March 22, 2016

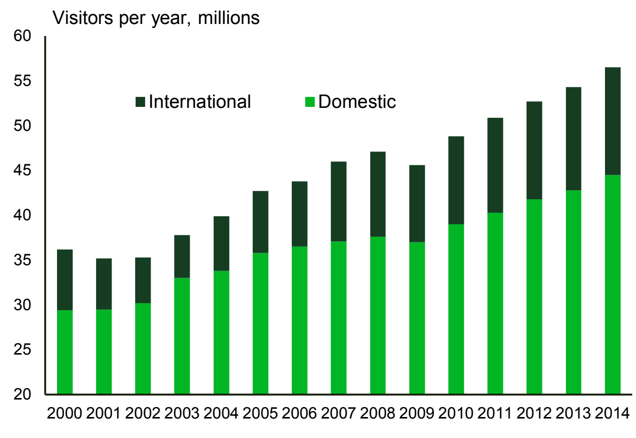
HIGH-FLYING DOLLAR TAKES SOME SHINE OFF NEW YORK TOURISM

Highlights

- The New York City tourism industry enjoyed spectacular growth over the past several years. The number of visitors to the Big Apple grew by 24% since 2009, reaching a record 56.5 million in 2014 – 6.5 times its population.
- This surge in tourism provided an important life-line for the local labor market during the recovery, generated substantial positive spillovers for government coffers, and boosted activity in hotel, retail, and condo real estate markets.
- Much of the industry's early recovery was related to international tourism, while domestic travellers were still on the sidelines. However, a strong dollar and weaker global economic conditions will leave international travellers playing second fiddle this year and next.
- Fortunately, demand from domestic visitors will continue to rise. But due to lower per visit spending domestic travellers will provide only a partial offset. As a result, overall tourism spending will moderate, with the slowdown most apparent in the luxury segment.
- The slowdown in tourism-sensitive industries will not derail the city's economic recovery. The metro's diverse base of high-value-added industries provides a solid foundation which will keep the economy on an upward trajectory.

The New York City tourism industry had an impressive run over the past several years. The number of visitors to the City That Never Sleeps grew by 24% since 2009, reaching a record 56.5 million in 2014 – 6.5 times its population. Growth in tourism-related spending was even more impressive, advancing by 45% over the same period. The dollars spent by visitors on accommodation, restaurants, shopping and entertainment all helped to kick-start New York's economic recovery. They boosted employment in tourism-exposed industries, replenished government coffers, and drove strong growth in commercial real estate construction. The majority of the action has been concentrated in Manhattan, but there are signs that activity is broadening across the city. Last year, travel guide publisher Lonely Planet ranked Queens as the top destination to visit in the U.S. and about a third of new hotel construction in the city is slated to take place outside of Manhattan.

