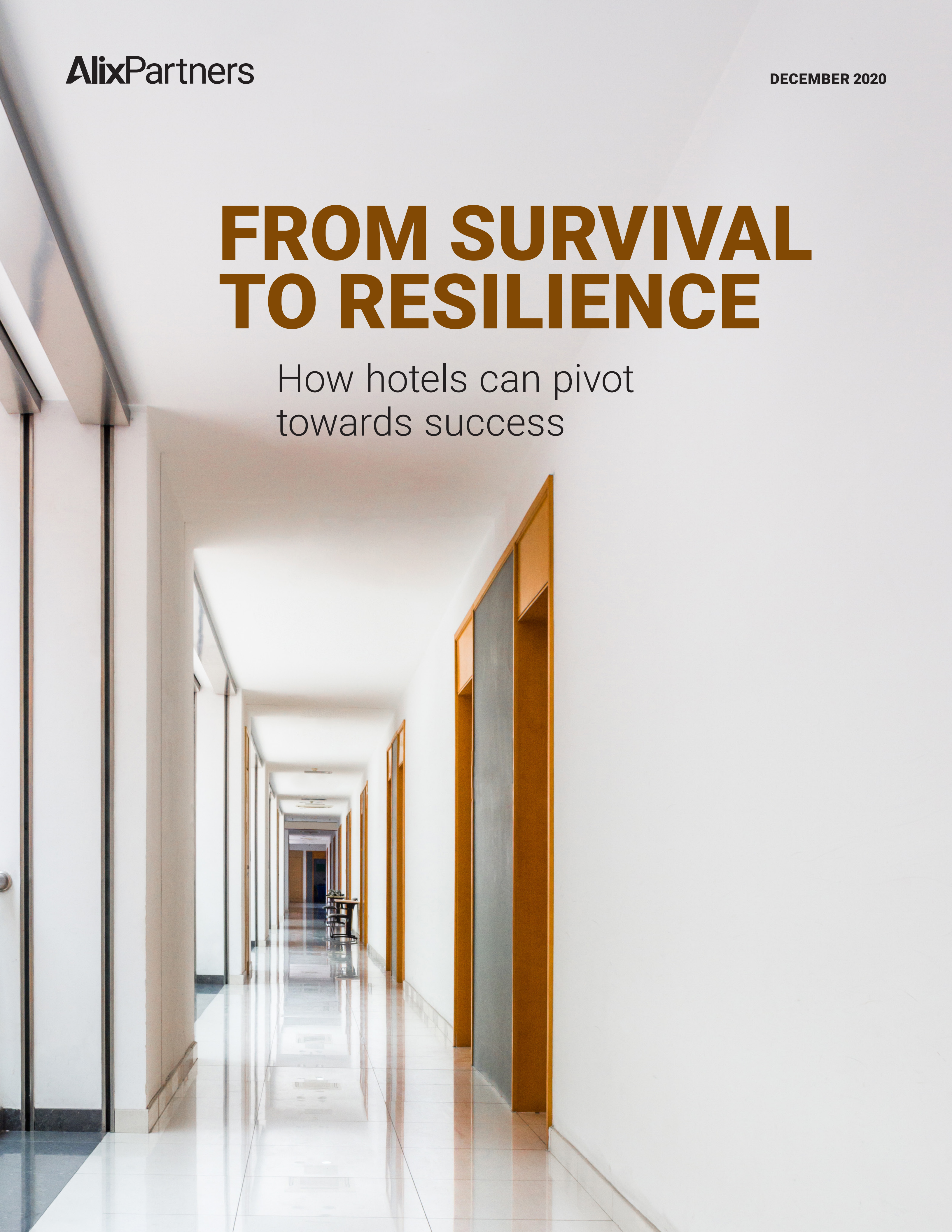
AlixPartners

DECEMBER 2020

FROM SURVIVAL TO RESILIENCE

How hotels can pivot towards success



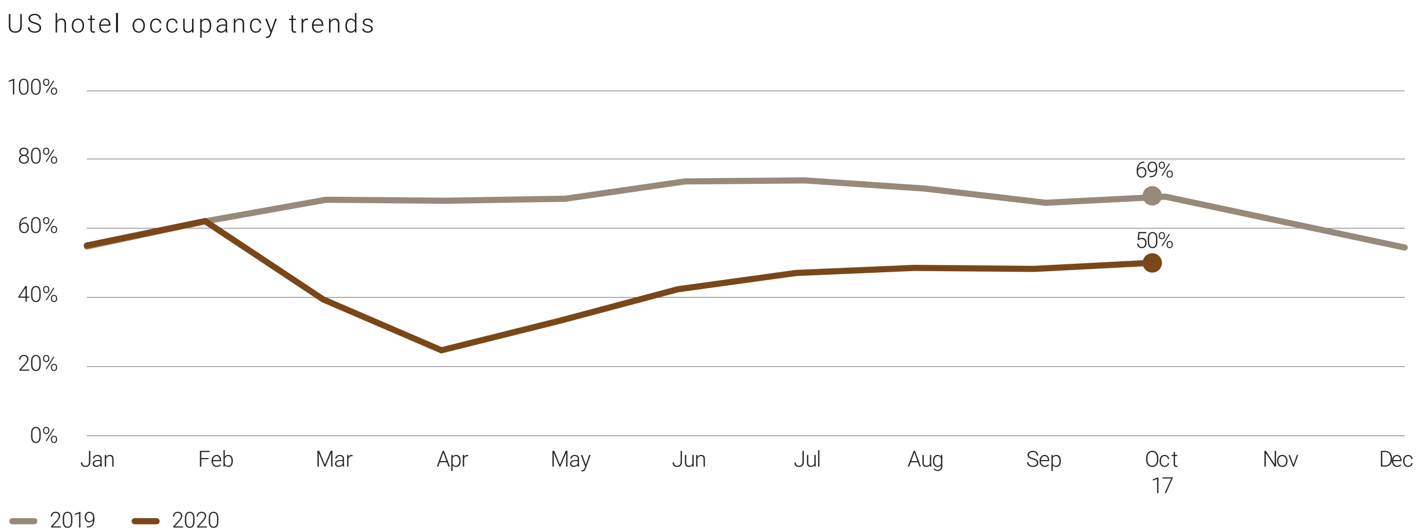
Unprecedented disruption in the hospitality industry continues as travelers stay home amid the COVID-19 pandemic. Findings from AlixPartners' latest research into consumer behavior suggest that this situation isn't going away anytime soon. To safeguard their future, hotel operators could proactively pivot from merely surviving to achieving resiliency.

The travel sector counts among the hardest hit by the pandemic's impact–if not the hardest. Consider the unprecedented levels of distress seen this year in the space. In September 2020, the industry still had over $20 billion in hotel commercial mortgage-backed security (CMBS) loans reported to be 30 or more days delinquent. Let's put this in perspective: There were just $1 billion in delinquent hotel loans in December 2019. And during the financial crisis of 2008 to 2009, delinquent CMBS loans peaked at $13.5 billion – far less than the Fall 2020 figure.[1]

True, the CMBS delinquency rate has fallen in weeks of late. However, this is largely due to forbearance grants in the hotel sector, borrowers' being allowed to tap into reserves, and investment firms' extending high interest loans to financially strapped operators rather than fundamental shifts in operating performance driven by the beginnings of a recovery.

What's more, despite some improvement in in-country leisure travel over recent months, the industry remains severely depressed. For instance, the number of jobs in the sector has already dropped by 23%[2] during the crisis – and that's just to date. Nearly 65%[2] of hotels remain at or below 50% occupancy, suggesting that many are under the breakeven threshold. Yes, US occupancy has improved since April's lows of roughly 22% (figure 1). But RevPAR has been trailing at nearly half of last year's levels (figure 2) and represents a deterioration that's four times the impact of the 2008 to 2009 financial crisis.

