-and-see" is impacting demand, supply, and the stocks in unusual ways

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What's Inside

An in-depth update to our RevPAR outlook

Following deep analysis of our aggregated "Big Data" and "Alternative Data" in our internal RevPAR data research, combined with conversations with our network of private hotel owners, overall *forward-looking* RevPAR trends for US full-service hotels continue to reflect a low and unvolatile RevPAR growth environment. The latest forward intelligence (combined with similar findings in recent months) suggests no major changes to our expectations either for occupancy or rate – **this is unusual for this stage in the lodging cycle and a focus in this note.** While in theory, such indicators might raise the question of RevPAR growth hitting the bottom for this cycle -- *we have yet to see an inflection point in forward trends to indicate the bottom of the cycle and subsequently we forecast 2018's growth to be slightly lower than 2017's* . To be clear, we are not saying a late-cycle re-acceleration in RevPAR cannot happen, rather there is no conclusive evidence it has begun yet.

- In this month's note, in addition to our usual insight into future RevPAR trends, we take a deeper look (beginning on page 14) at what has intrigued us as longtime lodging analysts – the unique characteristics reflective of this late lodging cycle and how this is impacting the stocks. We believe the current demand-supply equilibrium, combined with relatively stable though uninspiring macroeconomic conditions, have led to an unvolatile forward hotel demand trajectory and a bifurcation of expectations for the lodging stocks.

The stocks: We view the C-Corps in an overall better spot vs. the hotel REITs due to their pipelines (a source of earnings growth that REITs do not have) and from lower required property-level CapEx (just because RevPAR is +1% does not mean that a hotel owner should cut back on the 5-10% annual CapEx.) Additionally, supporting the C-Corps is not just US pipeline growth but exposure to the international environment – where in aggregate there is strong y/y RevPAR and pipeline growth. We think the more internationally-focused and higher-quality names, namely HLT and MAR, should be the biggest beneficiaries.

Our RevPAR projections unchanged, this itself is news given where we are in the cycle:

Our expectations for US full-service branded (aka the typical domestic Marriott or Hilton branded hotel) continue to be +0-2% for 2017 (3Q at -1% to +1% and 4Q at +1-3%; if anything we believe 3Q is tracking towards the lower-end and 4Q is tracking towards the higher-end) and -0.5% to +1.5% for

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2018. HLT and MAR will likely provide 2018 RevPAR guidance concurrent with their 3Q earnings results in October/November and we will be very surprised if their outlook is materially different from ours (historically it has not).

- While holiday shifts will make for a weak 3Q17 and a stronger 4Q17, we expect the second half of 2017's RevPAR growth rate will be approximately 50-75 bps. lower than the first half's approximately +2%.

3Q17 continues to shape up to be a very weak quarter for Group/convention business (tough comps due to holiday shifts and RNC-Cleveland and DNC-Philadelphia last year) but our 3Q RevPAR forecast for US full-service hotels remains at -1.0% to +1.0%. Companies such as H, HST, and RHP that have outsized exposure to Group/convention business will likely come in below this range. *Note that this is the first time this cycle that we have had a minus sign in front of a quarterly forecast.* We believe companies largely communicated the impact of the holiday shifts appropriately on the 2Q earnings calls, although we would not be surprised to see some negative investor sentiment simply due to optics if 3Q RevPAR ends up negative.

Our 4Q forecast is +1-3%. 4Q will benefit from the Jewish holiday shift in October (3Q is hurt by the shift). In the reverse of 3Q, companies such as H, HST, and RHP that have outsized exposure to Group/convention business will likely come in above this range.

We are maintaining our 2018 forecast of -0.5% to +1.5%. As there is a de minimis number of room reservations on the books at this point other than some group blocks, rather than actual room bookings like we use for a near-in forecast, driving our 2018 forecast at this time are:

- Continued gradual deceleration of demand with no negative shocks nor any material bump-up to GDP expectations;
- New room supply ticking up to +2.5% in 2018 from +2.2% in 2017 for the total US and to +3.3% in 2018 from +2.7% for the top 50 markets.
- Given higher supply for the REIT-centric markets, we see the 2017 RevPAR growth range 100 bps. lower for the hotel REITs than for the more geographically diversified C-Corps.

Quarterly Tracking

	3Q17	*4Q17*	*2017*	*2018*
	Overall	**Overall**	**Overall forecast**	**Overall forecast**
Jul-17	-1% to +1%	+1-3%	+0-2%	-0.5% to +1.5%
Jun-17	-1% to +1%	+1-3%	+0-2%	-0.5% to +1.5%
May-17	-1% to +1%	+1-3%	+0-2%	
Apr-17	-0.5% to +1.5%		+0-2%	
Mar-17	+0-2%		+0-2%	
Feb-17	+0-2%		+0-2%	
Jan-17	+0-2%		+0-2%	
Dec-16			+0-2%	
Nov-16			+0-2%	
Oct-16			+0-2%	
Sep-16			+0-2%	
Aug-16			+1-3%	
Jul-16			+1-3%	
Jun-16			+1-3%	

Source: STRH Research

Monthly Commentary for US Full-Service Hotel RevPAR

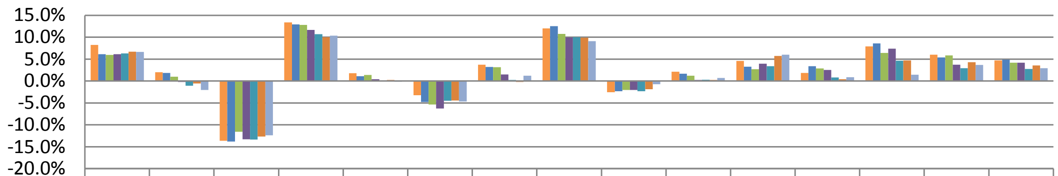
3Q17:

- **July:** For US full-service hotels, the month finished at approx. -0.5% y/y RevPAR growth. Luxury hotels outperformed Upper Upscale due to the calendar shifts.
- **August:** Looks to be a clean comp but early indications are uninspiring. We see August tracking at +0-1% at this point. The month received a positive bump from the eclipse on August 21st although the impact was more measurable for limited-service hotels, rural and interstate locations, and non-top-25 markets (a few exceptions such as Nashville and St. Louis were near the heart of the eclipse zone). It is unclear how Hurricane Harvey will impact the Gulf Coast and Texas (some hotels will likely be full for months with displaced residents and relief workers, other hotels will likely be closed for months), though historically weather events have been a net positive for hotel visitation, especially for limited service hotels (we note, CHH was a large beneficiary of Hurricane Katrina for several months).
- **September:** Group business will likely be hurt by the shift in the timing of the Jewish Holidays. Rosh Hashanah was Sunday, October 2nd last year and shifts to Wednesday, September 20th this year. This shift will likely impact a lot of business and group travel this week. Secondly, Yom Kippur was Wednesday, October 12th last year and shifts to Friday, September 29th this year, which we expect will hurt business and group travel on the 28th-29th. Both of the above now benefit October. We think September could easily be a negative RevPAR month for US full-service hotels.

