Hospitality & Retail Outlook

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Eight months into the COVID-19 pandemic, Hospitality and Retail are the clear laggards in commercial real estate. The front end of the pandemic heavily impacted both sectors and they continue to post poor year-over-year performance metrics, though the similarities end there. What are the short-term prospects for each sector?

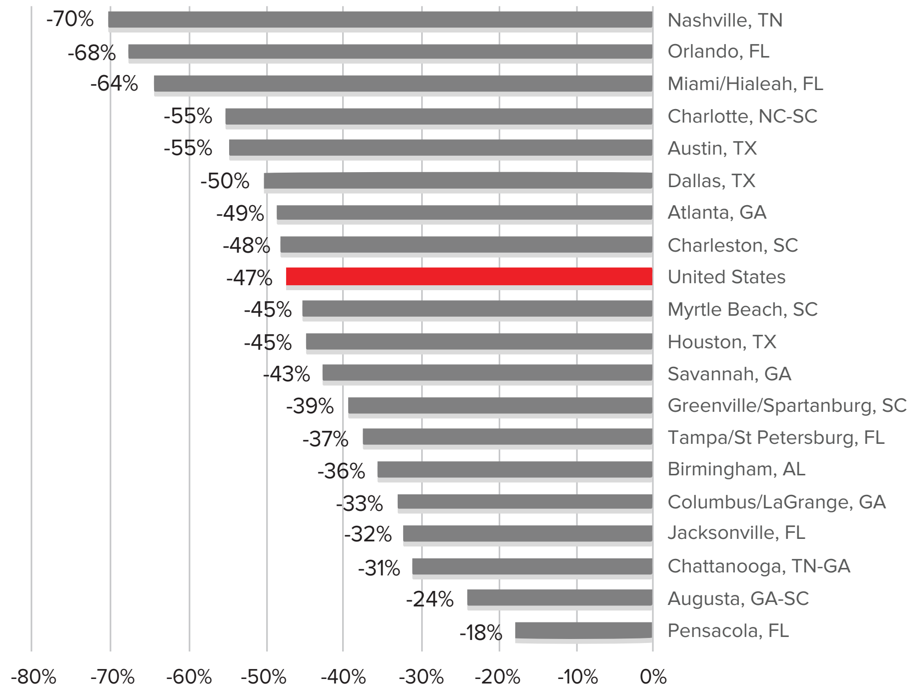
COVID-19 fatigue temporarily boosted hotel vacation sales in smaller SE markets.

At the end of 2019, the Hotel sector was at a cyclical peak, riding a wave of stronger operating metrics that had grown for nine consecutive years. Though Revenue per Available Room, (RevPAR, the chief operating metric for hotel properties), had almost reached the limit of its growth trajectory, and future room deliveries for 2020 and 2021 exceeded expected demand, occupancy levels and average daily rates were at historically high levels in most markets within the Synovus footprint. Many hospitality experts agreed that the Hotel market cycle would turn downward over the next three to four years but with metrics so far above the historical mean, the movement would be slow to develop. The arrival of COVID-19 completely changed that, coming out of nowhere to stop the hospitality industry in its tracks. It was the very definition of a Black Swan.

Initially all hotel properties were negatively affected, and RevPAR declined a staggering -70% over March, April, and May. Business center hotels in major metro areas bore the brunt of the impact as conferences were cancelled and corporate travel ground to a halt due to shelter-in-place orders. Vacation travel was similarly ravaged by quarantine and social distancing efforts, but this wouldn't last long as a hemmed-in Southeastern populace was ready to travel when summer arrived. June saw droves of vacationers driving to nearby destinations in secondary, tertiary, and beach markets, eschewing the larger major metro areas favored by corporate and international travelers. Accordingly, the pace of recovery has been faster in these smaller markets, with the bulk of them posting RevPAR declines less severe than the national average.

But as vacation season winds down and companies bring their employees back into the office, what should we expect for hotel properties in the Southeast? The pace of recovery in these smaller markets should slow, though not to the degree of larger major metro markets, and the hospitality sector will continue its long march towards normalization. Increased corporate sales efforts could moderately stoke demand for business accommodations. A vaccine would certainly help, with an early 2021 delivery potentially accelerating the pace of recovery for both smaller and larger markets. Business center hospitality sectors could stabilize in 2022, and smaller markets with vacation/tourist characteristics could completely recover by the end of 2021. Conversely, slower delivery of a vaccine could push recovery times out to 2023-2024, depending on the market and the type of hotel.

Aug 2020 YOY % Δ RevPar



Struggling retail sector sees surprising wins in multiple categories.

Retail entered 2020 in a state of flux as brick and mortar industry participants grappled with the expense of implementing omnichannel distribution systems, competition from e-commerce, high debt loads, and an inability to trim labor costs. These factors drove 9,900 store closures in 2019 and 5,700 store closures in 2018; preliminary estimates for 2020 called for 12,000 store closures. COVID-19 acted as an accelerant for Retail, exacerbating issues that had been in place for several years and pushing store closures to record annual levels — 14,000 as of August with a projected year-end figure of 20,000. Despite the preexisting negative outlook for the sector, Retail has posted some surprising wins as the pandemic persisted through the summer.