CHART 1: THE BIG APPLE WELCOMES RECORD NUMBER OF VISITORS



Source: NYC & Company, TD Economics

Despite the strong performance over the last several years,

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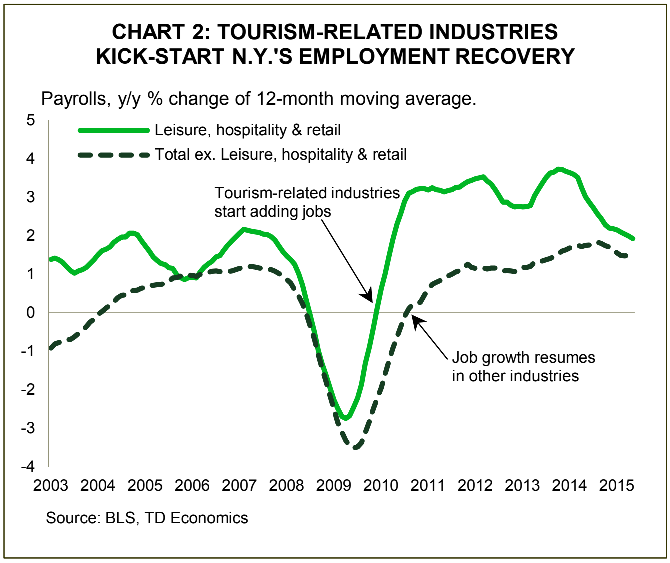
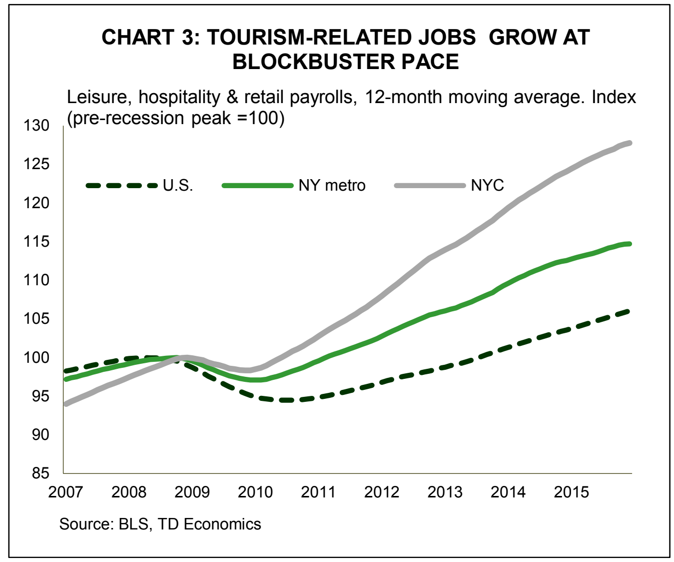




tourism activity is expected to moderate due to weaker demand from international visitors. A strong U.S. dollar and weak economic conditions in some key home countries for NYC visitors will weigh on spending by overseas travelers. This is particularly so in the luxury segments which are especially exposed to international demand. The weakness may manifest in rising vacancy rates in high-end hotels, reduced luxury condo transactions and prices and weaker sales (and slower hiring) in high-street stores, restaurants, and other entertainment venues. To some extent, weaker luxury-segment demand will be offset by strength in the non-luxury segments. Non-luxury demand is more dependent on domestic visitors who continue to benefit from robust job creation, rising disposable income, and improving household balance sheets.

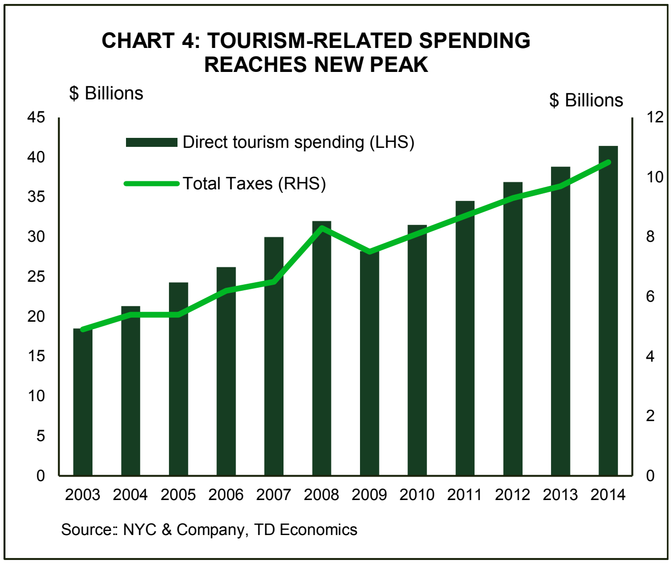
Fortunately, the slowdown in tourism-sensitive industries will not derail the city's economic recovery. The metro economy represents a diverse microcosm of businesses, including many in high-value added sectors, such as the expansive professional and business services, recovering financial industry and the rising number of high-tech and media startups. This sentiment is further corroborated by TD's Small Business Poll, which found that while 18% of business considered decreased tourism and deterioration of global economic conditions to be a challenge, the vast majority of NYC's small business owners (86%) were optimistic about 2016. This is a considerable improvement over the 2015 results, when only 70% of responders felt this way, and points to the rising level of confidence of business owners in the local economy.[1]