4Q17:

- **October:** Group business should be helped by the shift in the timing of Yom Kippur. October will likely be one of the stronger months of the year and should come-in at or above the high-end of the +1-3% 4Q range.
- **November:** Similar to November 2016, November 2017 is surprisingly strong for Group business and could come in at the high-end of the +1-3% 4Q range. We note Group RevPAR results were flat the week of Election Day last year which could make for an easier comp for that week. However in the following week Group was +17.8%.
  - **What is disconcerting is November group pace continues to fall, a trend we have seen for four months.** Over that time period, group pace has fallen approximately 300 bps. November still looks very positive but perhaps less so than expectations earlier in the year.
- **December:** Looks to be the weakest month of the quarter. We suspect this is from Christmas falling on a Monday this year vs. a Sunday last year. To see the impact of this shift we look back to 2006, the last time Christmas fell on a Monday. For the week RevPAR was -7% with Sunday-Monday averaging -15% y/y (and keep in mind 2006 was a much better year for RevPAR growth than is 2017).

**Net of Supply Growth Changes to 2017/2018/2019
Y/Y Citywide Group Pace (by Quarter/Year)**



	1Q17	2Q17	3Q17	4Q17	YE 17	1Q18	2Q18	3Q18	4Q18	YE 18	1Q19	2Q19	3Q19	4Q19	YE 19
Pace as of January 2017	8.2%	2.0%	-13.7%	13.4%	1.8%	-3.2%	3.7%	12.0%	-2.6%	2.1%	4.6%	1.8%	7.9%	6.0%	4.7%
Pace as of February 2017	6.1%	1.8%	-13.8%	12.9%	1.1%	-4.8%	3.2%	12.5%	-2.3%	1.7%	3.3%	3.4%	8.6%	5.4%	4.9%
Pace as of March 2017	6.0%	1.0%	-11.6%	12.8%	1.4%	-5.4%	3.1%	10.8%	-2.1%	1.2%	2.7%	2.9%	6.4%	5.8%	4.2%
Pace as of April 2017	6.1%	-0.2%	-13.3%	11.7%	0.4%	-6.3%	1.5%	10.0%	-2.0%	0.3%	4.0%	2.5%	7.4%	3.7%	4.2%
Pace as of May 2017	6.3%	-1.1%	-13.4%	10.7%	0.0%	-4.5%	0.3%	10.0%	-2.3%	0.3%	3.4%	0.8%	4.6%	3.0%	2.8%
Pace as of June 2017	6.7%	-0.5%	-12.7%	10.0%	0.3%	-4.4%	-0.2%	9.9%	-1.9%	0.3%	5.8%	0.4%	4.7%	4.3%	3.6%
Pace as of July 2017	6.6%	-2.0%	-12.4%	10.4%	-0.2%	-4.7%	1.2%	9.1%	-0.7%	0.7%	6.0%	0.8%	1.4%	3.7%	2.9%

Source: STRH Research, TAP. Figures are net of new supply.

On the good news front, international RevPAR growth continues to be positive. Anecdotal evidence (pre-Barcelona) suggests that fears related to further terrorism in Europe have dissipated in some key markets (Paris in particular). Due to the timing of the Barcelona incident near the end of the summer and well after most non-Europeans have booked summer and fall leisure travel to Europe, we expect any negative demand reaction to the Barcelona incident to be muted. This assumes that we have no further incidents in the region. Nevertheless, the y/y comparable is favorable in light of the geopolitical environment this time last year. While we admittedly have far less visibility into the future in Europe and Asia than we do for the US, July RevPAR of +9.6% in Europe continues the positive trend from approxmately +7% in 2Q. The bad news is this strength is only a benefit to the C-Corps, most notably for HLT and MAR. The weakening of the euro appears to have subsided in the last few months, although relative to the last few years, Europe is still relatively affordable for foreign visitors. Similar to 2Q results, if there is upside for MAR and HLT in 3Q, we believe it will come mostly from international results.

- **East Asia by and large still presents a considerable long-term growth story for the C-Corps.** While we are seeing supply maturation in some of the primary emerging markets (a good sign for rate integrity in our view), there are growth opportunities in many other markets. July RevPAR in Asia-Pacific was +4.4% in US$ (compared to +3.4% in June and +2.1% YTD).

<u>Examining the Three Customer Segments:</u>

Leisure travel: Our latest pricing and demand observations from our RevPAR data research show RevPAR growth for summer and fall leisure travel still tracking at approximately +2.0-3.0% for US full service hotels (approximately 50-100 bps. higher for limited service properties), unchanged from our prior expectation. These figures are roughly 100-150 bps. lower than the summer of 2016 which we believe is due to a bit more supply growth and less of a positive impact from y/y decreases in gas prices; the latter was a boost to leisure travel in 2015 and 2016. While an extended booking cycle initially created strong occupancy gains, as arrival dates have gotten closer these gains have subsided.

- Our analysis of multiple data sources including e-forecasting and OTAs indicates summer occupancy growth is lagging while revenue is being driven upwards by increases in hotel rates. This is a change from last summer where leisure RevPAR was driven by both occupancy and rate growth. During the summer months, leisure travel represents about 40% of hotel business for most C-Corps and hotel REITs vs. 25-30% in other seasons.

