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Truist Securities

Lodging REITs

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What's Inside

An analysis of recent hotel labor cost trends, one of the critical components impacting hotel EBITDA margins

Hotel P&L Analyzer: June GOP margins +9,630 bps y/y on +357% Total RevPAR. Resort ADR gains helping.

We dive into the latest and not-so-greatest on hotel labor and related issues

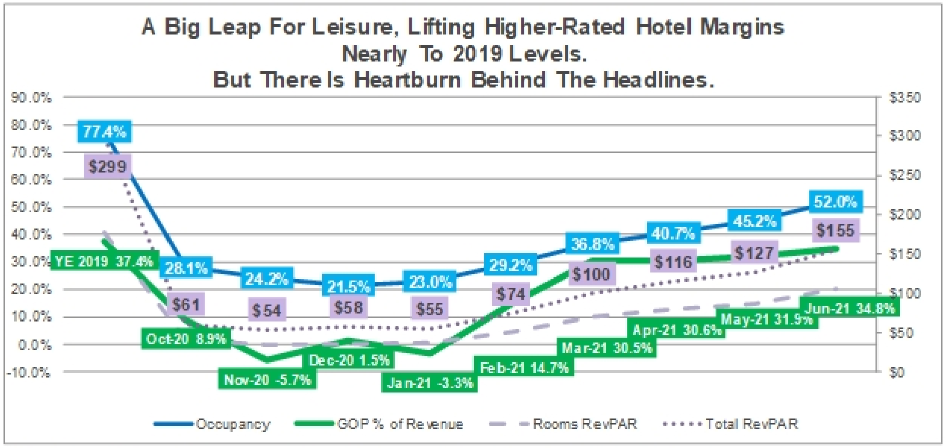
What's Incremental To Our View

Based on "big data" observations from higher-rated U.S. hotels (data source: HotStats): June: +9,630 bps of y/y GOP margin growth on +357.0% Total RevPAR (Rooms RevPAR + outside-of-the-room spend). May: +12,490 bps of y/y GOP margin growth on +540.9% Total RevPAR.

We view 2Q y/y comparisons noisy. However, per HotStats data we estimate absolute GOP margins for 2Q about 32% which we find a remarkable feat. The backstory may be less sustainable with resorts' ADRs skyrocketing and driving headline margin growth -- countered by rising labor costs largely not reflected yet in results.

The good news: headline margins are attractive when compared to YE 2019. REIT executives may be content if not surprised at their 2Q bottom lines compared to forecasts 90-120 days ago. The results noted above are likely to bode well for 2Q full-service REIT earnings (most REITS have decent exposure to resorts and/or leisure markets; even Ryman (RHP, Sell) is likely to benefit from SoundWaves in Nashville). To an extent, C-corp base fees will also benefit from strong leisure ADRs. The most detailed stats so far this earnings are in our view from Pebblebrook's (PEB, Miller, Hold) earnings call.

- Other good news is that we are not hearing of major resistance to overnight daily housekeeping being eliminated including from corporate travel agencies (dirty wares piling up in hallways -- different story). The positive impact to margins from fewer housekeepers may be 100-200 bps or more at stabilization for large full-service hotels and where we and perhaps others are modeling conservatively for now.
- **How long full-service REIT margins can hold once we shift out of a primarily pent-up leisure environment to the fall months, that is another story. We expect July margins and to an extent August will be similar if not superior to June -- enough to possibly make 3Q another robust quarter to the bottom line.** We have less conviction and less optimism on margins especially post-Labor Day. Some hoteliers still suggest they cannot forecast more than one month in advance.



Notes: Comp sets may differ from month to month. We evaluate headline results for high-level comparisons.
Some properties have reopened over the course of recent months (including competitive properties), which may impact above.
Resort/leisure-oriented hotels may have an overweight influence on 2020/2021 results.