The COVID-19 recession differs from the Great Recession insofar as it is a supply-driven recession. The Great Recession was fueled by a lack of demand driven by massive job and wealth losses, but there has been no shortage of demand for retail goods in the current recession. Supply has been the issue; broken supply chains, closed stores and restaurants, and shelter-in-place orders have prevented the consumption of goods and services. Demand is quite healthy, fostered by stimulus checks and more generous unemployment benefits at the lower end of the spectrum. The impact on the upper end of the wealth spectrum has been minimal, preserving that group's ability to consume higher-priced goods and services. This is evident in the large year-over-year increase in recreational vehicle purchases like RVs and boats. Seventy percent of marine dealers nationwide reported increased sales in the spring, and overall boat sales are up 59% in 2020, with used boat sales 74% higher than last year.

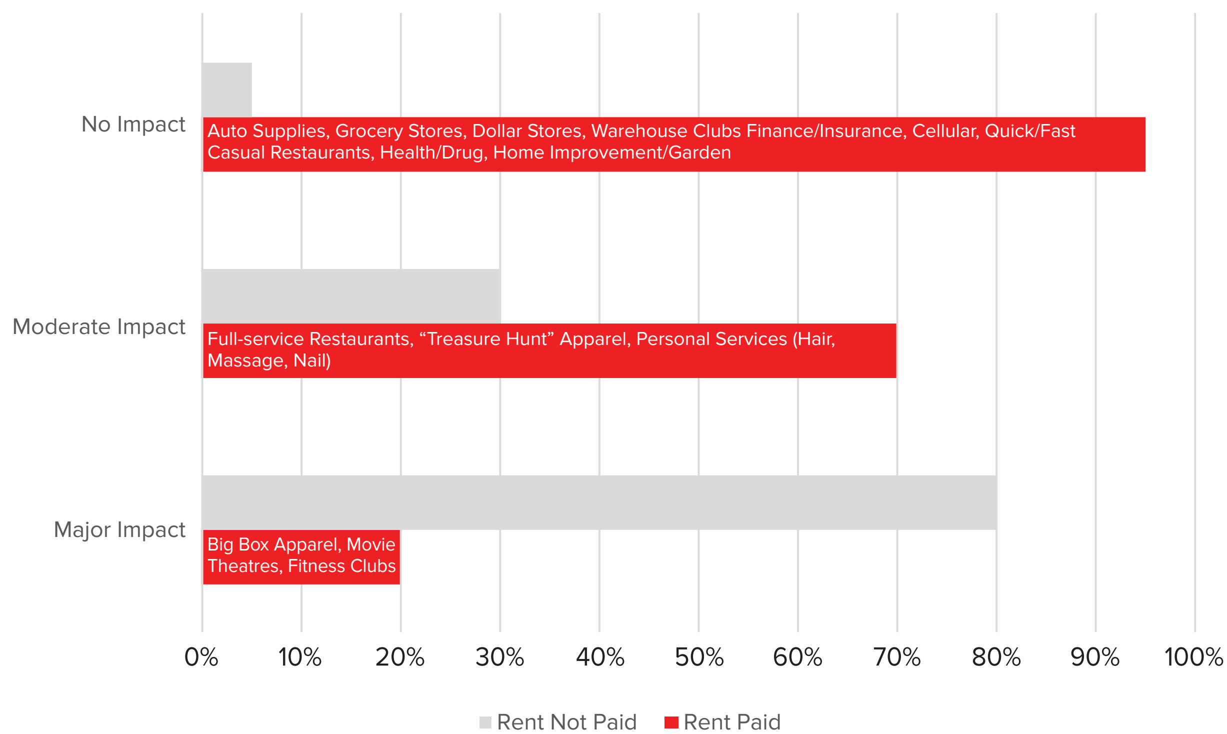
Cooped-up homeowners, now face-to-face with needed improvements, are flocking in waves to Lowe's, Home Depot, or the local garden/hardware store. A Consumer Specialist survey reported that 57% of homeowners pursued a project during the pandemic, spending on average $1,750 per project.[1] Home Depot recently announced the construction of three distribution centers in the Atlanta area, all designed to fortify supply chains and deliver product to consumers faster.

What other retailers are faring well in the COVID-19 environment? Look no further than rent collection data, where retailers fall into three clear-cut categories: Those who paid more than 90% of 2019 rent, those who are paying roughly half of 2019 rent, and those that paid virtually no rent. So, it should come as no surprise that the top-tier retailers include quick service restaurants, grocery stores, drug/health stores, cellular stores, and the home improvement and garden segment. Those paying virtually no rent include movie theatres, fitness facilities, and big box apparel companies who were facing bankruptcy pre-COVID.

The surprise is in the middle segment, where industry darlings like TJ Maxx and other "treasure hunt" retailers find themselves unable to stock shelves because there hasn't been overstock available for purchase from the Spring season. This trend has subsided as supply chains recover. Whether the current winners will continue to perform post-COVID-19 remains to be seen, but at minimum these silver linings have helped hedge the pandemic's impact on the retail sector.

[1] *Consumer Specialists, "How COVID-19 is Reshaping the Home Improvement Market," July 2020*

2020 Rent Collections



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