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Impact of COVID-19 on the Hospitality Industry and Implication for Operations and Asset Management

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Introduction

Among all real estate asset types, hospitality real estate assets, together with retail, have witnessed the most disruption from the COVID-19 pandemic. As one of the most service-intensive real estate asset types, the risks facing hospitality real estate underscore potential cascading damages to and fragilities of the global physical landscape. This article focuses on the impact of COVID 19 and ongoing adaptation of the hospitality industry, with specific attention to the short- and long-term impacts of COVID-19 on its business operations and asset management strategies. Based on secondary data compilation and from academic and industry reports and content area experts, this article aims to create a reflective and instructive document for industry and students to build their understanding on the changing performance of the lodging sector and adjustments in its practices brought about by the pandemic.

Impact of COVID-19 on travel and hotel industry performance

According to the US Travel Association, travel spending declined by 42 percent in 2020 (nearly $500 billion) from 2019, with international travel and business travel suffering the sharpest declines. International travel spending fell 76% (compared to 34% for domestic travel) while business travel spending reduced 70% (compared to 27% for leisure travel) (U.S. Travel Association, 2020). Since the World Health Organization declared COVID-19 a global pandemic in March 2020, hotels worldwide have seen precipitous declines in occupancy. North American hotels closed 2020 with a 43 percent occupancy and a RevPAR decline of 48 percent in the same year, according to Smith Travel Research. Hotel closures, layoffs and furloughs resulted in 8.3 million lost jobs in just March and April 2020, and 498,000 jobs lost in December 2020. With reduced staff, service levels were bound to be affected and the American Customer Satisfaction Index (ACSI) clearly shows a decline in satisfaction scores and an increase in customer complaints after the outbreak of the pandemic. American Traveler and Consumer sentiment research results from US Travel Association show that Americans are still wary of travel, albeit a growing expression of interest in safe travel destinations (American Customer Satisfaction Index, 2020).

With the increasing availability of vaccination and a gradual return of travel and other economic activities in society, hotels, together with other service-oriented asset types, will begin to receive more foot traffic and welcome back their guests. As one of the most impacted industries by the pandemic, the lodging industry has seen several prominent hotels in major destinations close. In fact, about 200 of the 700 hotels located in New York City have closed since COVID-19 hit, and many of those closures are expected to be permanent as debts mount. While the hotel industry is no stranger to event-induced down cycles, the pernicious nature of this pandemic has been particularly challenging. At this stage, we will reflect on specific business impacts of COVID-19 on hotel companies and asset managers, examine the issues, tactics and strategies they need to implement in order to remain resilient and reframe their near- and long-term prospects.

With over 55,000 branded, independent, and managed hotels and five million+ hotel rooms in the United States (American Hotel & Lodging Association, 2020), the lodging environment had become complex in the past several years for owners, operators, and asset managers. As a capital- and labor-intensive industry with high financial and operating leverage, the precipitous downward demand induced by the pandemic has tested the resilience and management capabilities of the various participants in the lodging industry: owners, asset managers, operators, franchise companies, developers, lenders, suppliers, and employees.

Post-COVID commercial real estate and hotel investment trends and sentiment

Based on the recent Urban Land Institute and PwC Emerging Trends report, in 2020 most commercial real estate was broadly affected by COVID-19 in a negative way. Specifically, properties with a public use component such as offices, retail, apartments, hotels, sports and entertainment venues have been singled out as potential spreading locations for the coronavirus, most of which were at times either shut down and/or had use restrictions imposed. Among the report's surveyed respondents, only 44 percent felt comfortable making long-term strategic real estate investment decisions; 74 percent of the lenders and 67 percent of the equity investors indicated tighter underwriting standards for new real estate projects, with the overall consensus of poor to fair hotel investment and development prospects in 2021 (PwC, 2021). Smith Travel Research indicated that most 2020 projects were deferred versus abandoned (Hood, 2021). Due to the reduced performance levels, the hotel transactions market dropped in 2020. While the economic uncertainty widened, the availability of debt dwindled, and the large bid-ask spread prevailed. For distressed hotels, sales were consummated at 15 to 40 percent discount to pre-pandemic values, which led to private equity and Institutional investors taking advantage of reduced pricing.

Instilling travel confidence: industry and brand safety initiatives

With daily statistics on the number of cases, deaths, and related news items bombarding consumers through various media channels and platforms, it is not surprising that travel confidence since the breakout of the pandemic has been low. Based on MMGY's December Travel Safety Barometer (MMGY Travel Intelligence Report, 2020) (ranging from 0 to 100), traveler perception was cautious. While international travel scored 35, closer-to-home domestic travel was perceived to be safer with the Barometer index reached 50. Travel safety perception also varied by segments, where dining and entertainment were still viewed unsafe (47) and lodging fared slightly better at 51. However, business travel and cruise were viewed as unsafe, scoring at 38 and 30 respectively. Despite the improvement in traveler sentiment conveyed by the Travel Safety Barometer, the hospitality industry needs to continue to work on their safety protocol messaging to convince the wary consumers.

