Ferguson Partners

2023 Hospitality Outlook

A view on what is driving opportunities through potentially turbulent times ahead.

After an extended period of recovery post pandemic, we expect the global hospitality sector to enjoy some long overdue tailwinds through 2023. As interest rates rise, many view hospitality as a favorable investment and a good hedge against inflation due to the uniquely short lease periods and ability to adjust rates on a nightly basis. Within the United States, industry leaders are beginning to see increased equity allocations to hospitality investments from other real estate asset classes.

As we evolve through a bear market, the cost of debt capital has increased significantly, resulting in a downward impact on valuations. Assets with debt backed by CMBS will see increased defaults and enforcement over the next 24 months, creating distressed opportunities for private equity investors to pursue. While transaction volume is down substantially, more balance sheets remain strong and we anticipate a mild contraction among industry investors.

Despite the challenges the industry has recently faced, there are a number of opportunities:

- With the proliferation of remote work, the average length of stay has increased by as much as 15% and group business has also been on the rise. Therefore, hotel product with meeting space is highly sought after and is commanding a premium.
- As the Millennial and Gen Z segments make up the largest portion of travel consumers, soft brands will be in high demand as these consumers seek unique experiences with independent brands.
- Investors view the select service and extended stay categories to offer healthy margins with solid cash flows, attracting both group and transient business.
- The leisure segment continues to perform well and the uber-luxury category, which caters to the top 1% of the wealth, will be one to watch as it continues to evolve.

These conditions have wide ranging impacts on the business, not just to owners, but to the hotel brands, operators, and advisors. While owners will focus on rigorous asset management strategies and opportunistic investing, hospitality brands are shifting further away from hotel operations. The brands will continue to evolve into large consumer marketing machines valuing loyalty programs, payments products and other ancillary business lines through strategic partnerships. Although we may see some further consolidation among the third-party operators with the reduced transaction volume, managers will likely experience a plateau in market share and new management contracts.

Owners, brands and operators all continue to emphasize the value of technology and data. As such, expect further investment in artificial intelligence and business analytics tools to optimize operations and increase efficiencies.

As it relates to capital deployment across geographies, there is a consensus among industry leaders that London ranks highly as a safe haven for investment with favorable tax policies. Southern Europe will experience continued investment activity as will the Middle East, specifically in Saudi Arabia. There is also the challenging dynamic between the United States and China. Nonetheless, as more investors view China as an increasingly influential country there will be increased investment in cities like Hong Kong. Having just reopened its borders, Japan is highly attractive to many investors, and this is further intensified by a weak yen and strong US dollar. While gateway cities in the United States remain attractive, the Sun Belt markets are garnering increased attention from investors.

Assuming the capital markets stabilize in 2023, we are cautiously optimistic hospitality will continue to recover. We expect those who are well capitalized and prepared to take advantage of the opportunities, to be rewarded with returns that will outpace other real estate investment alternatives.

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