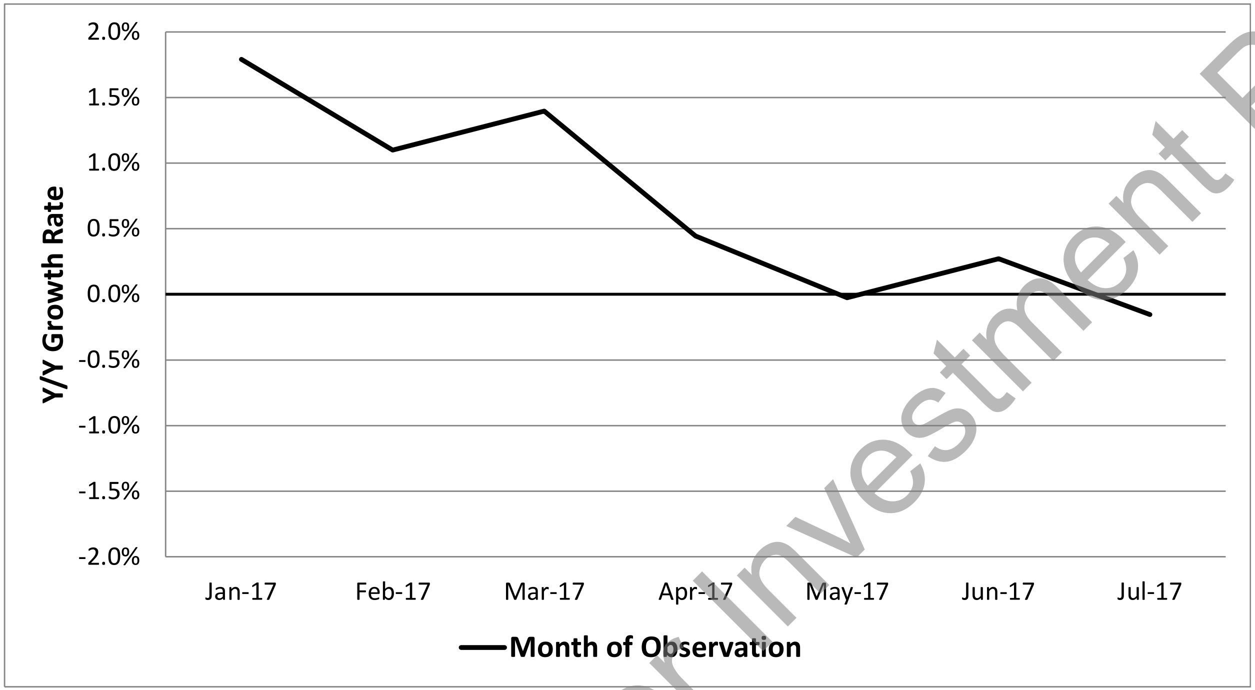
Individual business travel RevPAR expectations (visibility is about 60 days) continue to hover around zero to slightly negative growth (primary data source: corporate travel agencies and OTAs) with no major changes over the past month. The good news is that corporate travel demand is growing; the bad news is that the same-store growth rate is being completely offset by new room supply. We believe the growth on the demand side is due to 1Q17 S&P earnings growth of roughly 11% and 2Q17 growth of about 10%. Earnings growth is expected to slow to approximately +5% in 3Q17 and rebound to roughly +11% in 4Q17. Individual business travel represents approximately 45% of business for the typical C-Corp and upper-upscale centric REIT.

- **That said, given corporate profitability growth, why isn't it translating into better RevPAR growth rates for this customer?** We believe it is due to the fact that while the S&P has started to show earnings growth after two years of not having done so, much of this earnings growth is from share repurchases and cost cutting as opposed to revenue growth. By comparison, S&P 500 revenue growth for 1Q-2Q was roughly +5% vs. low-teens earnings growth. *Share repurchases certainly do nothing for corporate travel and we know that the easiest cost cuts to make are from travel & entertainment.*

Forward-looking Group/convention demand expectations were stable over the past six weeks (primary data source: TAP).

- **2017: In-the-year-for-the-year group pace fell by 50 basis points (although much of the drop was due to refined 2Q actual group results).** Headline group demand ("rooms blocked and sold") is now pacing approximately -0.2% (net of new supply) vs. +0.3% in our previous observation. Notably, we have adjusted our previous observation by -20 bps -- this is due to lower supply growth expectations in 2017. To our headline pace figure we add roughly 1.5 percentage points of pricing growth to come up with a Group RevPAR expectation of approximately +1.0-1.5%. Comparably, Marriott noted on its August earnings call that 2017 group revenue pace for company-operated full-service hotels in North America was approximately +1.0-1.5%, down modestly from +1.7% in the May earnings call.

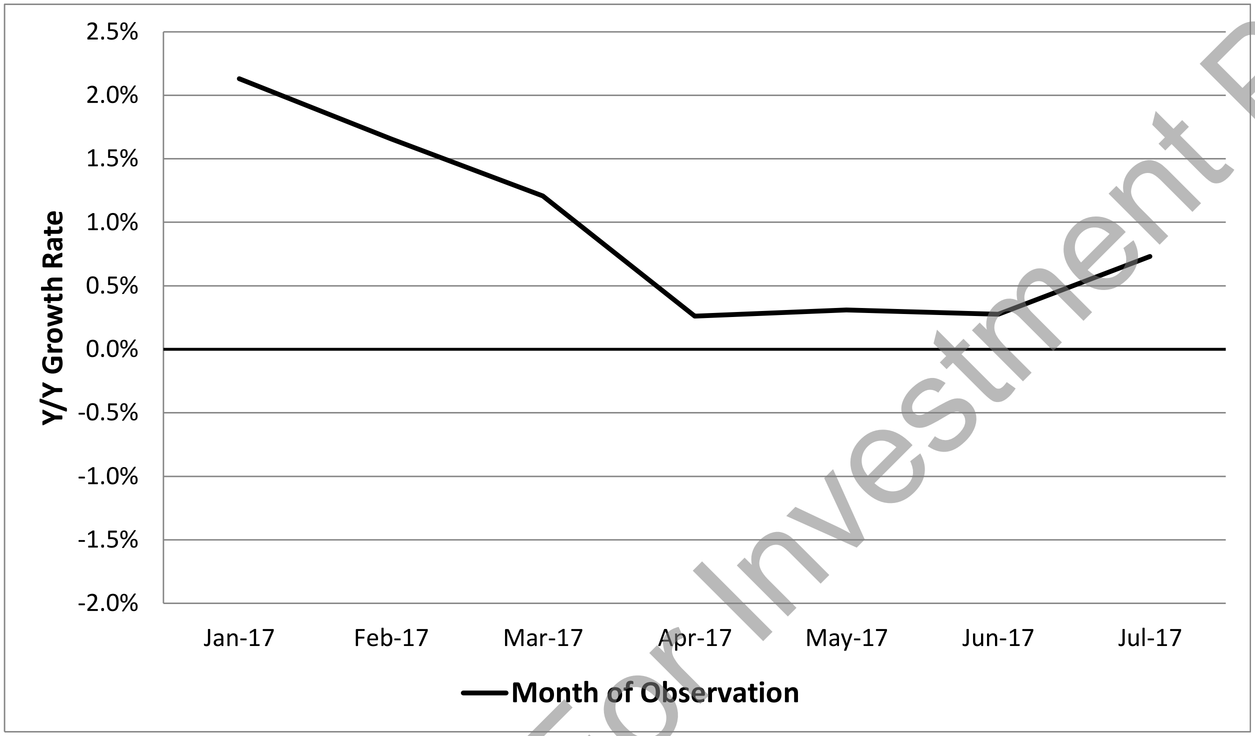
2017 Group Demand Pace Trend



Source: STRH Research, TAP

- **2018:** Current indicators show slight demand growth over the past month for Group/convention stays in 2018 (not enough growth to indicate a positive trend). Headline group demand is now pacing approximately +0.7% vs. the prior observation of +0.3% (net of new supply). Similar to 2017, the prior observation figure was adjusted by 20 bps due to lower supply growth expectations in 2018. To this we add about 1.5 percentage points of rate growth to come up with a projection that same-store Group RevPAR is tracking at approximately +2% for 2018 at the moment.
  - **Importantly, while the 2018 pace looks better in aggregate**, on a month-to-month basis the pace changes are quite varied. This is to be expected this far in advance of the reservation date. In our opinion, it is too early to put too much stock into 2H18 group pace changes. More relevantly, 1Q18 pace continues to hover around -2% (a tough comp due to inauguration/women's' march and from an unfavorable Easter shift).

