THE LINNEMAN LETTER

Hotel Market Close-up: Dallas-Fort Worth MSA

Overview and Economy. The Dallas-Fort Worth MSA is the fourth largest in the U.S., with a population of 7.7 million. It is among the largest U.S. hotel markets, with 99,000 rooms in 814 hotels, according to CoStar/STR. At the end of the second quarter of 2023, the MSA had 4,000 hotel rooms in 10 properties under construction. According to CoStar/STR, the 12-month rolling average hotel occupancy rate in Dallas-Fort Worth was 72.7% in June of 2023, up from just 33.7% in the first quarter of 2021. Real (2022 dollars) running 12-month revenue per available room (RevPAR) was approximately $76 in April 2023, compared to $67 the prior year and $73 in December 2019. The real average daily rate (ADR) increased from $109 to $121 per key over the last year. The outlook for the MSA hotel market continues to improve as the COVID-19 pandemic moves into the rear-view mirror. Normalcy has largely returned, though we will have to monitor how the latest strain of COVID impacts travel in the near-term.
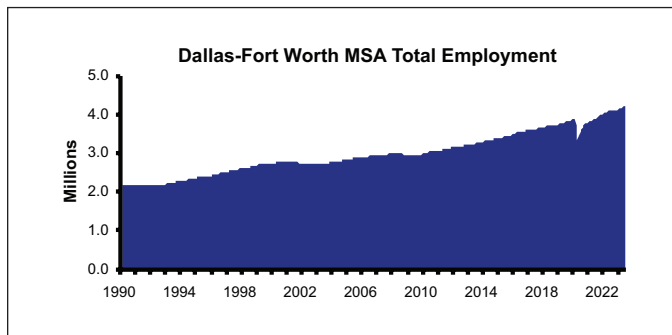

figure 1

Between February and April 2020, Payroll Survey employment in the MSA declined by 580,000 jobs (15%) but subsequently added 920,000 jobs (27.8%) from the bottom through July 2023 (latest available). Total Payroll Survey employment stood at 4.2 million jobs in the MSA in July. Major employers in the MSA include Walmart, American Airlines, Dallas ISD, Texas Health Resources Inc, Bank of America, Lockheed Martin Aeronautics, and Baylor Scott & White.

All major employment sectors in the MSA saw year-over-year growth through July 2023. The other services sector saw the largest year-over-year growth (10.1%), followed by the mining, logging, and construction (9.5%), and financial activities (5.2%) sectors over the same period. The industries with the highest employment in the MSA are trade, transportation, and utilities (21.1%); professional and business services (19%); and education and health services (11.6%).

In previous issues, we have discussed a covariance analysis that was first published in the *Wharton Real Estate Review* (spring 2007) and is regularly updated in this publication. The analysis examines how various economic indicators behave in individual metropolitan areas based on national economic changes. Specifically, for each MSA, we estimated an equation, which summarizes how a 100-basis point (bp) change in national employment affects the local indicator. The equation consists of a constant ("alpha") for each market and a "beta," which is a multiplier applied to the national percent change in employment. The alpha indicates MSA growth that is independent of national growth, so if there is no national job growth, alpha is the expected annual percentage change in MSA employment. The beta for the U.S., by definition, is equal to 1.0. An MSA with a beta of 1.0 registers (on average) an increase of 100 bps in employment growth plus alpha when national employment rises by 100 bps. A beta that is less than 1.0 indicates that the MSA does not boom (or bust) to as great an extent (around its trend) as the national economy, while a beta of greater than 1.0 indicates that such an MSA experiences swings of greater magnitude than the percentage changes at the national level.

With an employment beta of 1.04, employment in the Dallas-Fort Worth MSA responds with modestly 4% higher magnitude than national employment changes around its trend. The MSA has a beneficially high alpha of 1.15, indicating that local employment is expected to increase by 1.15% when U.S. job growth is zero. Due to the interaction between the MSA's alpha and beta, Dallas-Fort Worth has a breakeven point of -1.11, indicating that the MSA is expected to have positive employment growth even when U.S. employment is as low as -1.11%. The model's R-squared statistic of 0.87 indicates that the forecasting model for Dallas-Fort Worth explains future job growth with a strong 87% "fit."

