Market Snapshot: Can Hotels Hold Their Ground in 2017?

Major gateway markets across the US received record-high tourism levels throughout 2016, exceeding the low expectations set because of geo-political issues and economic volatility. Tourism and leisure spending is forecast to rise even more in 2017, as consumer confidence has been on an upward trend this year so far, which many attribute to the Trump administration's potential for deregulation. Though the lodging sector posted solid overall performance last year, many are cautiously observing whether it can remain steadfast against last year's hurdles of new supply production, the rise of alternative accommodations, and the subsequent softening in property values and income growth.

Market Trends: Major Metros Suffer as Cheaper Travel Options Sought

According to Trepp data, the average occupancy rate for lodging properties backed by CMBS loans is 74.4% as of February 2017. A recent TreppTalk blog stated that the national hotel occupancy rate improved just 10 basis points to 65.5% in 2016. The highest growth rates were observed in secondary markets, West Coast metro areas, and Washington D.C. Some major markets, including Houston, Miami, and New York, posted negative growth rates. CMBS loan issuance for the lodging sector reached a healthy $13.0 billion, though this is still down from its recent yearly peak of $21.7 billion in 2014.

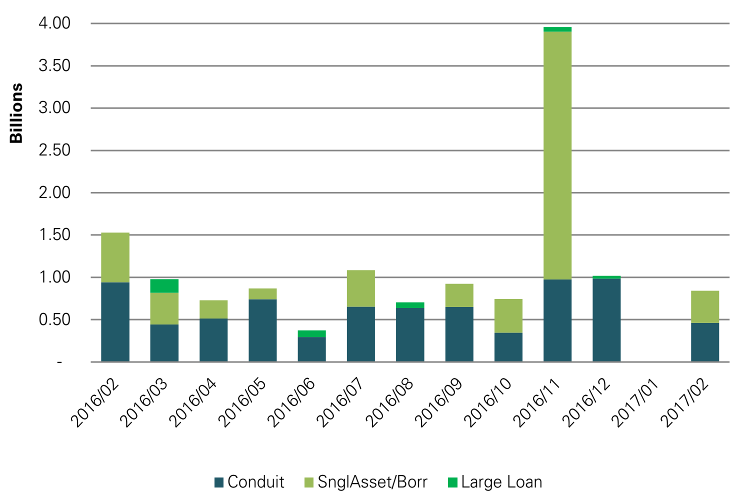
It seems the hotel sector held its ground last year against the odds, as increased supply levels were also coupled with forceful market disruptors such as Airbnb and Homeaway. Alternative accommodation sites, armed with innovative ideas and interfaces, compete with lower-tier hotels for the 30-50% of total hotel demand that seeks lower-priced stays.

Looking ahead at 2017, JLL expects hotel transactions within the U.S. to "remain flat" at a forecasted volume of $29 to $31 billion. Private equity pulled back significantly on hotel transactions through most of 2016, making way for institutional investors, which are expected to command a strong buyer share again this year. The REIT sector is also anticipated to contribute a major portion of lodging market activity in 2017. Although REITs haven't posted a significant transaction volume in recent years, a comeback seems likely after lodging/resort REITs posted a 24.3% total return in 2016.

Will Issuance Top Recent Peak?

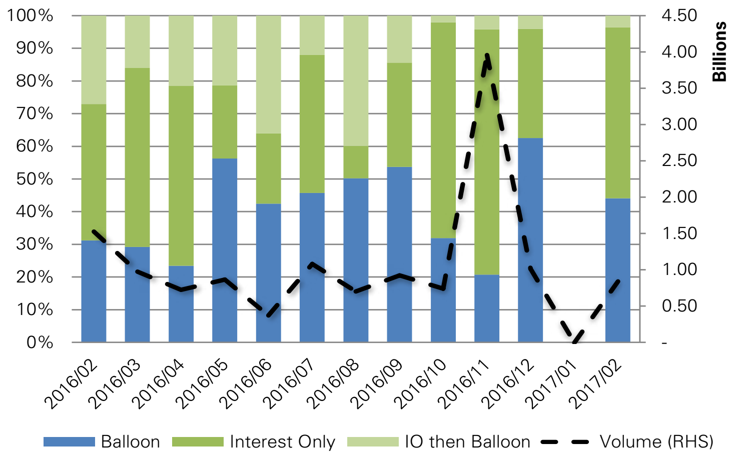
Lodging CMBS issuance came in at $842.0 million in February, down slightly from the recent 12-month average of $1.08 billion. The highest monthly issuance recorded in the past year was $3.96 billion this past November, nearly $3 billion of which were single-asset/single-borrower (SASB) loans. In February, a total of $461.0 million across 26 conduit loans was securitized, and $381 million was issued between two SASB notes. Conduit loans represent 54.8% of the lodging CMBS paper issued over the last 12 months, while SASB loans comprised 42.0%. The remaining 3.2% of the balance issued fell under the large loan category.