Source: HotStats, Truist Securities Research

- **2Q21 estimates:** We estimate GOP margins of approximately 32% for the HotStats sample, with relatively stronger results for many leisure hotels and resorts able to drive significant room rate growth. We see mixed-to-very challenged results for urban and corporate-oriented hotels where occupancy is light, room rates are declining, and in some cases staffing and other operating costs are elevated. We think especially of 1,000+ room hotels with significant meeting space, energy usage, and a staff that needs to at least upkeep the properties to basic standards.

Now we shift to the not-so-good news: most full-service hotels remain far from normalization. Public and private hoteliers note rehiring remains extremely difficult at many hotels, in some cases not improved by the removal of COVID unemployment benefits, and with increases in hourly wages seen across the service industry and beyond not fully reflected in the headline margin results as rehiring is only in the early stages for many hotels.

- **Even for the hotels with impressive ADR growth, issues are bubbling in some leisure markets where REITS own hotels.** Local tourism infrastructures are in some cases not able to handle the capacity of tourists. Maui's mayor noted last month for airlines to bring fewer tourists to the island (Associated Press). We are curious what the Lodging REITS would say to that, especially given what the storyline was last summer. **In some other markets, owners are also facing an increasingly active front from hotel labor organizations** and local governments that pass ordinances (recently for example in West Hollywood, CA on housekeeping) that we find onerous on hotel operations/staffing and margins (Boston Globe). In markets where occupancy has not come back quickly, we think there is a real possibility of increased hotel closures due to these pressures, which at the end of the day may not service the labor organizations well if their members struggle to find employment. The more liquid REITS should be better positioned than private hotel owners at least over the long term if supply is reduced.
- **We encourage investors to have a critical ear if/when C-suite executives speak to the benefits of higher room rates on lower demand during 2Q earnings. This imbalance is in our view not a good long-term solution.** The main saving grace for hoteliers on the margin front is that demand is not fully back so neither is staffing. But let us consider the ramifications. In Las Vegas for example, we have heard from our private contacts about a new term called "dragging", where a shortage of clean linens and towels at hotels (due to tight labor) are leading to hoteliers "dragging" rooms out of service in the middle of the week so that there is greater availability for high-paying weekend guests. We do not know the implications to the convention industry but such a phenomenon could have negative ramifications in major convention citywide markets if this strategy transpires in 4Q and next year when hoteliers hope to host larger groups.

The latest and "not-so-greatest" on hotel labor and margins:

This weekend's cover story in *Barron's* focused on labor issues and not surprisingly highlighted hotels. At the ALIS conference last week, labor was a primary discussion point. We expect labor to be issue #1 or #2 on REIT earnings calls (the recovery of business travel being the other main story).

We view what may be occurring on the macro and what we see in the many news articles on hotel labor may not reflect some of the important subtleties for full-service hotels. We discuss a few themes below and encourage those curious to read a longer piece in Hotel Business where we and a number of owners and operators shared their opinions on the future of hotel labor.