Our model projected that the MSA would lose 4.2% of jobs given that national employment declined by 6.3% during the Financial Crisis. The MSA overperformed, resulting in an actual loss of just 2.1% of jobs. In the subsequent recovery, U.S. employment grew 17.5% from the bottom through February 2020, while metro employment increased 32.1% over the same period, on

par with our predicted 32.3% growth from the bottom. Between February and April 2020, the U.S. lost 14.4% of jobs, while the MSA lost 15%. As the economy reopened, U.S. employment increased by 23.6% (through July 2023), implying corresponding growth of 24.1% in the MSA, below the actual growth of 27.8%.

The MSA unemployment rate reached 8.4% in the fourth quarter of 2009 and steadily declined during the Financial Crisis recovery, reaching 3% in February 2020. In comparison, the national unemployment rate peaked at 10% in October 2009 and declined by 650

figure 2

figure 3

figure 4

bps, to 3.5% through February 2020. In the wake of the shutdown, the official MSA and U.S. unemployment rates spiked to 12.4% and 14.7%, respectively, in April 2020. Most recently, the MSA official unemployment rate stood at 3.8% in July 2023 (latest), equivalent to the U.S. rate of 3.8% in August.

Hotel Market Statistics. The MSA's rolling occupancy rate stood at 76.2% in February 2020 but was just 42.6% in February 2021. At 72.7% in June 2023, Dallas-Fort Worth's hotel occupancy is showing considerable improvement but remains below its pre-pandemic level. This is in comparison to Dallas-Fort Worth's long-term average (since 2009) occupancy of 70.5% and the all-time high of 80.4% seen in 1993. The U.S. average occupancy rate was 65.9% in February 2020 and stood at 63.5% in June 2023.

Real 12-month rolling RevPAR in the MSA stood at $76 in June 2023, a net increase of about $9 per key (13.7%) compared to a year earlier. The current level is 13.1% below the high of $87 per room. The real 12 month rolling ADR in the MSA was $121 in June 2023, an increase of about $12 per key (11%) over the prior year. By comparison, real U.S. RevPAR and ADR were $94 and $148 per key, respectively, in June 2023, reflecting year-over-year increases of 15.9% and 9.5%.

The MSA hotel market has experienced a remarkable recovery after the pandemic shutdown, driven by increased travel and tourism and consumers' willingness to pay high rates. Dallas-Fort Worth's hotel inventory has averaged about 1,100 new rooms annually over the past 10 years. While the MSA's ADR is down 8% from the record high set in May 2021, Dallas-Fort Worth's real RevPAR rates saw strong growth over the past year.

Visitor Trends. Dallas-Fort Worth is known for its historic locations and sporting events. According to the Dallas Tourism Public Improvement District, an estimated 22.5 million people visited Dallas-Fort Worth in 2021. The Dallas Zoo, Dallas Museum of Nature and Science, the Dallas Museum of Art, and the Dallas Aquarium are notable attractions that bring tourists to the city every year. The region is also home to four major sports teams: the Cowboys, Mavericks, Stars, and Texas Rangers.

