

Hospitality trends

Observations from the annual Phoenix,
AZ Hospitality Sector Roundtable



Building a better
working world



About this report

- ▶ EY surveyed hospitality sector leaders in Phoenix, Arizona, and invited these individuals to a roundtable on 3 November 2016 to discuss the survey results and industry trends.
- ▶ Our survey and discussions focused on the economy, transactions, capital markets, brands, technology, millennials and the industry's focus on trends affecting the broader US hotel market. The results of the survey are represented in the charts on the following pages.
- ▶ All respondent and participant names are confidential, and their responses were used only in combination with others to maintain their anonymity.

EY would like to thank the individuals who took the time to complete the survey and attended EY's Phoenix, AZ, Hospitality Sector Roundtable.

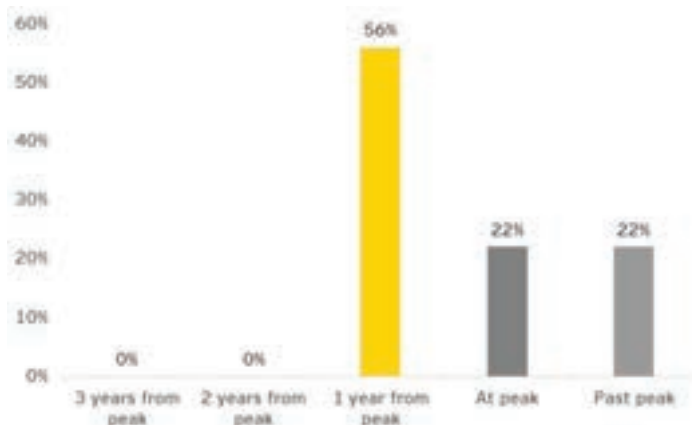
If you have questions about this survey or the Phoenix, AZ, Hospitality Sector Roundtable, please contact Mike Straneva at michael.straneva@ey.com, Steve Klett at steven.klett@ey.com or Michael Fishbin at michael.fishbin@ey.com.



The economy

More than half of the survey participants (56%) believe we are 1 year from the peak of the cycle, while 22% believe we are at the peak and 22% believe the peak has past. Major concerns include high supply and property taxes. The general consensus was that while the market is seen slowing down in primary markets, there are still pockets with strong fundamentals in secondary markets, including Phoenix.

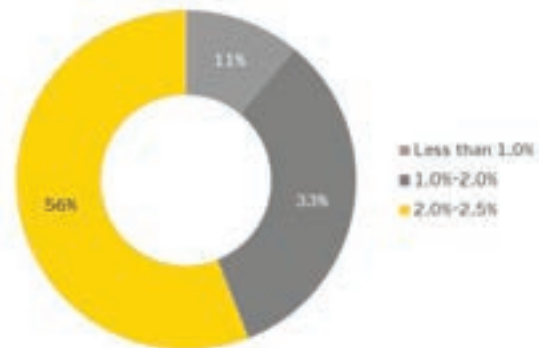
Where are we currently in the lodging cycle?



Source: EY

The US economy experienced steady gross domestic product (GDP) growth of 3.5% for the third quarter of 2016. In the fourth quarter of 2016, the economy had experienced lower growth of 1.9%. Based on the survey responses, participants had been more optimistic than what was recognized in Q4, with 56% anticipating growth of between 2.0% and 2.5%.

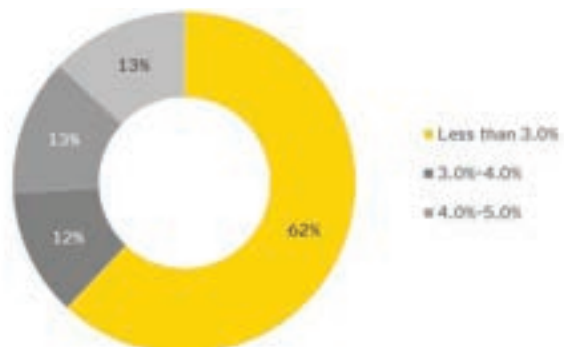
GDP outlook for 2017



Source: EY

The survey respondents forecast revenue per available room (RevPAR) growth, with 62% of respondents expecting RevPAR growth to be less than 3.0% for calendar year 2017. The average growth in RevPAR between 1988 and 2015 was 3.3%, but during the past three years, RevPAR growth has been more than 5.2%. In the US, RevPAR has a 0.47 correlation with nominal GDP.