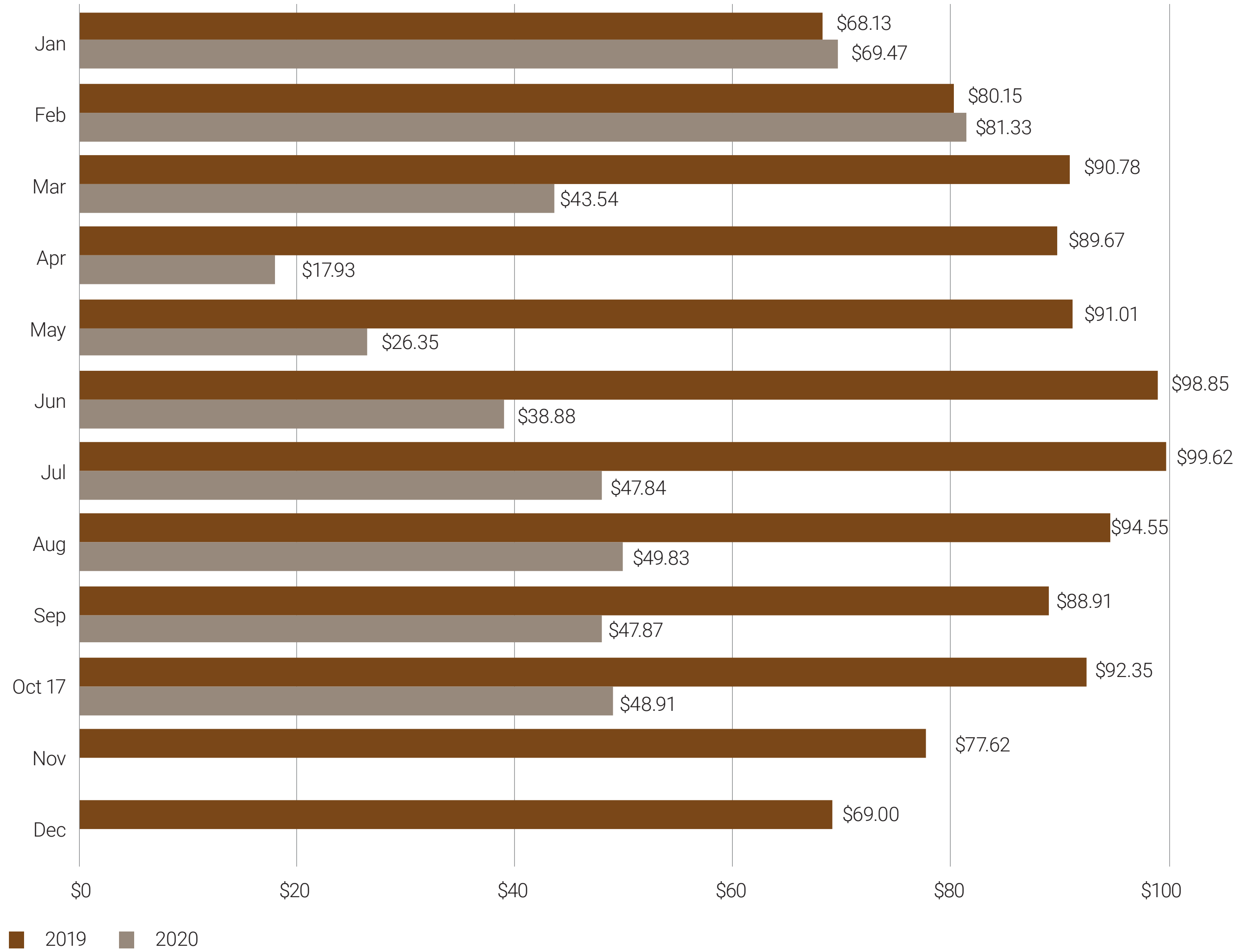
FIGURE 1: MONTHLY OCCUPANCY RATE OF HOTELS IN THE US



Source: Published by hotelnewsnow.com, survey by STR, accessed from Statista

1. Source: trepp
2. Source: American Hotel & Lodging Association (AHLA)

FIGURE 2: MONTHLY AVERAGE US HOTEL REVENUE PER AVAILABLE ROOM



Source: Published by hotelnewsnow.com, survey by STR, accessed from Statista

HARD REALITIES . . .

Unfortunately, many industry experts are not forecasting a return to 2019 RevPAR levels until 2023 to 2025. For example, STR anticipates a demand and occupancy recovery by 2024, with RevPAR upticks to follow in 2025. While optimism around recent vaccine breakthroughs has many hoping the recovery horizon will be shortened, consumer behavior has likely been permanently altered. Additionally, there is large consensus that we are heading toward a different economy, one characterized by widespread battle over share of wallet.