Investment and Sales. Real 12-month rolling hotel sales volume in the MSA stood at $418 billion through the second quarter of 2023, about $1.4 billion (298%) higher than the first quarter 2021 level. The latest real
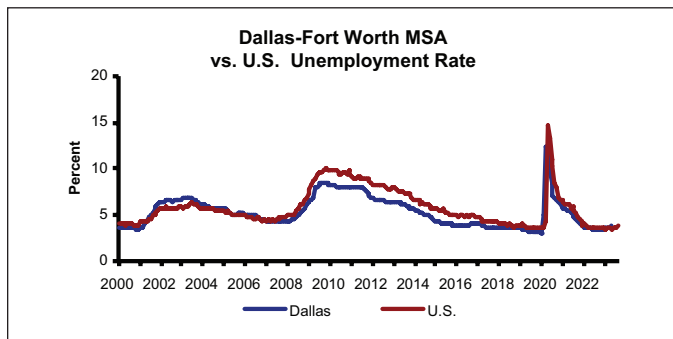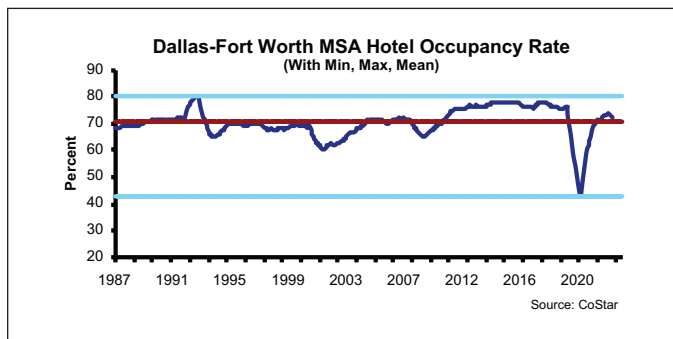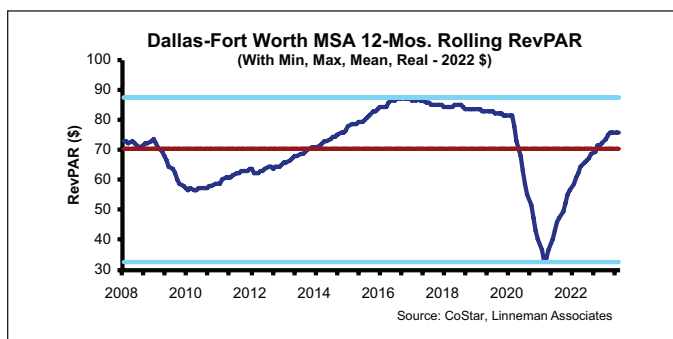
sales volume is 63.3% below the all-time high and is 12.4% above the long-term average of $372 million. The historical low of just $13.5 million in sales volume in the MSA was seen in the first quarter of 2002.

Notable hotel transactions in the year's first half included the 299-room Upper Upscale Hilton Dallas Plano Granite Park trading for $86 million ($287,625/key) and the Upper Upscale 304-room Renaissance Dallas at Plano Legacy West Hotel for $136 million (447,368/key) in June.

In the second quarter of 2023, the average CoStar

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figure 7

cap rate in the Dallas-Fort Worth hotel market was 8.6%, 40 bps lower than the historical mean of 9%, but up 30 bps from a year earlier.

In the second quarter of 2023, the four-quarter moving average real price (2022 dollars) per hotel room in the MSA stood at approximately $127,000, about 5% above its long-term average (since 2000) of $121,000 per room. Local hotel property pricing decreased by 0.8% over the year. Each transaction is highly negotiated and sometimes distressed.

Major buyers of Dallas-Fort Worth hotel properties over the last five years include: Extell Development Company ($235 million); HN Capital Partners ($175 million); Summit Hotel Properties ($139 million); GIC Real Estate ($139 million); and Brookfield Corporation ($98 million).

Major sellers of Dallas-Fort Worth hotel properties over the last five years include: Crescent Real Estate Equities ($425 million); NewcrestImage ($279 million); Blackstone ($276 million); Sam Moon Group ($136 million); and CTF Development ($120 million).

Development and Construction Pipeline. According to CoStar, 10 new hotels (1,764 rooms) were completed in the MSA in 2022. This compares to the 10 hotels (1,615 rooms) that were completed in 2021. At the end of the second quarter of 2023, there were 32 hotels (4,000 rooms) under construction in the MSA, according to CoStar. In comparison, Lodging Econometrics reported in the second quarter of 2023 that 3,400 rooms in 25 projects were under construction, 8,000 rooms in 69 projects would be started in the next 12 months, and 10,000 rooms in 90 projects were in early planning.