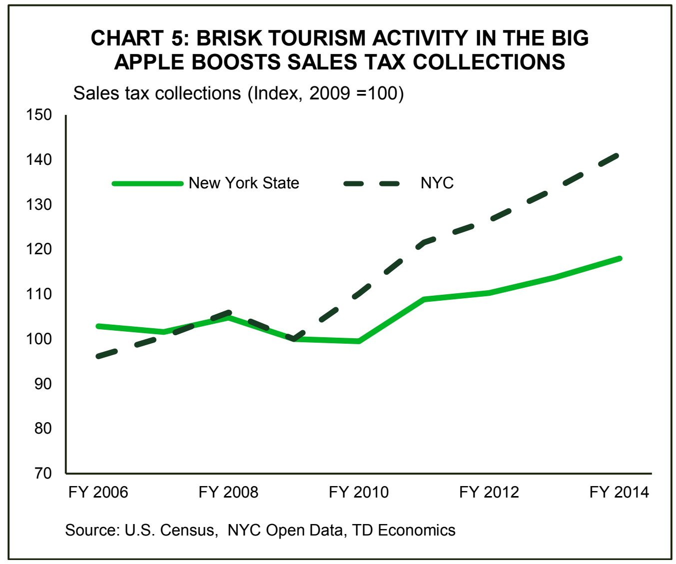
Tourism jump-started NYC employment recovery

It is hard to underestimate the importance of tourism for the New York metro during the latest economic recovery. The Big Apple's tourism sector has weathered the Great Recession considerably better than the national one. It also began adding jobs nearly a year before hiring resumed in other areas of the economy (see Chart 2). While accounting for just 2.3% of the metro's GDP and 9% of its payrolls, the leisure & hospitality industry – which includes hotels, restaurants, museums and Broadway theaters – has been punching well above its weight, churning out nearly a quarter of all new jobs since the trough. In addition to shows and dining, no trip to New York City is complete without a shopping spree, making the retail sector dependent on tourism activity. Together, leisure & hospitality and retail sectors have been adding jobs at more than twice the pace of other industries (see Chart 2) and were responsible for one out of every three jobs created during the recovery. While the metro's gains are impressive, they were even stronger in the core of tourism activity. New York City employment in retail, leisure & hospitality industries grew by 30% since the trough – more than 3 times the national average (see Chart 3). Ultimately, if not for the blockbuster growth within the tourism industry, the employment recovery would have been considerably more protracted.

Government coffers getting a boost

The economic benefits of a robust performance in the tourism industry extend beyond the direct impact of visitor dollars on jobs and income. The spending by non-residents also substantially impacts tax revenues. In 2014 visitors to





New York City spent $41 billion on tourism-related items, boosting government revenues at the local, state, and federal level by nearly $10.5 billion (see Chart 4). This was the highest level of tourism-related tax collections in the metro, exceeding the pre-recession peak by nearly 30%. Once again, the impacts are concentrated in New York City, which accounts for the bulk of the tax intake, collecting 70 cents of every dollar of state and local tourism tax revenues. This is a consequence of where the tourism activity is occurring, but also because New York City levies a variety of city-specific surcharges. For example, the sales tax in NYC is 8.875% compared with 4% state-wide. The city also charges a 5.875% hotel room sales tax and a $1.5 flat room fee – imposed on top of the city's sales tax. There is also a 5% supplemental tax on passenger car rental services, applied in addition to the statewide 6% tax.[2] All in all, these additional surcharges have contributed to the 40% gain in NYC sales tax collections during 2009-2014 period – nearly triple the state-wide growth (see Chart 5).