[Figure 1] Lodging: Issuance by Deal Type



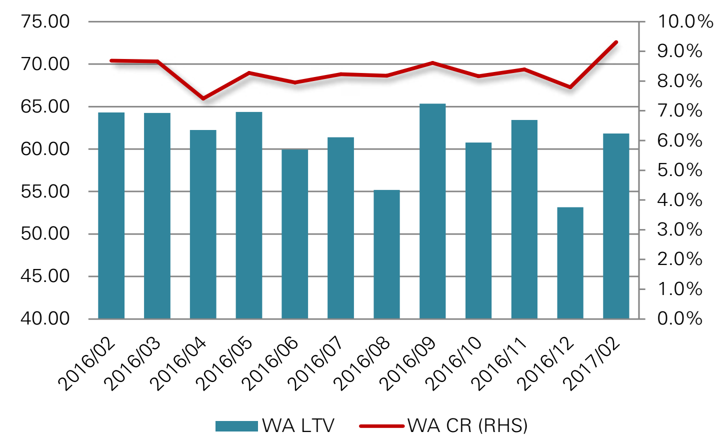
Source: Trepp

[Figure 2] Lodging: Issuance by Amortization Type



Source: Trepp

[Figure 3] Lodging: Conduit LTV and Cap Rates



Source: Trepp

Cap rates for conduit lodging loans plateaued around 8.2% in the third and fourth quarters of 2016. However, the weighted average cap rate at securitization rose slightly to 9.3% last month. Some investors expect cap rates to increase slightly in 2017 due to slowing hotel income growth and interest rate hikes. Still, many are confident that market size, liquidity, and the business-friendly policies expected from the Trump administration will keep the US hotel market a top target for investors.

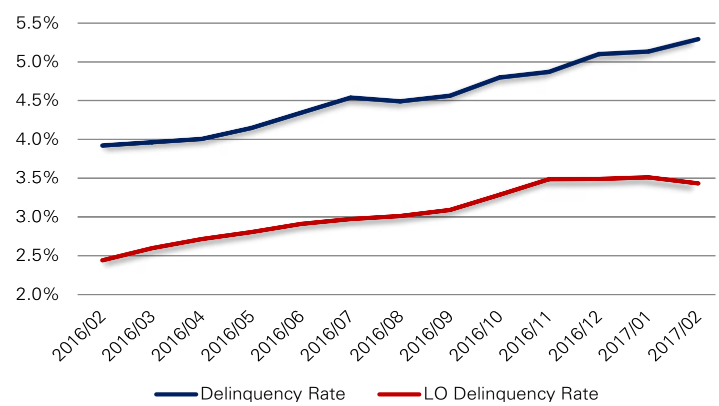
Low Delinquency & Loss Rates Speak to Health of Lodging CMBS

The delinquency rate for lodging CMBS is relatively low compared to the national CMBS delinquency reading and the rates of the other major property types. The overall delinquency rate, which has been on an upward trend over the last 12 months, came in at 5.31% in February. Conversely, the lodging delinquency curve has been relatively unchanged at around 3.5% since November, and dipped slightly last month to 3.43%. The only property type with a lower delinquency rate is multifamily, which hit 2.82% in February.

The largest lodging loan to become newly delinquent last month was the $21.0 million Holiday Inn Express NYC Fifth Avenue loan, which represents 2.68% of the remaining balance behind JPMCC 2015-FL7. The loan was transferred to the special servicer last August due to imminent monetary default. It was returned just a month after, modified with a B-note split and maturity date extension. Now, the loan is 60 days delinquent, and has been transferred to the special servicer for a second time.