In fairness to the hospitality industry and hotels, they have reacted remarkably well to this challenge and rolled out several industry, corporate and property level safety policies, procedures, and measures. The American Hotel and Lodging Association (AH&LA) took the lead in establishing industry-wide hotel enhanced cleaning guidelines with their "Stay Safe" initiative, a program developed in conjunction with a representative advisory council. These guidelines were based on benchmarks established by public health authorities, such as the Center for Disease Control and Prevention, to instill a sense of confidence for hotel guests and employees that the industry was united behind a common set of cleaning and safety practices. Since its issuance in April 2020, "Safe Stay" has been widely endorsed by the major hotel companies as well as industry and state hospitality associations. It was a timely and excellent starting point. Since the launch of "Stay Safe," all the major hotel companies have launched their own safety protocols to assure their associates and guests that they are taking added precautionary measures as they begin to open for business. Implementation of these protocols may continue to be a challenge due to the diversity of owners, reduction of staff, limited brand oversight, and range of hotel products, size, location and design elements. Being largely a human contact business with multiple guest and employee touchpoints, ongoing monitoring of these protocols will be vital for instilling a perception of safety, particularly as travel slowly returns to normal. With social media and other platforms negative feedback is only a click away.

Marketing and asset utilization

As travel demand declined from March 2020, operators and asset managers looked at creative ways to generate revenue and utilize hotel assets. While large meeting and convention business is still at least one year away, hotels have generated ideas to spur local and regional leisure travel. Concepts, such as "Staycations" and other food and beverage packages, have supported hotel weekend travel. Some hotels have worked with local hospitals to convert part of their hotels to accommodate traveling nurses, healthcare workers, and in some cases even COVID patient centers. The work from home concept has helped hotels located in resort destinations to offer long-term discounted room rents to induce guests to convert their hotel rooms into temporary home offices. As work from home incurs the risk of an unhealthy lifestyle, some hotels have created stay packages with a wellness and fitness component. Typical operational policies have also been relaxed to spur travel, including free cancellation and flexible check-ins and check-outs. Some hotels have even leased out underutilized kitchen space, converted into "Ghost Kitchens," (a COVID-era "pivot"), where the kitchen is used to prepare and deliver food to select service hotels or local customers.

The pandemic has challenged revenue managers, who are an integral part of a hotel's asset utilization and optimization team. In a recent best-practice panel discussion hosted by Hospitality Sales and Marketing Association International (HSMAI), certain insights emerged. While discounting isn't producing better results, revenue managers are analyzing the profit from a revenue strategy perspective versus based on occupancy. Marketers have focused on various market intelligence sources to understand different segments of the market, their travel motives, behavior, value perception changed by the pandemic, and increased emphasis on client communication. The current crisis has made forecasting a challenge as hotels cannot rely on historical data and will need to input more externally generated data points to create predictive models for demand forecasting.

The guest and service experience

The post-COVID operation requires an unprecedented degree of versatility for hotels. The careful management of social distancing and implementation of imperative hygiene measures are critical to restore customers' confidence and generate renewed demand. As announced by the World Travel and Tourism Council, hotel operators and asset managers should anticipate a global protocol for the “new normal” to be adopted by international hotel operators and independent hotels. How to think innovatively about new functions within the same physical space is vital for post-COVID hotel asset management. For example, redesigning hotel public areas through rearrangements of furniture layouts and encouraging broader use of outdoor settings when the weather allows are two of many new possibilities. In addition, how to innovate and implement new technologies in various operational steps is critical – such as automating check-in/check-out, enabling contactless transactions throughout the guest’s journey, and utilizing mobile apps for food ordering and laundry services during stay. In short, the operational priority is to re-imagine the existing spaces and streamline services in order to respond to the new context while keeping in mind the guest experience and profit optimization.

Financial and cash flow management

Liquidity management, cash flow management, and allocation of working capital are also increasingly important as hotels are forecasting a gradual restart. With the current drought of travelers and reduced demand for business travel, it may take several years for hotels to ramp up and re-stabilize their operations. During this process, it is critical for them to reevaluate the share of fixed costs in favor of a more variable structure to benefit from a hybrid model before the demand grows back to its normalcy. While cost management needs to consider the impact of the occupancy rate, hotel overheads, salary costs, and the performance of the various points of sale, adapting and reinventing a new operating business model is critical. How to identify new opportunities, including the alignment of business volume with the right scale of workforce costs, needs to be a priority.

Capital expenditures

To keep hotels functioning, fresh and relevant, hotels spend five to nine percent of their revenues to replace and update capital items such as Furniture, Fixtures, and Equipment (FF&E). Hoteliers significantly reduced capital-expenditure spending in 2020 because of the COVID-19, dropping from almost $7.3 billion in 2019 to about $2 billion, according to a new trend analysis report by Hotel News Now (Wroten, 2020). The report also stated that hoteliers changed their spending emphasis this year, focusing on matters such as cleaning and sanitation equipment, signage about social distancing and wearing masks, reconfiguring food-and-beverage outlets, and installing air-filtration systems and deemphasizing expenditures such as software and technology upgrades, new room designs, and fitness center improvements.