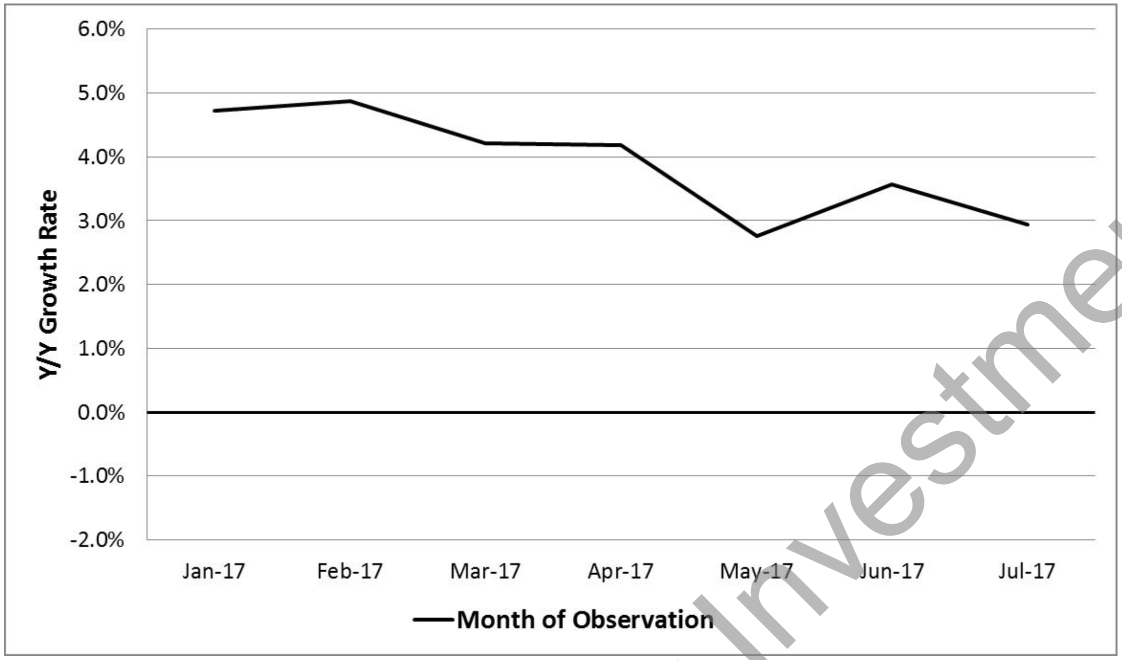
2018 Group Demand Pace Trend



Source: STRH Research, TAP

- **2019: We are introducing our preliminary pace trends for 2019.** We advise readers that these figures represent a fraction of what will be the aggregated actual bookings (we estimate that the 2019 pace represents about 20-30% of what will actually be booked). The group pace for now mostly reflects citywide and far-in-advance in-house group bookings. The wildcard of course is how actual "paid & stayed" attendance is vs. the initial projection.
  - We have seen some moderate slippage in 2019 pace since the beginning of the year. Our net-of-supply group pace for 2019 is approximately +3% at the moment (but decelerating), aided by a recovery in San Francisco. Due to the highly preliminary pace figures, we are not introducing a RevPAR component at this time.

2019 Group Demand Pace Trend



Source: STRH Research, TAP

Segmentation By Company			
	Transient Corporate	Transient Leisure	Group
REITS			
CHSP	45%	20%	35%
DRH	45%	20%	35%
FCH	50%	25%	25%
HST	45%	15%	40%
LHO	55%	20%	25%
PK	45%	20%	35%
RHP	5%	15%	80%
SHO	45%	20%	35%
PEB (not covered)	60%	20%	20%
C-corps	Transient Corporate	Transient Leisure	Group
CHH	45%	45%	10%
H	40%	20%	40%
HLT	50%	20%	30%
IHG	45%	40%	15%
MAR	45%	20%	35%
WYN	45%	45%	10%

Source: STRH Research

Major Markets - A Mixed Bag:

In North America, Canadian cities such as Montreal, Toronto, and Vancouver continue to look strong. We see this in part due to attractive FX for American travelers. Unfortunately, very few REITs (only HST in our coverage) own hotels in Canada.

- **Miami** seems to be turning a corner in the second half of 2017 due to easy y/y Zika comps and the weekly STR results seem to be indicating this as well.
- **Houston and Pittsburgh,** both oil/energy markets, are still tracking negative for the rest of the year. While oil prices have seen a rebound over the past year, jobs have not materially returned. Additionally, both of these markets should have well above average new room supply.
- **San Diego** also looks to be a leading market with moderate supply growth and relatively strong demand.

Boston: Looks to be a flat RevPAR grower for 3Q but very strong in 4Q. The first quarter of 2018 starts out very strong as well.

Est exposure to Boston market								
	CHSP	**DRH**	**FCH**	**HST**	**LHO**	**PK**	**RHP**	**SHO**
Boston	15%	16%	12%	6%	19%	2%	0%	17%
Rank	4	3	5	6	1	7	8	2
Note: Est. exposures include surrounding areas								
Source: STRH Research, Company data								

Chicago: 3Q will likely be challenged, down mid-single digits, with 4Q flatish for overall RevPAR growth. Chicago looks to be an above average market over the next year.

Group/convention outlook for Chicago

1Q17	2Q17	3Q17	4Q17	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	3Q19	4Q19
23.1%	10.6%	-14.9%	-2.4%	5.0%	3.0%	61.4%	14.4%	-9.4%	4.9%	-14.7%	-22.1%

Source: STRH Research, TAP

Est exposure to Chicago market								
	CHSP	**DRH**	**FCH**	**HST**	**LHO**	**PK**	**RHP**	**SHO**
Chicago	12%	13%	0%	4%	7%	6%	0%	8%
Rank	2	1	7	6	4	5	7	3
Note: Est. exposures include surrounding areas								
Source: STRH Research, Company data								

Los Angeles: Due to tough comps, overall 3Q and 4Q look to be weak, down low-single digits. For 2018, 1Q looks very strong while 2Q looks very weak.