RevPAR expectations 2017



Source: EY

Transactions

Survey respondents feel confident that 2017 will be better than 2016 for transactions, with 22% saying they plan to acquire, compared with only 11% in 2016 whose strategy was to acquire. Market participants commented that owners have been selling properties as RevPAR growth accelerated between 2015 and 2016. As RevPAR continues to grow in certain southwestern and western markets, owners are more willing to develop and acquire additional properties.

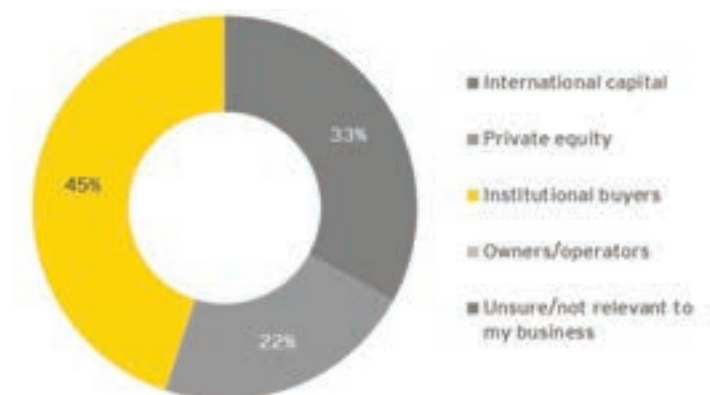
While most respondents at this roundtable were unsure of pricing concerns, a third (33%) felt that they have faced the greatest competition from foreign capital groups in terms of acquisition pricing. Respondents believe this trend has the potential to vary, depending on the foreign government's policy and unsustainability seen in the extremely high premiums being paid. Market participants do not anticipate this happening soon, but expressed several instances of being priced out of deals by foreign capital groups.

Investment strategy in 2016 and 2017



Source: EY

Pricing competition



Source: EY

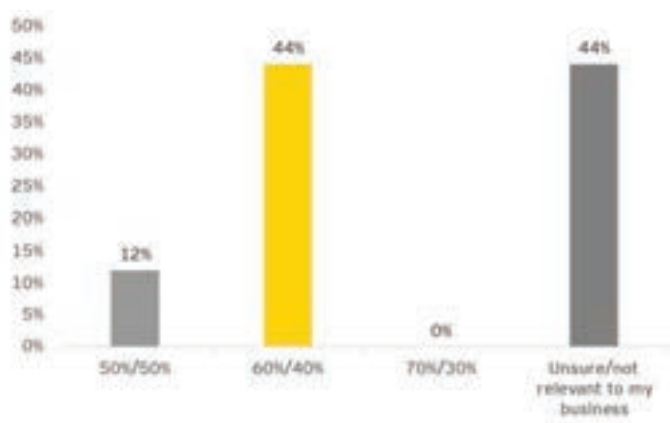


Capital markets

Market participants expressed little change in their strategy for financing hotel transactions during the upcoming six months.

Given that most respondents believed that the market is at or near the top of the cycle, it is not surprising that we have seen a slight uptick in deals planned using 50% debt and 50% equity compared with 70% debt and 30% equity during the past six months.