Submarkets
▪ ***Dallas CBD.*** With an inventory of 21,000 rooms, the submarket had an occupancy rate of 64%, a 12-month ADR of $187, and 529 rooms under construction in the second quarter of 2023. The submarket saw a 12-month RevPAR of $120.
▪ ***Irving North Area.*** With an inventory of 9,400 rooms, the submarket had an occupancy rate of 69.4%, a 12-month ADR of $127, and 668 rooms under construction in the second quarter of 2023. The submarket saw a 12-month RevPAR of $88.
▪ ***Denton/Lewisville/McKinney.*** With an inventory of 13,000 rooms, the submarket had an occupancy rate of 68.9%, a 12-month ADR of $100, and 1,000 rooms
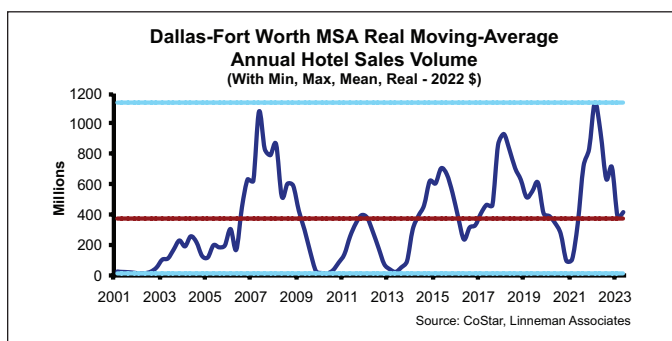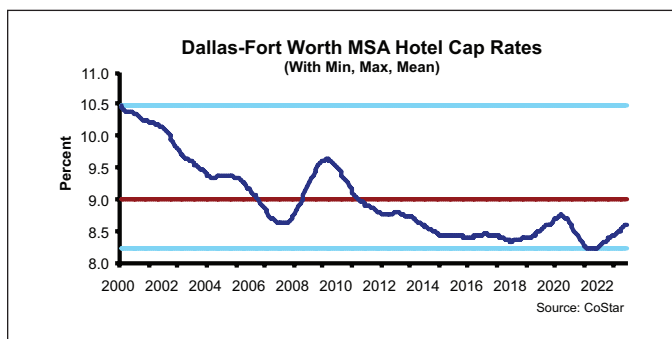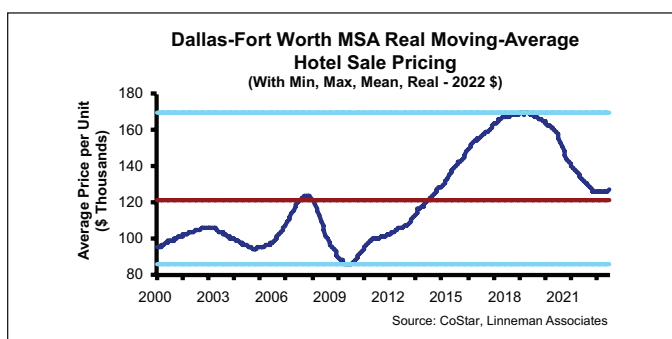
under construction in the second quarter of 2023. The submarket saw a 12-month RevPAR of $69.

▪ **Addison/LBJ Freeway.** With an inventory of 12,000 rooms, the submarket had an occupancy rate of 65.7%, a 12-month ADR of $101, and 295 rooms under construction in the second quarter of 2023. The submarket saw a 12-month RevPAR of $67.

▪ **Dallas South/East.** With an inventory of 13,000 rooms, the submarket had an occupancy rate of 66.1%, a 12-month ADR of $89, and 444 rooms under construction in the second quarter of 2023. The submarket saw a 12-month RevPAR of about $59.

▪ **Fort Worth CVD/I-820 West.** With an inventory of 10,000 rooms, the submarket had an occupancy rate of 66.6%, a 12-month ADR of $151, and 1,000 rooms under construction in the second quarter of 2023. The submarket saw a 12-month RevPAR of $100.