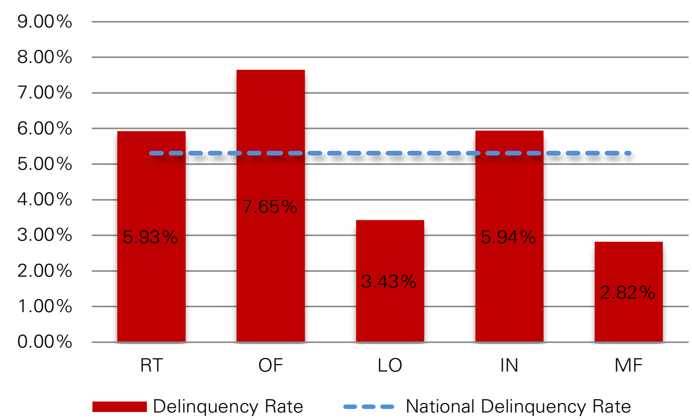
February loss dispositions for the lodging sector were relatively high, as about 10% of the month's total

[Figure 4] Lodging: Delinquency Rate



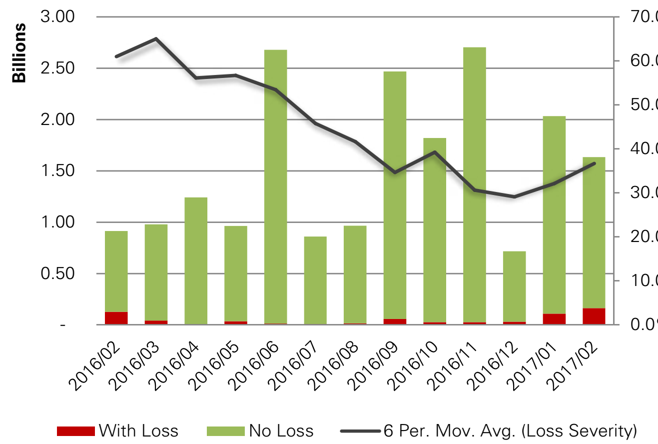
Source: Trepp

[Figure 5] February Delinquency Rates by Property Type



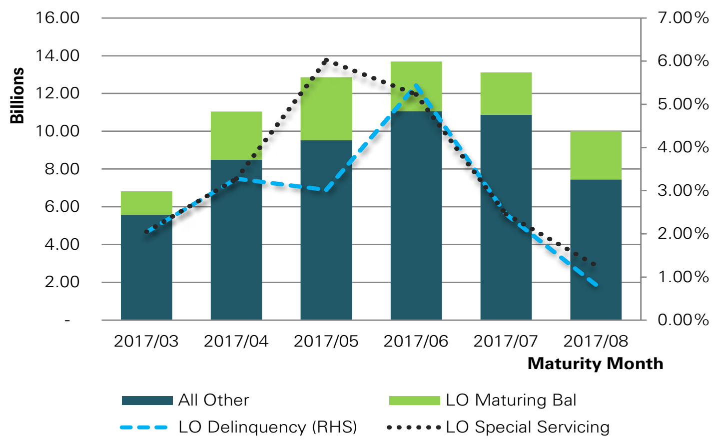
Source: Trepp

[Figure 6] Lodging: Monthly Dispositions & Losses



Source: Trepp

[Figure 7] Lodging: Maturing Loans



Source: Trepp

liquidation volume paid off with losses. This is up from the 12-month average, which came to 2.7%. Loss severity came in at 52.2% last month, pulling the six-period moving average up to 36.7%. Still, this average has been on a decline since the year-high of 65.1% measured last March. The average loss severity hit a low of 29.1% in December.

Looking Ahead: Will External Factors Weigh on Maturing Loans?

Over the next six months, approximately $14.5 billion across 378 lodging CMBS loans are coming due. Currently, 3.7% of this balance is currently in special servicing, and 2.9% is delinquent. The weighted average DSCR for loans maturing in the next six months is 1.70x, though loans maturing in March possess the lowest weighted average of 1.31x.

Over the next six months, the rate of delinquencies by maturity month peaks in June, with 5.44% of the $2.8 billion lodging CMBS coming due listed as currently delinquent. The rate of loans in special servicing by maturity month peaks in May, as 6.02% of that $3.3 billion is currently with the appointed servicer.

[Figure 8] Current Average Occupancy by Property Type

Source: Trepp

When looking at the wall of maturities overall, the lodging sector has posted very low delinquency and special servicing rates compared to other major property types. The sector's performance reflects a resilient tourism industry, as travel and leisure spending has still increased enough to offset the obstacles posed by high supply and the rise of alternative accommodations. However, the "uneven" growth from 2016 is a trend to watch. Although investors are beginning to tap into the growth potential within secondary markets, this shift may also come with a drop in lodging demand for some higher-priced major markets.

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