Capital structure past six months (debt/equity)

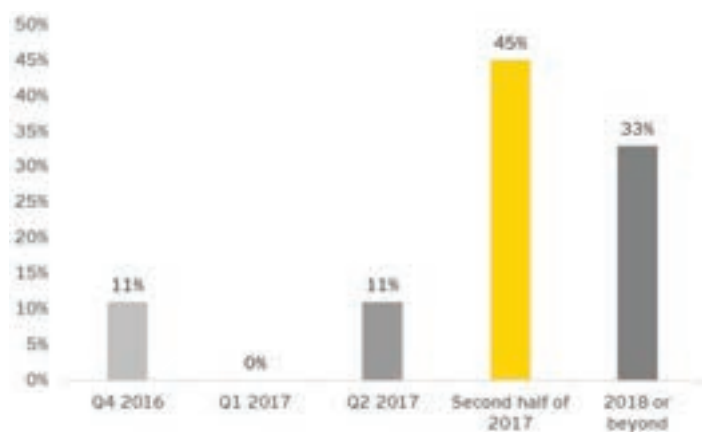


Source: EY



When asked about the return of the commercial mortgage-backed securities (CMBS) market, participants overwhelmingly responded that lending activity would pick up further into the future; 45% believed this will happen in the second half of 2017, and 33% saw 2018 or beyond. Most believe that the slow uptick in deals currently being seen will take time to ramp back up.

Anticipated return of CMBS market



Source: EY



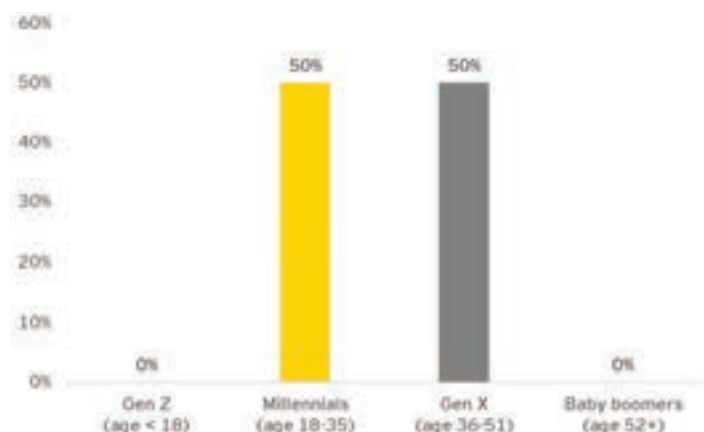


Brands

The primary customer focus in the hospitality industry are the millennial and Gen X segments, as further reflected in the survey results. According to research performed by The Center for Generational Kinetics, a consulting firm focusing on issues of millennial consumers, millennials are on pace to outspend baby boomers on hotels by 2017, with expectations that millennials will dominate the purchases in the travel industry by 2020.¹ As brands compete for revenue from this customer class, it is essential to tailor development toward the details millennials value: customized experiences, digital convenience and attention to design.²

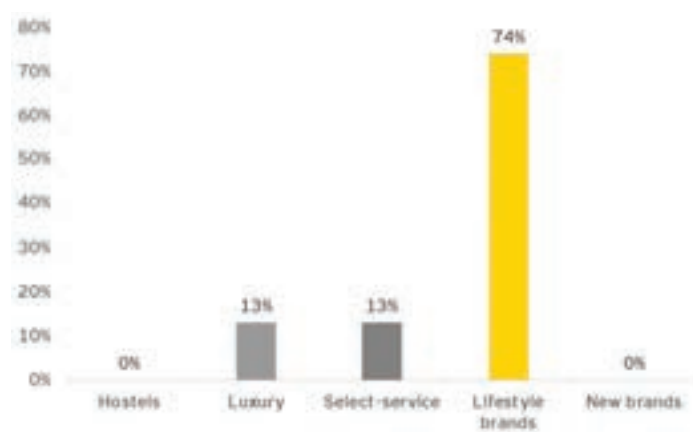
As participants look to 2017, investments are anticipated to be directed toward lifestyle brands, including soft brands. According to The Highland Group in partnership with STR, Inc., lifestyle and soft brands are design-centric; upper mid-scale to luxury; nationally franchised or at least affiliated with a nationally franchised distribution; and include an element of food service, ranging from lounges offering light food and beverage options to a full-scale restaurant.³ While lifestyle brands adapt to current trends, soft brands are set apart from others in a major chain by their uniqueness in design and naming. This investment focus pairs well with the emphasis on millennials, who value design and modernity.