Opportunities and Challenges. Dallas is home to a wide range of industries, including defense, financial services, information technology, telecommunications, and transportation. While absorption is slowing modestly in 2023, the market remains tight. There are almost 4,000 rooms scheduled for completion by year-end 2024 in the metro area.

Our research indicates that the MSA's employment breakeven statistic is -1.11, indicating that that U.S. employment can be as low as -1.11% per year and Dallas-Fort Worth employment growth will still be positive. Thus, the MSA is well-insulated from economic weakness at the national level. However, we do not project a recession within the next several years.

Over a five-year period, Texas will receive about $35.4 billion in funding through the Infrastructure Investment and Jobs Act passed in November 2021. Federal highway programs ($26.9 billion) will receive the bulk of the funding, while public transportation ($3.3 billion), drinking water infrastructure ($2.9 billion), airports ($1.2 billion), bridge replacement and repairs ($537 million), electric vehicle charging network ($408 million), broadband expansion ($100 million), wildfire protection ($53 million), and cyberattack protection ($42 million) will also receive allocations. These investments will generate near-term jobs, while improving infrastructure to help long-term growth.

Dallas-Fort Worth International Airport announced it is beginning construction on a long-awaited sixth terminal as a part of its massive renovation project.

Terminal F will be built on the southwest side of the airport. The $1.6 billion project will add 15 new gates during its first phase, set to be completed in 2026, with additional gates expected thereafter. The project was announced in 2019 but put on hold due to the pandemic.

Construction on Dallas' highway cap park over Interstate 35E is underway, with the first deck completed and phase 1 of the park slated to open in 2024. The project centers on 2.8-acres of land that will be built over a recently reconstructed highway. The park will bridge a community that has been split in half since the Interstate was built in the 1950s. The park, called Southern Gateway Public Green, will consist of a raised pedestrian walkway, a playground, and spaces for dining, retail, and performances. With the North and South Oak Cliff neighborhoods reconnected, several developers have already announced intentions to bring new residential and retail opportunities to the area.

Outlook. Our statistical employment forecasts are net of construction jobs due to the volatility and short-term nature of that sector. We forecast that the MSA will add about 270,000 non-construction jobs (about
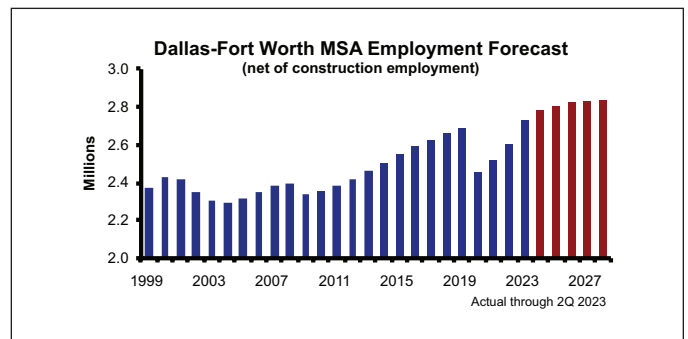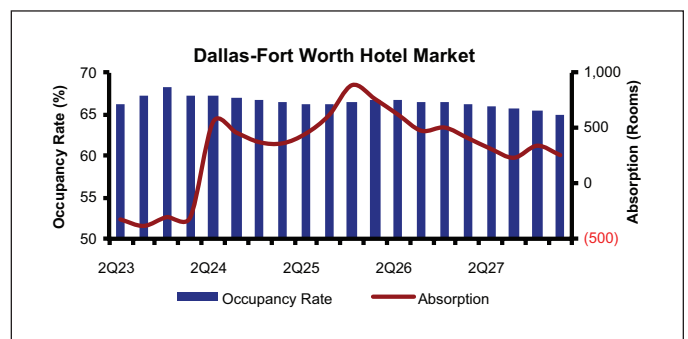
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54,000 per year) between 2023 and 2028. We expect that the second-quarter 2023 occupancy rate of 72.7% will rise to 75.5% next year before slowly increasing to 76.2% in 2028.