

COMPASS



HOTEL MARKET

JANUARY 2022

Lodging Market Recovery in Sight

Transitioning from a pandemic-driven economic cycle, the U.S. hospitality industry continues to exhibit signs of recovery and sustained revenue gains due largely to the roll-out of COVID-19 vaccines, growing corporate work from anywhere policies, and the rebound in leisure travel courtesy of the “revenge travel” phenomenon.

In Minnesota, occupancy in the hotel sector reached 48.2 percent at the close of 2021. Aligning with national trends, the state’s leisure sector experienced the most dramatic recovery. In greater Minnesota markets, such as Duluth, Minnesota North, and Minnesota South, RevPAR has already surpassed pre-pandemic levels. In contrast, the Twin Cities metro area, which is heavily reliant upon mid-week corporate travel, has been slower to bounce back. Key factors impacting revival of the Twin Cities lodging market include the emergence of COVID-19 variants, which have curtailed corporate travel, ongoing supply chain issues and a tightening labor market.

These same factors have stagnated the supply of new construction. All told, just four new hotel projects are currently under construction in the Twin Cities and scheduled for completion in 2022:

- The 222-room Four Seasons Hotel anchoring the north end of Nicollet Mall in downtown Minneapolis
- The 112-room Hilton Home2 Suites in the Prospect Park neighborhood of Minneapolis
- The 215-room dual-brand Cambria Hotel/Fairfield Inn & Suites in the Downtown Minneapolis West market
- The 151-room Hyatt House hotel near the Mall of America in Bloomington

Construction is also slated to resume on the 5-story, 120-room Courtyard by Marriott in downtown St. Paul which was suspended in August 2020 due to arson. A Spring 2023 opening is anticipated.

Buoyed by stimulus relief programs available through the Small Business Administration (SBA), most hotel owners have been able to keep assets under control and operational throughout the pandemic, and many will come to benefit in the form of increased asset value due to the restricted development pipeline associated with rising construction and financing costs.

HOTELS YTD DEC 21 vs. DEC 19

Source: CoStar

| | OCCUPANCY % | | ADR \$ | | REVPAR \$ | |
|----------------------------------|-------------|------|--------|--------|-----------|-------|
| | 2021 | 2019 | 2021 | 2019 | 2021 | 2019 |
| UNITED STATES | 57.6 | 66.1 | 124.67 | 131.21 | 71.87 | 86.76 |
| MINNESOTA | 48.2 | 61.8 | 104.15 | 116.27 | 50.24 | 71.90 |
| MPLS-ST. PAUL, MN-WI | 44.4 | 66.4 | 100.55 | 120.80 | 44.69 | 80.21 |
| DULUTH, MSA | 59.1 | 60.8 | 141.17 | 129.91 | 83.44 | 78.96 |
| ST. CLOUD / I-94 CORRIDOR | 45.7 | 53.4 | 104.05 | 100.92 | 47.59 | 53.88 |
| ROCHESTER (MN) | 46.7 | 65.3 | 109.51 | 119.99 | 51.10 | 78.33 |

For investors, potential opportunities in the Minnesota hotel sector appear selective. Sellers are outwardly optimistic, whereas many buyers are still hoping to acquire assets at a discount. There has also been some lender hesitancy given the unknown inflationary impacts and potential for new variants. However, capital is available for hotels that meet underwriting criteria. Once again, the SBA has been instrumental in coming to the aid of entrepreneurial hotel investors by bridging the financial gap with lenders. Funding is coming from traditional sources as well as smaller community banks in the markets where the assets are located.

While recent sales in greater Minnesota and other leisure markets have traded at par or above pre-pandemic pricing, uncertainty in the Twin Cities hospitality market has triggered discounted pricing. In Minneapolis during the fourth quarter of 2021, the 229-room DoubleTree Suites sold for a reported \$29.75 million (\$130,000 per room), the 214-room Westin Minneapolis sold for \$47.5 million (\$222,000 per room), and the 281-room Marquette Hotel sold for \$60.55 million (\$215,000 per room) – all trading noticeably below the prior sale price. Despite the reduced pricing and lagging hotel occupancy, these transactions suggest that investors still have confidence in the strength of the Twin Cities' diverse economy and are looking to capitalize on prevailing market conditions.

| HOTELS % CHANGE YTD DEC 21 vs. DEC 19 | | | | | | | Source: CoStar |
|---------------------------------------|-----------|-------|--------|----------|------------|------------|----------------|
| | OCCUPANCY | ADR | REVPAR | ROOM REV | ROOM AVAIL | ROOMS SOLD | |
| UNITED STATES | -2.0 | 6.7 | 4.6 | -16.1 | 0.9 | -11.9 | |
| MINNESOTA | -8.9 | 1.8 | -7.3 | -26.5 | 4.3 | -18.2 | |
| MPLS-ST. PAUL, MN-WI | -26.5 | -14.0 | -36.7 | -41.2 | 5.6 | -29.3 | |
| DULUTH, MSA | -2.8 | 8.7 | 5.7 | 7.3 | 1.5 | -1.3 | |
| ST. CLOUD / I-94 CORRIDOR | -14.4 | 3.1 | -11.7 | -10.6 | 1.2 | -13.3 | |
| ROCHESTER (MN) | -28.5 | -8.7 | -34.8 | -26.7 | 12.4 | -19.6 | |

Outlook

As the post-pandemic economy comes into view moving into 2022, the commercial real estate industry – particularly the hospitality sector – will benefit from continued U.S. economic expansion driven by domestic spending, which has exceeded pre-pandemic levels. The next major performance milestone for Minnesota and the Minneapolis metropolitan area lodging sector will be whether the industry can recover demand to the extent it would have achieved based on the growth rate heading into 2020.

The stage is certainly set for hotel demand to experience full recovery as the impact of the pandemic gradually wanes and the return-to-the-office movement and corporate travel pick up speed. Yet variables, such as another variant impacting air travel, rising labor costs, and ongoing inflationary pressures, leave the lodging industry in a state of flux.

That said, greater Minnesota's leisure market has already demonstrated its capacity for recovery. Additionally, with a typical number of large events on the books at the Minneapolis Convention Center, rising average daily room rates and increasing occupancy levels, there is cause for optimism across the Twin Cities hospitality sector as well.

THE COMPASS REPORT

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3500 American Blvd W Suite 200
Minneapolis, MN 55431
+1 952 831 1000
cushmanwakefield.com