AlixPartners' consumer research on the travel sector further backs this up. Consumers in 7 major markets around the world say they have cut back on travel spending more than 14 other key consumer sectors during the pandemic (figure 3). They also are more reluctant to return to travel and leisure activities than to other sectors, including restaurant dining and retail shopping. In fact, consumers in our survey said they don't expect to resume activities such as renting a car or reserving accommodations through Airbnb until, on average, four to five months from now. Resumption of air or cruise-ship travel won't happen for another six months, our respondents suggest (figure 4).

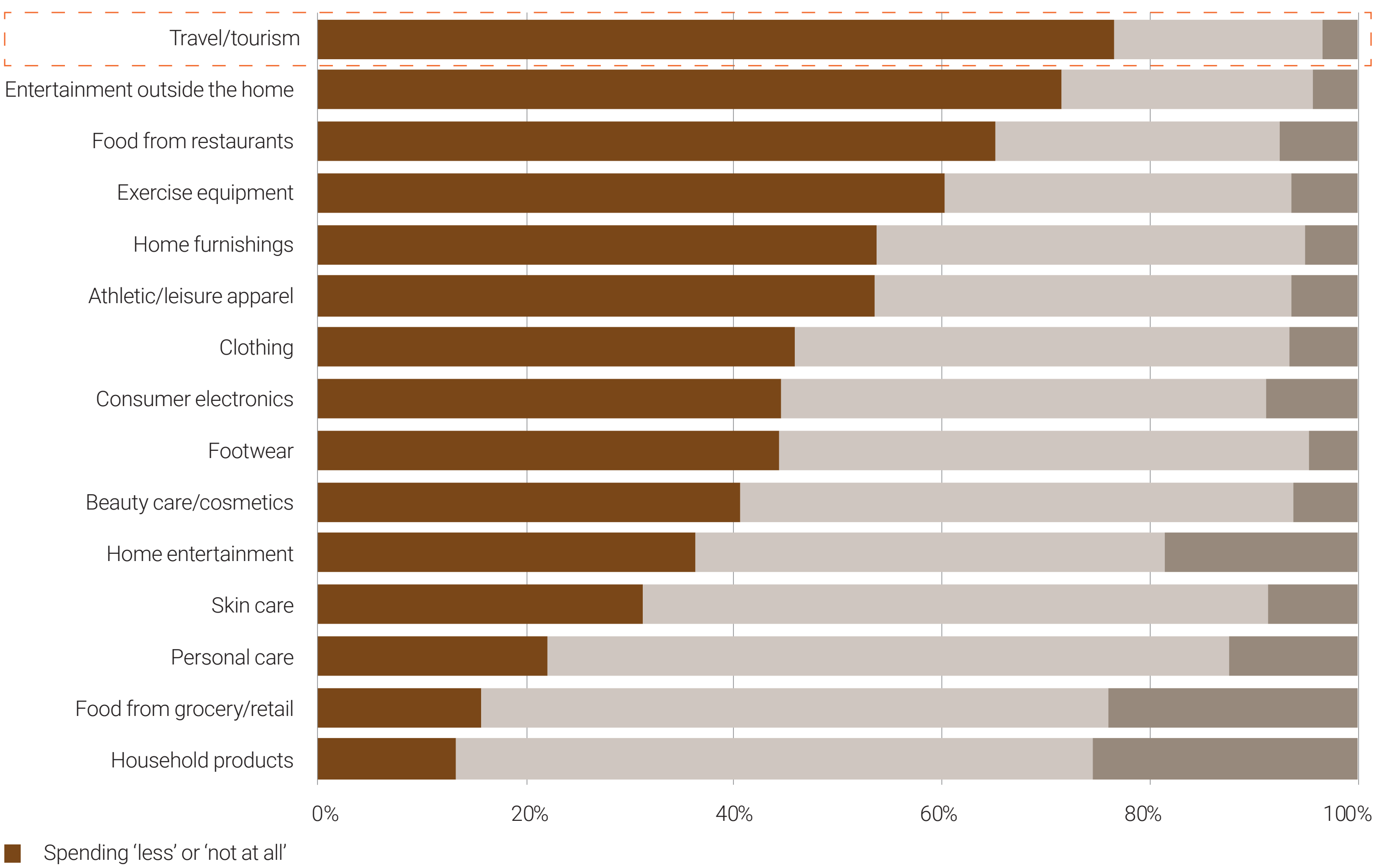
And for the hotel sector, only 12% of global consumers reported staying at such accommodations since the crisis erupted. As much as 44% of those who were not currently utilizing hotels (but typically do so) said they planned to wait a year or even longer before staying at a hotel, or they were unsure.