Customer segment focus



Source: EY

Lodging products most ripe for investment



Source: EY

¹ Ed Watkins, "How millennials will change travel by 2020," *Hotel News Now* website, www.hotelnewsnow.com/Articles/24758/How-millennials-will-change-travel-by-2020, accessed 6 December 2016.

² Daisy Carrington, "Hotel brands no longer sell rooms. They sell experiences," *CNN Business Traveller* website, <http://www.cnn.com/2016/06/17/hotels/hotels-selling-experiences/>, accessed 9 December 2016.

³ Stephanie Ricca, "Report defines boutique, lifestyle, soft brand," *Hotel News Now* website, <http://www.hotelnewsnow.com/Articles/25561/Report-defines-boutique-lifestyle-soft-brand>, accessed 9 December 2016.

Technology

None of the respondents felt that the industry has taken all of the necessary steps to protect customer data. Cybersecurity experts believe that even the best-funded and most-prepared companies are at risk of a breach, and therefore, post-breach protocol is an ever-expanding area of focus. Market participants emphasized the need for establishing post-breach protocol in advance of any problems.

Cybersecurity preparedness

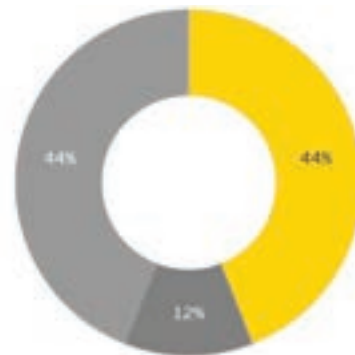


- The industry is unprepared, and we are going to see unprecedented security breaches in the near term
- The industry has felt the effects of the recent breaches and is in process of taking the necessary steps to protect customer data
- The industry has taken the necessary steps to protect customer data, and effective cybersecurity is now in place

Source: EY

Respondents emphasized mobile applications along with the use of social media as the most important technological investments to enhance customer satisfaction. While having mobile applications is an important part of the guest experience, and of particular value to the millennial customer segment, news sources, such as Forbes, indicate that data analytics increasingly is more important to understanding guest behavior. Specifically, data analytics can be used to understand the lifetime value of a specific customer to the hotel.⁴ Rather than simply observing one visit, big data analyzes customer behavior over a longer horizon to normalize behavioral trends to identify customers with a higher overall lifetime value to the hotel's business model.

Focus of technology investments



- Mobile applications to facilitate/enhance guest experience
- Data analytics to understand guest preferences
- Use of social media/peer review sites to solicit guest feedback

Source: EY

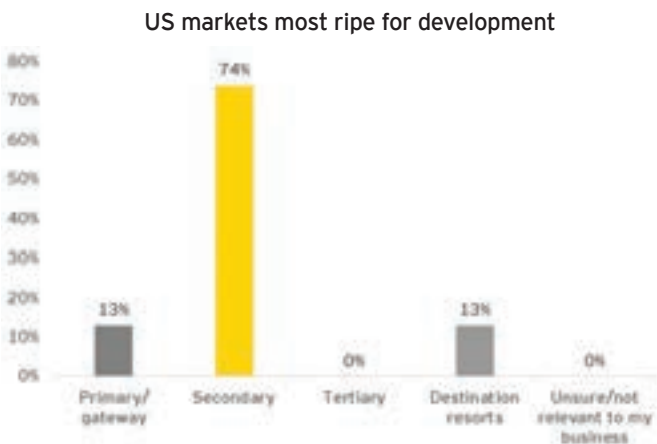
⁴ Bernard Marr, "How Big Data And Analytics Are Changing Hotels And The Hospitality Industry," *Forbes website*, <https://www.forbes.com/sites/bernardmarr/2016/01/26/how-big-data-and-analytics-changing-hotels-and-the-hospitality-industry/#78783bc11c22>, accessed 13 December 2016.