- **Low immigration to the U.S. was mentioned far into the Barron's piece but did not receive much focus. For hourly staff, we view low immigration as a structural long-term issue for hotel margins that is pressing but more so to full-service hotels given sheer numbers of staffing and higher service standards than some lower-priced hotels.** Immigration issues (and more broadly concerns for prospective arrivals given some hostile/anti-immigration communities) was a pressing issue for hoteliers pre-COVID, especially given low unemployment and our view of general disinterest for many Americans to take difficult low paying jobs. We struggle to see the low immigration issue go away in the next several quarters.
- **For higher-priced hotels, we view managerial burnout as a rising issue and problematic. Effectively, we think some property managers may leave the industry for greater work/life regularity.** The challenge we see is that training a housekeeper or front desk clerk is very different than the loss of someone with a decade or more of hotel experience especially with training in the service standards of a higher-end hotel with complex operations.
- **For full-service hotels and more broadly many service industry companies where there is a large customer expense (airlines as well), we also view increasing pressure from some hostile guests leading to an undesirable work environment. We do not see this issue resolving anytime soon although having a mix of travelers shifting to business from leisure should eventually help**. We think from the experience of a guest who is spending in some cases hundreds of dollars more a night on lodging versus 2019 and finding the following: restaurants closed, longer wait times for service, rooms not necessarily well-kept, and then shifting policies on mask wearing and safety protocols. Add to the experience before hotel arrival: airline passengers are dealing with flight delays/cancellations and long customer service wait times. Rental cars are in some markets hard to find. And unfortunately the travel experience boils over in public view. The NY Post noted airline workers taking self-defense courses given a rise in passenger outbursts, sometimes violent.
  - However, we note (somewhat controversially but we think widely accepted within the travel industry) that the guests that are being most aggressive with employees and generating the headlines in the news are also ones that generally do not travel as much and in some cases where expectations are not realistic or at the very least accommodating. More pointedly, we do not expect as many outbursts to be accepted on planes and at hotels where the majority of guests are business travelers. This should be obvious: who wants an airline or hotel company to contact an employer when their guest yells at or physically attacks a service employee? We note that for over a year and a half, the leisure customer has dominated airplanes and hotels -- and perhaps it is for good reason why some service industry employees are increasingly at wits end. We see fewer corporate travelers creating headaches, making for more pleasant work conditions for service industry employees as well.

HotStats monthly results:

June:

- **Rooms RevPAR of +361.7% and Total RevPAR of +357.0% compared with GOP margins of +9,630 bps y/y.**
  - GOP margins as a percentage of total revenue of 34.8% compares to -61.5% in the prior year.

May:

- **Rooms RevPAR of +539.0% and Total RevPAR of +540.9% compared with GOP margins of +12,490 bps y/y.**
  - GOP margins as a percentage of total revenue of 31.9% compares to -93.0% in the prior year.

April:

- **Rooms RevPAR of +867.2% and Total RevPAR of +752.6% compared with GOP margins of +22,340 bps y/y.**
  - GOP margins as a percentage of total revenue of 30.6% compares to -192.8% in the prior year.

1Q HotStats results:

- **March: Rooms RevPAR of +4.0% and Total RevPAR of -11.0% compared with GOP margins of +4,240 bps y/y.** We add that ADR for March was $189 vs. $216 in the prior year. Occupancy was 36.8% vs. 31.0% in the prior year.
  - GOP margins as a percentage of total revenue of 30.5% compares to -11.9% in the prior year.

  - **We note that margins north of 30% on 37% occupancy compare to YE 2019 margins of 37% on 77% occupancy. Clearly there is a major disconnect.** As we have discussed several times in recent months, there is a financial consequence to managers handling hourly tasks -- although we cannot view the current fundamentals as sustainable. Quite frankly, we also view managers in client-facing roles that do not have a background in hotel operations (for example: Directors of Sales and related roles) may be less desirous to clean bathrooms when other industries are hiring for sales tasks today.
- **February: Rooms RevPAR of -70.3% and Total RevPAR of -73.6% compared with GOP margins of -2,220 bps y/y.** We add that ADR for February was $174 vs. $227 in the prior year. Occupancy was 29.2% vs. 75.4% in the prior year. For most markets, February 2020 was a fairly normal travel month although there was already slippage in some gateway markets.
  - GOP margins as a percentage of total revenue of 14.7% compares to 36.9% in the prior year.
- **January: Rooms RevPAR of -75.7% and Total RevPAR of -77.7% compare with GOP margins of -3,280 bps y/y.** January ADR, reflective of a colder weather month, was $159 vs. $220 in the prior year. Occupancy was 23.0% vs. 68.3% in the prior year.
  - GOP margins of -3.3% compare to 29.5% in the prior year.

Companies Mentioned in This Note

Pebblebrook Hotel Trust (PEB, $22.49, Hold, Gregory Miller)
Ryman Hospitality Properties, Inc. (RHP, $76.70, Sell, C. Patrick Scholes)

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