Group/convention outlook for Los Angeles

1Q17	2Q17	3Q17	4Q17	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	3Q19	4Q19
3.4%	70.2%	-14.0%	1.4%	18.8%	-37.3%	16.5%	12.6%	-19.8%	13.3%	-15.5%	11.1%

Source: STRH Research, TAP

Est exposure to LA market								
	CHSP	DRH	FCH	HST	LHO	PK	RHP	SHO
LA	11%	1%	7%	5%	9%	0%	0%	10%
Rank	1	6	4	5	3	7	7	2
Note: Est. exposures include surrounding areas								
Source: STRH Research, Company data								

NYC: Could actually squeak out a positive RevPAR growth result for 2017, which should be considered a success given the massive amount of supply that has and is coming into the market. Helping NYC are new regulations on short-term rentals (Airbnb) which may take some of the new "shadow supply" pressure away. That said, we believe it will be difficult for NYC to see much above flat RevPAR growth in 2017 as new hotel supply looms large.

- A major headwind to same store RevPAR growth in NYC is several years of compounded 4-6% new supply growth. Per Lodging Econometrics, city-wide new room supply grew 5.1% in 2016 and is forecasted to grow 5.1% in 2017 and 8.3% in 2018. Even if some of these expected new hotels never open, we think it is difficult to envision that NYC will not have continued pressure from above-average supply over the next several years.

Est exposure to NYC market								
	CHSP	DRH	FCH	HST	LHO	PK	RHP	SHO
NYC	4%	10%	3%	11%	9%	6%	0%	4%
Rank	5	2	7	1	3	4	8	6
Note: Est. exposures include surrounding areas								
Source: STRH Research, Company data								

San Francisco: San Francisco, which was one of the best performing markets over the past two years, continues to show deceleration from the strong growth rates of 2015 and 2016. This is due to the renovation of the convention center and harder comps. Overall, the city is tracking around flat in 2H17. In our view, the good news is that 2Q17 likely represented the low-point for RevPAR growth and 2Q18 should be the first quarter of very strong (likely strongest market in the country) RevPAR growth. **Specifically, March 2018 should be the month where SF turns the corner.**

Group/convention outlook for San Francisco

1Q17	2Q17	3Q17	4Q17	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	3Q19	4Q19
-16.1%	-44.7%	-24.7%	-3.4%	-15.2%	51.4%	70.0%	9.0%	126.0%	49.5%	50.5%	66.1%

Source: STRH Research, TAP

Est exposure to SF market	CHSP	DRH	FCH	HST	LHO	PK	RHP	SHO
San Francisco	21%	1%	16%	7%	15%	12%	0%	8%
Rank	1	7	2	6	3	4	8	5

Note: Est. exposures include surrounding areas

Source: STRH Research, Company data

Washington DC: DC looks to only be a slightly negative market overall (group looks stronger than transient) in 3Q and modestly positive in 4Q. 1Q18 will have an extremely difficult y/y comp.

Group/convention outlook for Washington, D.C.

1Q17	2Q17	3Q17	4Q17	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	3Q19	4Q19
21.9%	-13.3%	10.9%	4.1%	-26.0%	28.3%	-46.2%	-18.8%	33.7%	-35.4%	9.7%	-4.7%

Source: STRH Research, TAP

Est exposure to DC market								
	CHSP	**DRH**	**FCH**	**HST**	**LHO**	**PK**	**RHP**	**SHO**
DC	3%	5%	0%	10%	16%	3%	23%	13%
Rank	6	5	8	4	2	6	1	3
Note: Est. exposures include surrounding areas								
Source: STRH Research, Company data								

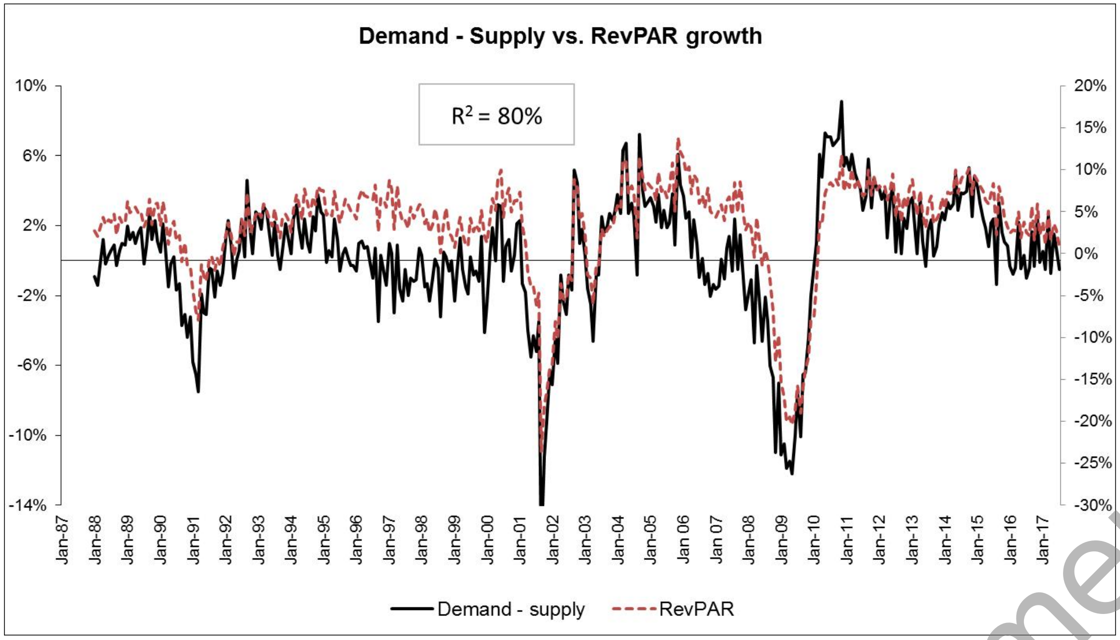
The Big Picture Topic: Why Have Forward Trends Been Unusually Unvolatile?

In summary:

- **Most importantly – there has not been a "shock" to end this lodging cycle. As we discuss below, there has yet to be a lodging cycle in recent decades that has not ended with a political, macroeconomic, or incident-related shock.** It is possible – although it would be very surprising to us – if a new lodging cycle commenced in the next 12-18 months based on current fundamentals. Fundamental trends do not support such an assumption, in our view.
- **Demand-supply fundamentals have remained positive well beyond the norm for recent lodging cycles.** Less pressure from supply growth (and near record high occupancies) keeps rate integrity relatively stable (for now).
- **The menagerie of both positive and negative macroeconomic and geopolitical matters, alongside uncertainty as to if/when significant pro-business legislation will positively impact lodging demand and ADR, has resulted in a "wait-and-see until 2018" attitude for corporate demand.** With few exceptions for REITs with unique situations at play, we see the low RevPAR/moderate supply growth/moderate economic growth environment all contributing to the "relatively" stable hotel REIT stock prices (despite some moderate downward trends as of late).