NYC is in the midst of hotel building boom

Impressive gains in the metro's tourism sector have also helped drive activity and investment in commercial real estate, as the city's retail and hotel operators experienced strong demand. Brisk growth in the number of visitors' to the Big Apple has pushed hotel occupancy rates to historic highs (see Chart 6). In the broader metro area hotels are 83.5% full, while those in Manhattan have occupancy rate of over 90%. Rising room rates and falling vacancies have spurred an unprecedented wave of new hotel development. Approximately 11,000 rooms were added to the city's inventory during 2014-15 period, ranging from boutique, family-friendly and super luxury brands. More remains in the pipeline, with an additional 17,000 rooms expected to be completed over the next two years (see Chart 6). Manhattan will remain the epicenter of new development; however, other boroughs will also see increased activity, with about 30% of new construction expected to take place in Brooklyn and Queens.[3]

Given that 40% of all visitors' dollars are spent on eating out and shopping, New York's retail commercial real estate demand also ramped up (See Chart 7). To cope with the demand, retailers expanded payrolls by 16% since the trough in the broader metro and by 25% in the NYC, compared with 10% nationally. Meanwhile, retail vacancy rate, which has barely budged even during the recession, continued to

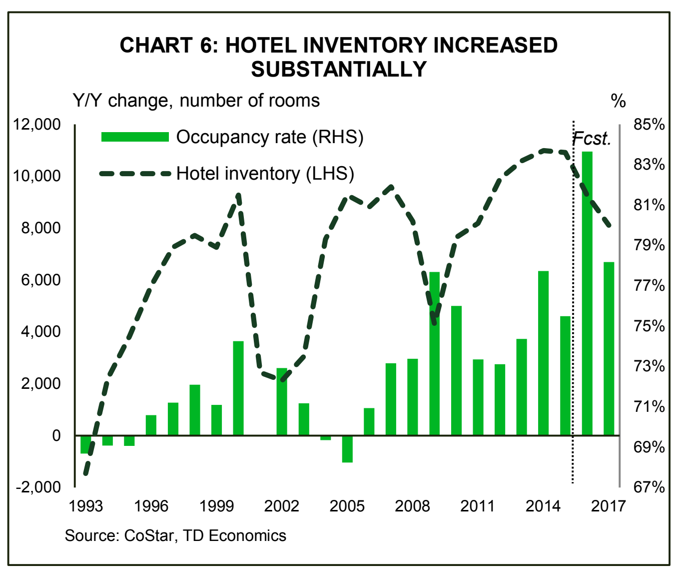
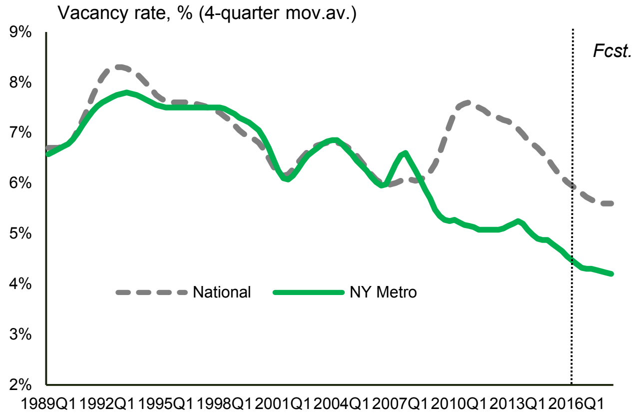
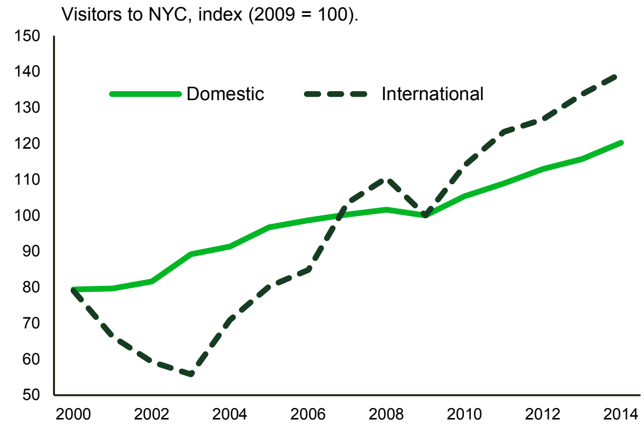


CHART 7: N.Y.'S RETAIL SPACE IS IN HIGH DEMAND



Source: CoStar, TD Economics

CHART 8: FOREIGN TRAVELERS LEAD THE WAY



Source: NYC & Company, TD Economics

trend lower during the recovery falling to record low levels.