To be sure, uninterest in leisure travel has contributed to this suppression of hotel use. But a large portion of it stems from the severe pullback on business travel, of which a chunk may be permanently gone. For example, Global Workplace Analytics forecasts hold that as much as 25% to 30% of the US workforce will continue working from home for multiple days each week through the end of 2021. Further showing the extent of this decimation of business travel, the number of tickets that travel agencies sold to corporate customers was 85% lower than a year earlier for the week ending November 1. Although this has improved from the 96% decline in mid-April, there is still a long way to go toward a rebound.[1]

FIGURE 3: THE TRAVEL SECTOR HAS HAD THE MOST CUTBACK IN CONSUMER SPENDING DURING THE PANDEMIC

Question: Since the start of COVID-19 stay-at-home orders, are you spending more/the same/less on each of these categories?

Global consumer spending during COVID-19

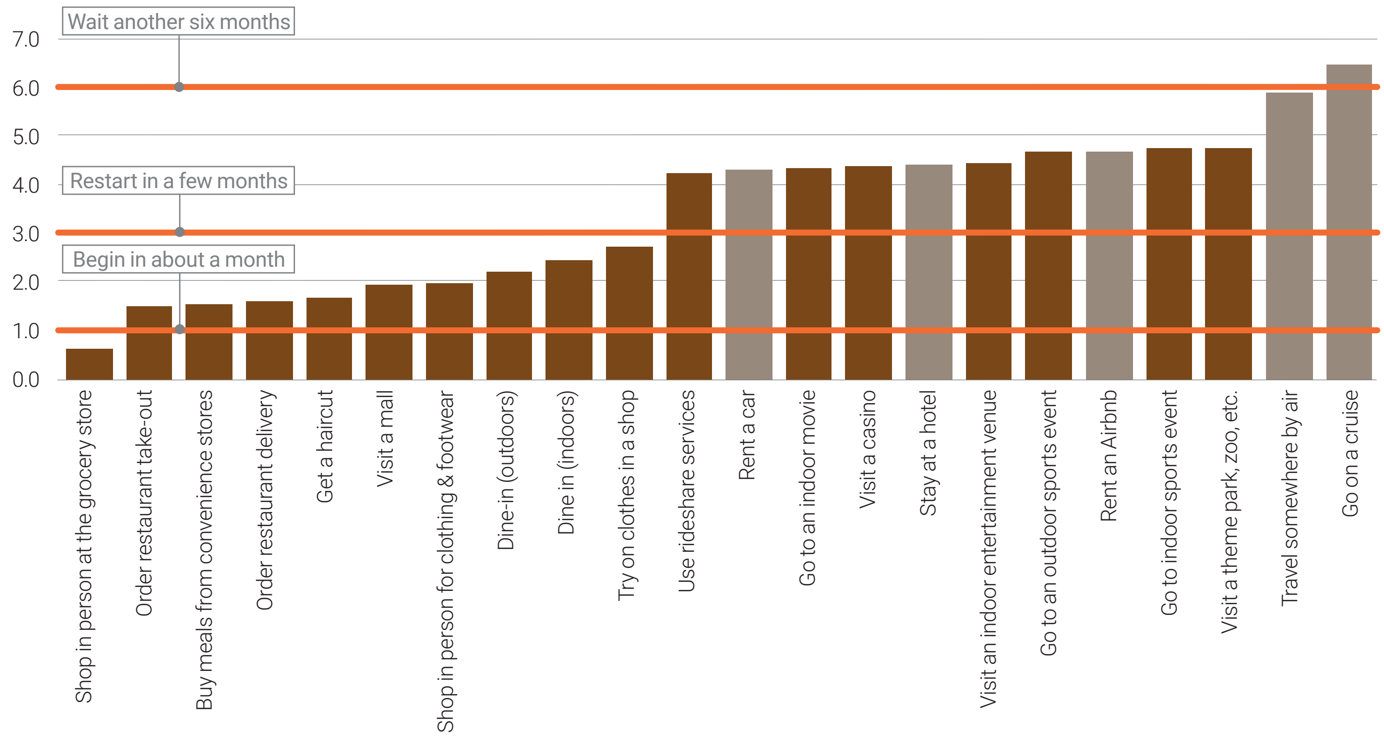


Source: AlixPartners Consumer Priority Study - Summer 2020

1. Source: Airlines Reporting Corp

FIGURE 4: CONSUMERS MORE RELUCTANT TO RETURN TO TRAVEL AND LEISURE ACTIVITIES COMPARED TO RESTAURANTS AND RETAIL

Average months consumer expects to restart activity (for those interested)



Source: AlixPartners Consumer Priority Study - Summer 2020

. . . BUT SIGNS OF HOPE