Unusually unvolatile for late cycle: It is interesting to us that the industry fundamentals that make up the RevPAR equation – demand and supply – are both growing at low rates at this stage in the lodging cycle. This is a different scenario than what typically occurs towards the end of a lodging cycle, where RevPAR growth ends up slowing largely due to significant supply growth with a cycle ending following a demand shock. As we have noted previously, **RevPAR has historically crashed & burned at the end of the previous three cycles (1991, 2001, 2008), so a potential "soft landing" is new and uncharted territory; Then again saying "this time is different" inevitably leads to it not being different.** But even *in absentia* of a demand shock, there are unusual differences in this cycle compared to the latter stages of the last three cycles.

As evident in the following chart, every lodging cycle decline since national data was first aggregated has been precipitated by the demand-supply spread shifting negatively. That trend has yet to occur this cycle. Since January 2016, the spread between demand and supply growth has averaged to +0.3% -- meaning that in the last year and a half, demand and supply growth have on average been roughly the same. Such a trend is atypical this late into a lodging cycle.



Source: STR, STRH Research

Supply growth: Less pressure from supply growth has led to the maintenance of the demand-supply equilibrium. Quite unusual for the latter periods of a lodging cycle, where occupancy remains at or near peak levels, is that supply growth has been modest in aggregate (although very high in a few markets).

- For example, per Lodging Econometrics, supply growth in Upper Upscale was +1.4% in 2007 but grew to +2.9% in 2008 (a +150 bps change). Whereas from 2016 to 2017, supply growth in Upper Upscale is expected to go from +1.5% in 2016 to +1.3% in 2017 (a decline of 20 bps) and increase by 70 bps from 2017 to 2018. **The lack of significant supply growth in Upper Upscale certainly contributes to the lower volatility in our unusually unvolatile forward intelligence over the past several months, as rate integrity has been largely maintained in aggregate.**
- Historically, significant RevPAR growth sustained over a number of years leads to supply growth significantly exceeding demand growth as developers rush to take advantage of unaccommodated demand (and profits). However, lending for new hotel construction has been conservative this cycle. Some banks and other typical hotel lenders revised terms significantly following the aggressively looser terms in the last cycle (where loan-to-values sometimes exceeded 80%). Note that high supply growth in combination with the Great Recession resulted in the worst lodging downturn in decades.
- **In this cycle, we believe the comparably low late-cycle supply growth has played an important factor in RevPAR growth not turning negative (yet) and contributing to the non-volatility in forward demand trends. Concurrently, we are only just getting to the stage in this cycle where supply growth exceeds demand growth – an incredible situation as we are in the eighth year of this lodging cycle.**

While the overall hotel pipeline in this cycle continues to rise, a mitigating factor is that new construction hotels are pushing out their openings into future years. This topic was discussed on our conference call with Lodging Econometrics and in our question to MAR on the 2Q earnings call.

- The rationale for the delay of openings is largely for two reasons: 1) labor shortages in construction; and 2) the hope/wait-and-see that the Trump administration will Make RevPAR Great Again. Few projects are getting cancelled outright – and rightly so as developers must go through multiple hurdles to get a project approved for development and financed. However, with a relatively more muted level of supply growth nationwide, existing hotels have a greater opportunity to hold or push room rates (even modestly) in a period of historically high occupancy, leading to the maintenance of rate integrity.

We can also look at the 1990s lodging cycle in comparison to this current cycle as the 1990s had a long economic growth period that continued despite geopolitical turbulence. In the 1990s cycle, occupancy turned positive in January 1992. About 5 ½ years into the cycle (May 1997), the lodging demand-supply spread turned negative (supply exceeding demand). At that point in the cycle, supply growth was 3.4%. In part because of the macroeconomic strength in the U.S., RevPAR remained positive for an extended period of time despite significant supply growth (RevPAR remained positive until April 2001). **As a comparison to the current cycle: supply growth reached 2.0% in April 1996 (52 months into that cycle) – and if we reach 2.0% supply growth this year, we will be 94 months into the current cycle.** Supply growth in this cycle has remained at around 1.9% since January 2017.

Current Expectations for Top 25 Market New Supply:

Supply By Top 25 Markets (Sorted by Pipeline Rooms Growth as % of Census)
As of 2Q17

	Census Rank	YE 2015 Growth Rate	YE 2016 Growth Rate	2017F Growth Rate	2018F Growth Rate	2019F Growth Rate
Nashville	24	2.4%	3.7%	3.5%	10.3%	6.4%
New York City	4	4.8%	5.1%	5.1%	8.3%	4.1%
Seattle	20	3.2%	2.3%	5.0%	6.4%	5.3%
Miami	14	3.0%	4.1%	3.2%	4.9%	4.4%
Denver	18	2.9%	2.6%	6.0%	3.7%	9.0%
Dallas	8	1.5%	3.2%	6.1%	3.7%	4.4%
Houston	9	3.6%	6.8%	3.9%	4.5%	5.4%
Boston	13	1.7%	4.3%	2.5%	4.8%	2.5%
Detroit	21	1.3%	2.3%	3.0%	3.5%	4.5%
Los Angeles	6	0.8%	1.0%	4.1%	2.5%	3.8%
Philadelphia	17	0.3%	1.6%	3.2%	3.9%	2.9%
Minneapolis	23	2.4%	5.9%	1.7%	3.1%	4.6%
San Diego	11	1.2%	1.6%	1.5%	1.8%	2.7%
Atlanta	7	0.7%	1.4%	2.0%	2.6%	3.3%
Washington, D.C.	5	1.6%	2.0%	1.9%	1.8%	1.9%
Anaheim	12	1.1%	3.3%	2.0%	1.4%	3.3%
San Francisco	15	0.7%	0.1%	2.7%	2.1%	1.1%
Tampa	16	0.7%	1.5%	3.4%	2.8%	2.3%
San Antonio	19	0.8%	1.9%	1.6%	1.7%	3.7%
Phoenix	10	1.4%	1.6%	2.1%	3.0%	1.5%
Chicago	3	2.6%	2.5%	1.0%	2.6%	1.8%
Orlando	2	0.8%	1.8%	0.7%	1.0%	1.4%
St. Louis	27	0.5%	1.3%	1.8%	2.1%	2.8%
Oahu Island	36	0.5%	1.3%	0.0%	0.6%	0.0%
Norfolk	25	0.6%	0.0%	0.8%	0.0%	0.3%
Total Top 25 Markets		**1.7%**	**2.6%**	**2.8%**	**3.3%**	**3.3%**

Source: Lodging Econometrics
Note: The largest market in the U.S., Las Vegas, is not included in this chart due to its casino orientation.