Overseas travelers flock in record numbers…

Much of the success of NYC tourism industry stems from the city's worldwide fame. NYC had topped the list of most visited U.S. destinations by overseas travelers every year since the data collection began in 1983. In addition to being the tourist-magnet of America, just like the rest of the country New York City tourism also benefitted from the relatively low value of the U.S. dollar that prevailed during most of the recovery. While a protracted economic recovery has kept domestic travelers somewhat on the sidelines, overseas visitors flocked to the city in ever greater numbers. After bottoming out in 2009, the number of international visitors to NYC has grown by an impressive 40% - double the increase seen among domestic travelers (see Chart 8). Large gains in international travelers were especially supportive, with overseas visitors spending more per trip than their domestic counterparts. Based on the estimates by NYC & Company – NYC's official tourism organization – international travelers account for just 20% of all visitors to the Big Apple but generate over half of all visitor spending.[4]

Among international visitors who arrive to NYC by plane, over 40% hail from just five countries: United Kingdom, Brazil, China, France and Australia. Importantly, much of the growth in international tourism over the last five years came from developing countries while developed countries have seen only modest gains. Arrivals from the UK – NYC's top source of international visitors – remained mostly flat, while France and Australia managed to increase their share only slightly. On the other hand, visits from Brazil and China have seen spectacular growth (see Chart 9). The number of travelers from Brazil has nearly tripled in five years, while those from China has increased fivefold, with the country surging from a distant 13th to 3rd place as far as share of NYC international visitors. Given its relative proximity to Canada, the city also receives large number of visitors from north of the border, but statistics are challenging to compile as many arrive in NYC by car or bus. Still, at the state level, New York is tied with Florida as the most popular U.S. destination among Canadians, attracting nearly 4 million overnight visitors in 2014, with many of these likely visiting New York City.

NYC also benefits from being a second home for many wealthy non-residents, both from out of state and out of country. Research by the National Association of Realtors (NAR) found that New York state accounts for only 3% of all real estate purchases by international buyer in the U.S. – a long way behind Florida (23%) and California (14%).[5] While at the state level figures appear modest, the relative level of activity is certainly higher in New York City, which is the fifth most searched city by potential international home buyers on NAR websites. Moreover, according to New York City tax data, nearly a quarter of all condos and co-ops citywide are not primary residencies of their owners. In Manhattan the share of non-primary residences is 29%, but reaches as high as 44% in some neighborhoods favored by investors, such as Midtown. In some Midtown condo towers 60% to 70% of all units are owned by non-residents.[6]