Hotel brands have worked with owners to ease their capital expenditure brand expectations and increase free cash flow. For example, Marriott along with other brands will be delaying all regular cycle renovations due in 2020 for one year and delaying all FF&E reserve funding for six months. The company will also be deferring all brand initiatives and suspending all brand audits for the time being. Marriott is also working with owners to close hotels on a temporary basis.

Human and social capital management

With staffing cost representing 30-35 percent of the operating expenses in a hotel, labor represents a significant expenditure for hotels. With hotel occupancies running well below 50 percent for the past year, hotels were faced with the difficult decision to cut staffing. With business running 75 percent below normal levels, the late Arne Sorenson, CEO of Marriott hotels had to make the tough choice of slashing 4000 corporate jobs. This scenario filtered its way to the property level across all hotel companies. The number of jobs in entertainment and recreation plunged 31 percent between September 2019 and September 2020, according to the Bureau of Labor Statistics, and the hospitality sector had an overall unemployment rate of 38 percent in 2020.

Managers and owners were challenged with making tough choices whether to layoff or furlough employees, who to layoff, and what benefits and severances to provide, while at the same time ensuring the safety of employees retained, dealing with union issues in tough union markets like New York, and hiring labor lawyers and consultants on issues to prevent future litigation. All in all, managers had to learn to manage under huge financial pressure with tremendous resource constraints, and yet maintain morale and service levels.

The current pandemic has presented an opportunity for hotel companies to convey trust and good citizenship. Whether it is an independent owner-operated hotel or part of an international brand company, by conveying empathy towards their employees, suppliers and the local community, these hotels will recover from the COVID crisis with a much stronger brand image. Supporting and appreciating healthcare workers, providing free meals, and assisting low-income employees are just some of the small or large gestures that will distinguish hotel companies and reinforce their social and corporate images going forward.

Asset managers and contract review

The pandemic induced downturn over the past 12-15 months has forced owners and the various contractually bound stakeholders such as brands, operators, lenders, and service providers to thoroughly review their agreements and contracts so they are each able to sustain the crisis for their mutual benefit and thrive post-COVID. As Chad Sorenson and Gabriel Stein have noted in their recent BHR article:

Asset managers played an integral role in identifying opportunities, and in many instances, led discussions with stakeholders around a wide array of relief strategies. The goals of these negotiations were to obtain fee relief, modify the scope of services, defer payments, and/or agree upon less restrictive terms which would provide additional operating flexibilities, allowing asset managers to focus the use of cash on the most *critical expenses. Industry partners were responsive to the needs of the hotels; brands loosened standards, operators reduced shared service fees, lenders waived Furniture, Fixtures & Equipment (FF&E) contribution requirements, and vendors agreed to payment plans. While many of these actions were self-serving to each party's pandemic survival strategies, these exercises gave asset managers a new playbook for future downturns, contract reviews, or performance concessions.*

One likely modification to future management agreements will likely categorize pandemics as force majeure events, with room to negotiate payment obligations, and authorization to close a property. Most current management agreements have a very loose association of a pandemic as a force majeure event.

The "manchising[1]" business model coined a few years ago describes a brand management contract that can be converted to a franchise agreement. This structure can offer benefits to both the brand and the owner. With the growth of quality third-party managers competing for opportunities, brands are finding that the management contracts space has become crowded and competitive. However, by allowing an investor the right to convert to a franchise, owners may be inclined to hire a brand manager as it provides potentially lower fees and the optionality they are seeking. As the value of a hotel deal upon sale is negatively impacted when it is encumbered with a management contract, and given the current uncertain environment where owners become dissatisfied with management performance and may want to exit the investment, unencumbered, manchising as a business model is gaining some traction with branded hotel companies and may stay on and grow after the pandemic.

Future and recovery outlook

As the situation evolves, other challenges will compel hotel owners and asset managers to think through various strategies for building resilience in the operating model and in the market segmentation. Using social media to develop a new sales and marketing strategy to attract a new segment of customers, in particular, a more domestic clientele, should be one of the priorities. The crisis will eventually be behind us, and as such, various stakeholders of the hospitality industry need to prepare operations for when life returns to normal, and hopefully the pent-up demand for travel will lead us to a robust recovery. Recruiting employees, training, maintaining safety protocols, and managing the guest experience are just some of the challenges on the horizon. We believe the hotel industry in general has adapted and grown more resilient and innovative during the crisis, and this will help them pursue new opportunities and better navigate the next crisis.

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[1] *Manchise Agreements: What To Know and Consider*
https://lodgingmagazine.com/manchise-agreements-what-to-know-and-consider/

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