Demand growth: Remains muted with the "wait-and-see" approach likely to impact 2018 corporate rate negotiations. Alongside hotel developers adopting a "wait-and-see" approach leading to the elongation of hotel pipeline growth, we see a similar trend with business-focused hotel demand. This is impacting both transient corporate (the individual business traveler) and corporate-related group (generally among the highest-rated in-house and citywide group demand in major markets). At this time, there is a very consistent messaging from our coverage: macroeconomic indicators are largely positive but there has not been a translation to significantly improving demand fundamentals.

- Without greater confidence in the future business environment, we do not expect hotels to have much opportunity to aggressively push corporate negotiated rates in 2018. And that will likely parallel with in-house corporate-related group rates. Note that a few 2Q earnings calls presented a more bullish/pollyannaish view – that corporations are optimistic about the economy, which will likely be reflective in 2018 rate negotiations.
- While we will not have a great indication of the results of 2018 corporate rate negotiations for another few months, our forward bookings intelligence on the group front and communications with corporate travel contacts suggest resistance to rate increases in 2018. And without any large spur to demand growth combined with moderately increasing supply growth, we see the equilibrium resulting in the continuation of the deceleration of RevPAR growth to low-single-digit positive.
- As positive here with muted and unvolatile demand is the industry has good visibility into cost controls. However, it is tough to fight the tide of wage growth in a stagnant-to-worsening RevPAR environment. REITs have so far been able to keep margins mostly flat to down slightly in a +1% (or worse) RevPAR environment. However, wage growth is a rising concern (and will be addressed in our next Lodging Speaker Series in September.)

The implication to the stocks from all these considerations is a continuation of the bifurcation between the Lodging C-Corps and the REITs. We note that manager/franchisor oriented Lodging C-Corps are up ~15% YTD (total return) whereas the REITs are slightly down vs. the S&P 500 index up ~9%. The C-Corps are natural beneficiaries of supply growth. Additionally, we think EBITDA growth for C-Corps is likely still achievable even in a flat RevPAR environment with moderate domestic supply growth (see MAR's earnings scenarios from their investor day for example). The bigger growth opportunity for the C-Corps in the near-term, both in terms of RevPAR growth and pipeline growth, continues to be from Europe and Asia in our view. Barring a global shock, we see the increased geographic diversification of the Lodging C-Corps as long-term positive albeit with increased risk befitting a greater mix of properties in emerging economies. The one major exception to this thesis is incentive management fee generation which largely lacks profit hurdle requirements in Asia (a positive theme that we expect to hear more about from the C-Corps – particularly if incentive fees decline in the U.S.).

- We also believe some investors have moved into the C-Corps from other consumer sectors, although we caution new investors to the space that lodging demand can be fickle (one night leases in hotels vs. multi-year leases in traditional commercial real estate).
- The new investor interest in the C-Corps has led to multiple expansion. We raised our EV/EBITDA multiples by ~50 bps for the highest-quality C-Corps post-2Q earnings.

The bifurcation of the Lodging stocks presents a more critical eye towards the hotel REITs. Most of the REITs have basically held their stock prices following the run-up post-election (largely unvolatile stock movement with slight deceleration of late). However, we see more risk to the downside for REITs leading into 2018 than we do for C-Corps. The combination of rising supply growth, wage pressure (an emerging trend), and the lack of sustainable positive corporate demand momentum combine for measurable headwinds. A saving grace for the REITs is we believe there are still opportunities to cut costs. For one, at high occupancy, staffing is full. For most hotels (non-unionized in particular), there will likely be opportunities to reduce staffing if demand falls at a measurable level. Second, while we believe that there is less fat in other operating areas as compared to the last lodging cycle, there is still low-hanging fruit both at the property and corporate level. **We do not hesitate to mention that some REITs were smartly undergoing property-level margin preservation initiatives well before RevPAR declines became actualized. We commend these efforts as simply good strategic leadership.** Nevertheless, we continue to favor C-Corps over the Lodging REITs especially given pressures on owned hotel margins from increasing labor costs.

- Assuming we do not see a rebound in demand in the near term, what are some of the tailwinds we are paying attention to that might lead to stock growth?

- Potential M&A activity/REIT privatization (examples: PK has actively stated its interest in acquisition and RLJ was pursued by Blackstone (BK, $31.64, NR) recently);
- A few REITs should see tailwinds from major property renovations and repositionings;
- The rebound in San Francisco particularly into 2019 (post the ramp-up of the Moscone Convention Center) shouldbenefit the majority of our coverage; and
- A weakening dollar (and no negative geopolitical shocks) positively impacting international inbound demand.

As we have written in our last several reports, while the RevPAR trends are uninspiring, the good news is we believe companies are likely not going to miss their (uninspiring and intentionally conservative per some company conference calls) guided ranges. If nothing else, that has at least prevented the stocks from giving back most of their November and December gains, along with the continued hope (but fading by the day) that President Trump will eventually Make RevPAR Great Again, in our view. **There are several relative bright spots that we believe will continue to prevent hotel stock prices from significantly contracting:**

1. **Other sectors considered "uninvestable" by investors.** Investors tell us other sectors which historically were in their investment universe have become “uninvestable” due to threats from Amazon (AMZN, $946.02, Buy, Squali) and the like. While we see Airbnb (private) as a threat to the hotel industry, we think the threat is nowhere near the magnitude of say Uber (private) vs. yellow cabs. A frequent comment we hear from investors when we discuss lackluster hotel fundamentals and expensive lodging stocks, most notably MAR vs. peers, is “Our other investment choices look far less attractive so we’re sticking with our investments in lodging for now.”
2. **Hotel REIT dividends are attractive and should be sustainable over the next year.** We believe unwillingness to have to go against a 6%+ dividend yield has kept investors from being overly negative (potentially shorting) the hotel REITs.
   a. **Concerning the hotel REITs, a big outstanding question that will arise in the next few months will be corporate rate negotiations for 2018.** Positively, consumer confidence remains high alongside small business confidence. However, the Conference Board’s CEO Confidence index fell 7 points in 2Q17 from the prior quarter. It is less clear if/how business sentiment will be impacted by the dissolution of some of the President’s business councils, the impending debt-limit deadline, and the possibility of a government shutdown later this year. We will start to get a sense of corporate rate negotiations in 3Q earnings commentaries and moreover when we see the REITs at our Boston conference in December.
   b. **Another emerging trend relates to increasing labor and benefit costs which is also a headwind to the REITs.** To this end, we invite investors to our next Lodging Speaker Series with CBRE Hotels’ Americas Research where this topic will be discussed by one of the industry’s leading experts on hotel labor costs. CBRE will also present their top-line forecasts and Cap Rate and hotel transaction trends – all relevant topics for REIT investors.