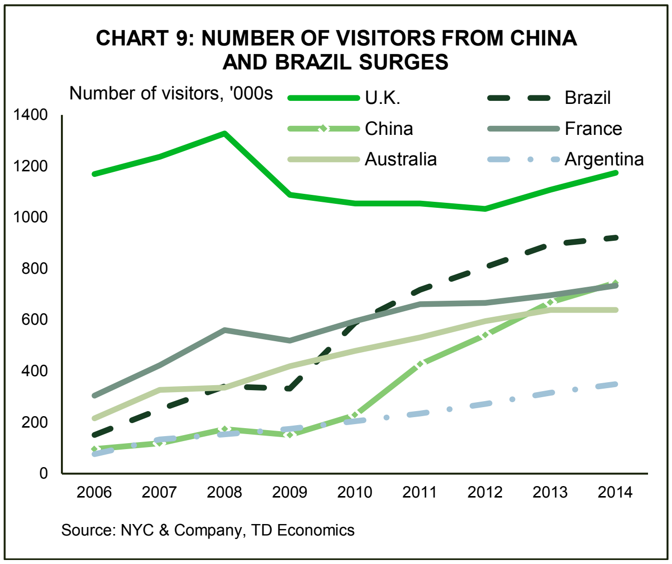
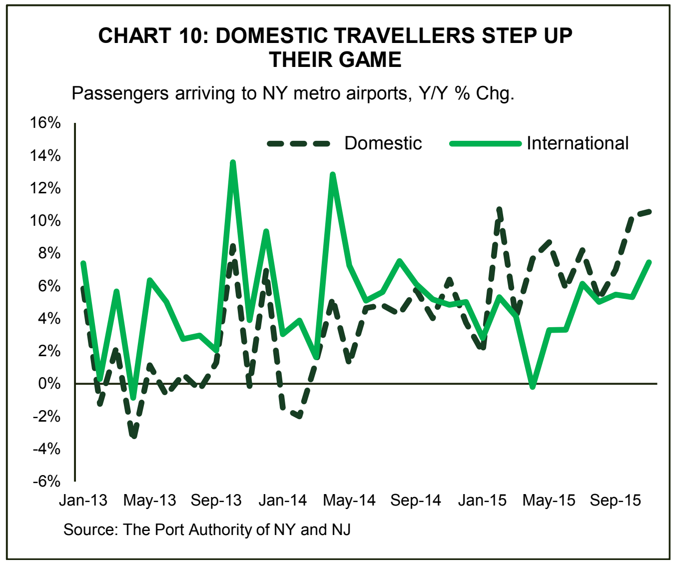


TABLE 1: SHARE OF VISITORS BY COUNTRY AND CHANGE IN EXCHANGE RATE		
	Share of visitors, %	Change in FX from Jan 2014 to Jan 2016, %
United Kingdom	9.8%	-13%
Canada	8.9%	-30%
Brazil	7.7%	-70%
China	6.2%	-9%
France	6.1%	-20%
Australia	5.3%	-21%
Germany	5.2%	-20%
Italy	4.2%	-20%
Spain	3.4%	-20%
Argentina	2.9%	-92%
Japan	2.4%	-14%

Source: NYC & Co., Bloomberg, TD Economics

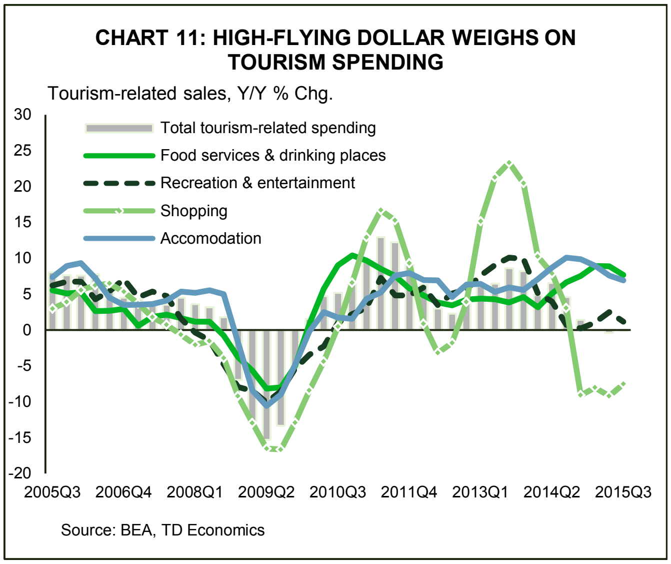


… but international support will wane

While international travelers helped to spearhead growth in New York's tourism industry, the high-flying greenback and slower economic growth globally may leave them playing second fiddle in the near-term. The Canadian dollar, for example, has lost some 30% of its value over the past two years, making potential trips considerably more expensive. The weaker exchange rate and a slowing economy are prompting many Canadians to scale down on trips and spending. In 2015 visits to U.S. have declined by some 16%, and are expected to fall to their lowest level since the recession this year. While the two provinces that border New York State – Ontario and Quebec – will fare comparatively better in economic terms, the currency effects span the country.