ADING

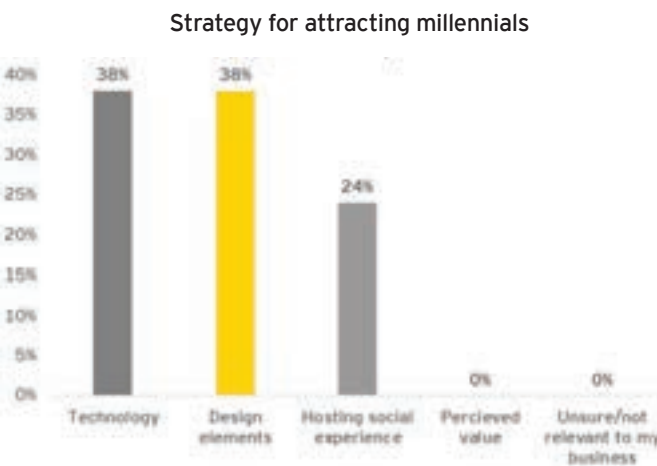
Industry focus

As we come full circle from the lodging cycle, 74% of the survey respondents indicated that secondary markets are most ripe for development. Significantly ahead of primary and destination resorts, this shows where development will continue into 2017.



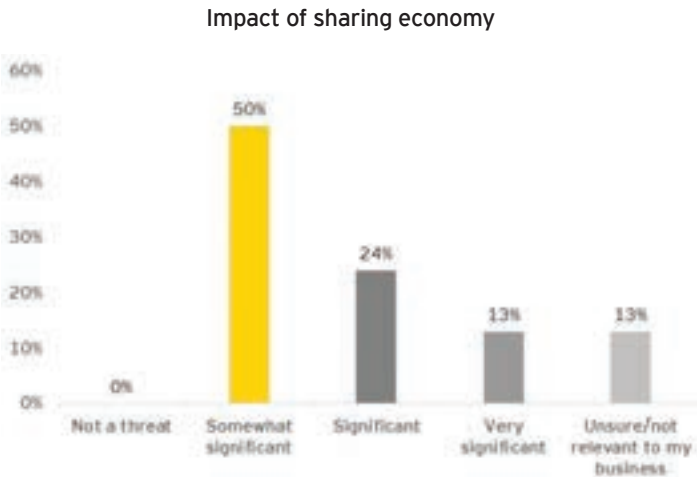
Source: EY

The majority of respondents believed that the strategy to attract the millennial population should be focused on both technology and property design elements, including both guest and common spaces. Frequently, technology translates to social media, involving online interaction and the sharing of stories and experiences. In exchange for more spacious common areas, millennial-focused hotels may downsize guest rooms, recognizing that millennials value social interaction more than time spent in the guest room.



Source: EY

Of those surveyed, 87% felt the sharing economy presents at least a somewhat significant threat to the hospitality industry, particularly due to the lack of consistent regulation intended to create a level playing field for traditional hoteliers and the downward pressure on the average daily rate (ADR) and occupancy. In addition, market participants noted that the sharing economy has induced a new demand from customers who previously could not afford to travel. Rather than looking at the sharing economy as pure competition, the industry should learn from its successes. Namely, the sharing economy excels at providing a sense of local community, customer engagement and a travel experience. By treating hotel stays as an experience rather than a commodity and making each guest interaction authentic and impactful, the threat from the sharing economy can be mitigated and serve as a meaningful lesson to the hospitality industry.



Source: EY



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1702-2199176
EYG no. 01992-171US

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