Price Target/Risks Summary

Lodging	TKR	Price 8/29/17	Rating	PT*	% upside down-side	2018E EBITDA ($M)	Target EV/EBITDA Multiple	Risks
Chesapeake Lodging Trust	CHSP	$25.17	Hold	$23	-9%	$183	12.0X	Upside risk: improvement in NY and Chicago markets Downside risk: softening of RevPAR trends in Boston or SF. Slowdown in real estate lending.
Choice Hotels	CHH	$60.15	Hold	$65	8%	$321	13.5X	Upside risk: conservative guidance. Downside risk: big catalyst of special dividend already baked into the stock.
DiamondRock Hospitality	DRH	$10.73	Hold	$11	3%	$254	11.5X	Upside risk: specific markets (esp. NYC) perform better than expected. Downside risk: company unable to locate properties to buy.
FelCor Lodging Trust	FCH	$7.17	Hold	$7	-2%	$215	11.5X	Upside risk: NY hotels outperform and company is able to execute hotel sales at accretive multiples. Downside risk: company unable to execute planned sale of hotels and NYC underperforms.
Host Hotels & Resorts	HST	$17.68	Hold	$19	7%	$1,419	12.5X	Upside risk: the company increases dividends by more than expected; NYC outperforms or is sold down at attractive multiples. Downside risk: Group underperforms. NYC hotels underperform and asset sales do not happen.
Hyatt Hotels	H	$58.10	Hold	$61	5%	$777	12.2X	Upside risk: Transient and group trends outperform expectations Downside risk: ongoing misexecution and volatility.
Hilton Grand Vacations	HGV	$35.48	Buy	$41	16%	$408	10.9X	Downside risk: Disruption in a major market (HGV more concentrated than peers), issues with Japanese customer (HGV more exposed than peers), difficulty sourcing additional fee-for-service inventory deals
Hilton	HLT	$62.89	Buy	$67	7%	$1,947	14.0X	Downside risk: overhang from remaining big sponsor ownership, slowing pipeline
InterContinental Hotels	IHG	$49.43	Hold	$51	3%	$899	13.5X	Upside risk: further acceleration in returning capital to shareholders. Downside risk: trends continue to worsen in Greater China
ILG	ILG	$26.20	Buy	$29	11%	$368	10.8X	Downside risk: membership base erosion as churn outstrips new timeshare sales
Lasalle Hotel Properties	LHO	$27.98	Hold	$26	-7%	$320	12.5X	Upside risk: ability to increase dividend. Downside risk: heavy D.C. exposure.
Marriott International	MAR	$100.23	Hold	$96	-4%	$3,139	13.7X	Upside Risk: Significant U.S macroeconomic improvement results in large recovery in transient corporate demand (and consequential >400 bps RevPAR improvement). Owned assets sell for premium prices relative to MAR expectations. Downside Risk: 2017 or 2018 is a recession year in the US. Geopolitical and policy risks negatively impact lodging demand.
Marriott Vacations	VAC	$113.75	Hold	$120	5%	$296	10.4X	Upside risk: Mix shift not an issue for margins, quicker execution/upsize of buyback program; Downside risk: inability to achieve development margin targets, inability to close asset sales or asset sales are done at lesser values than expected
Park Hotels & Resorts	PK	$25.98	Hold	$28	8%	$741	12.0X	Upside risk: The downturn in the lodging cycle is short-lived and positive macroeconomic trends result in increasingly positive RevPAR growth and improved EBITDA. Downside risk: Significant supply growth and macroeconomic challenges/shocks.
Ryman Hospitality Properties	RHP	$58.77	Hold	$59	0%	$385	12.3X	Upside risk:recovering group demand better than expected, better margin recovery. Downside risk: booking issues stickier than expected.
Sunstone Hotel Investors	SHO	$15.23	Hold	$15	-2%	$341	12.0X	Upside risk: valuation discount to peers. Downside risk: San Diego, Boston, LA exposure. Insufficient ADR lift from Boston Park Plaza/Marriott Wailea Beach renovations.
Wyndham Worldwide Corp	WYN	$96.65	Buy	$112	16%	$1,509	9.8X	Downside risk: the timeshare business is especially vulnerable to economic softness.

** All of our Lodging price targets are derived by applying a target EV/EBITDA multiple to our estimate for 2018 EBITDA*

Source: FactSet, STRH research

Companies Mentioned in This Note

Amazon.com, Inc. (AMZN, $946.02, Buy, Youssef Squali)
Carnival Corporation (CCL, $68.55, Buy, C. Patrick Scholes)
Choice Hotels International, Inc. (CHH, $60.65, Hold, C. Patrick Scholes)
Chesapeake Lodging Trust (CHSP, $25.01, Hold, C. Patrick Scholes)
DiamondRock Hospitality Company (DRH, $10.64, Hold, C. Patrick Scholes)
FelCor Lodging Trust Incorporated (FCH, $7.07, Hold, C. Patrick Scholes)
Gaming and Leisure Properties, Inc. (GLPI, $38.33, Hold, C. Patrick Scholes)
Hyatt Hotels Corporation (H, $57.97, Hold, C. Patrick Scholes)
Hilton Grand Vacations Inc. (HGV, $35.47, Buy, Bradford Dalinka)
Hilton Worldwide Holdings Inc. (HLT, $63.17, Buy, C. Patrick Scholes)
Host Hotels & Resorts, Inc. (HST, $17.53, Hold, C. Patrick Scholes)
InterContinental Hotels Group, PLC (IHG, $49.66, Hold, C. Patrick Scholes)
ILG, Inc. (ILG, $26.23, Buy, C. Patrick Scholes)
LaSalle Hotel Properties (LHO, $27.84, Hold, C. Patrick Scholes)
Marriott International, Inc. (MAR, $100.71, Hold, C. Patrick Scholes)
MGM Growth Properties LLC Class A (MGP, $30.24, Buy, C. Patrick Scholes)
Norwegian Cruise Line Holdings Ltd. (NCLH, $57.88, Hold, C. Patrick Scholes)
Park Hotels & Resorts Inc. (PK, $25.84, Hold, C. Patrick Scholes)
Royal Caribbean Cruises Ltd. (RCL, $120.76, Buy, C. Patrick Scholes)
Ryman Hospitality Properties, Inc. (RHP, $58.62, Hold, C. Patrick Scholes)
Sunstone Hotel Investors (SHO, $15.23, Hold, C. Patrick Scholes)
Marriott Vacations Worldwide Corp. (VAC, $113.54, Hold, C. Patrick Scholes)
Wyndham Worldwide Corporation (WYN, $96.31, Buy, C. Patrick Scholes)
Airbnb (private)
Blackstone (BK, $31.64, NR)
Uber (private)

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