The U.S. dollar has also gained ground against most other major currencies (see Table 1). However, unlike Canadians, overseas visitors still appear to have lots of appetite for trips to NYC, with international passenger traffic in metro's airports growing (see Chart 10). Still, those that do end up making the trip will likely spend less on shopping, recreation and dining, and perhaps opt for cheaper accommodation. National data on tourism spending bears out this trend with growth in tourism related spending on recreation and entertainment nearly stalling while spending on shopping is actually contracting (see Chart 11). Slower momentum in the tourism sector is already manifesting in the labor market. Hiring in leisure & hospitality and retail sectors recently slowed to about half the pace seen during 2011-2014 period.

Demand for the luxury accommodation has also eased. The overall occupancy rate in Manhattan hotels has remained relatively steady, but it has fallen by nearly 6% y/y for high-end hotels (those charging over $500 a night).[7] Occupancy is likely to ease further as large supply of newly completed units comes on the market in the coming years. The high-end of New York's real estate market is also facing a trifecta of headwinds emanating from the higher dollar, rising supply of new units and increased regulation. While many international investors crave for a slice of the Big Apple, they are unlikely to purchase it any price. Substantial price gains in recent years alongside the large appreciation of the greenback will likely temper appetite for NYC real estate. There are already signs that the Manhattan luxury segment is losing some of its luster. Median prices for the borough's most expensive homes – the top 20% of the market – are down 3.5% compared to their peak of $3.72 million reached in February of 2015.[8] The number



of contracts signed at $10 million and above dropped 16% from the previous year, and it took two months longer to sell properties priced above $4-million, with days on the market increasing to 243.[9]

Further downside risks to the sector also stem from increased regulatory oversight, both domestically and abroad. In an attempt to step up its anti-money laundering efforts the Treasury Department has announced new requirement to establish and report identities of buyers in all-cash real estate purchases valued over $3 million in Manhattan and Miami.[10] Many of these transactions are carried out through shell companies which often preserve anonymity of the actual buyer. For now new measures are slated to run from March to August; however this pilot project could lead to permanent changes in reporting requirements across the country. In the meantime, the temporary measure will increase regulatory hurdles for the real estate industry, and could slow transactions.

Domestic visits should help

While economic support from international travelers will ease, domestic tourism will continue to gather speed, benefitting from robust job creation, rising incomes, and improving household balance sheets. Moreover, low gasoline prices will leave more money in consumers' pockets for discretionary spending. This will make a trip to NYC by car more affordable for travelers from nearby states. Indeed, domestic travelers – which account for nearly 80% of visitors to NYC – are stepping up their game. On a year-over-year basis growth in visitors arriving by domestic airlines has outpaced international arrivals since February 2015 (see Chart 10). This trend is expected to persist this year and will help to mitigate the slowdown related to international tourism. Still, since domestic travelers tend to spend less per visit than their overseas counterparts, this offset will likely be only partial.

Bottom Line

Economic benefits of NYC's tourism industry are substantial. The industry has enjoyed spectacular growth over the past several years, directly providing an important lifeline for the local labor market during the recovery. It has also generated substantial positive spillovers for state and local government coffers, as well as hotel, retail, and condo real estate markets.

The ability to attract international tourists was a lynchpin to the industry's success. However the appreciating greenback and slowing growth in a number of emerging market economies will weigh on demand in this segment of the market. The headline number of overseas travelers should hold up relatively well given New York's status as a premier tourism destination. However, the impact will be apparent on the spending front, particularly in the luxury segment. On the bright side, the rising tide of domestic travelling on the back of a strengthening U.S. economy will help to mitigate some of this weakness. Additionally, the city's economy will continue to benefit from a diverse and growing base of high-value-added industries, which will keep growth on an upward trajectory.

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