Still, despite this negative outlook across the travel sector, there are some signs of hope – particularly for hotels. When US consumers resume travel, hotels will likely be their first stop. In fact, 58% of US consumers say they have already or intend to resume staying at hotels within a few months. Indeed, consumers' interest in hotels exceeds their interest in other activities by an average of 23%. Consider: The desire to stay at a hotel outpaces consumer intent across all other travel activities including renting an Airbnb (50%). And, it strongly exceeds their interest in traveling by air again (48%) or visiting another country (38%) (figure 5).

Thus, within the travel and tourism sector, hotels are better positioned to gain the first dollar in a recovery. Moreover, there appears to be money available to fuel this behavior: Among US consumers who said they tended to save for travel, this habit has remained relatively unchanged during 2020, with 1% more consumers reporting setting aside money toward a future vacation than prior to the pandemic.

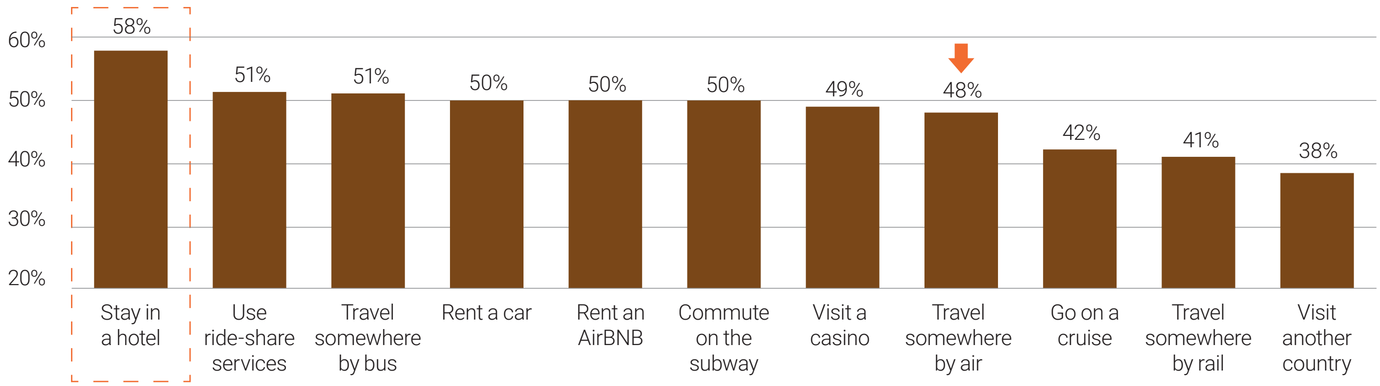
58%

of US consumers say they have already or intend to resume staying at hotels within a few months.

FIGURE 5: DESIRE TO STAY IN HOTEL LEADS IN TRAVEL AND TOURISM ACTIVITIES

Question: Tell us what you are doing across different aspects of your everyday life

US: currently doing or intend to do within a few months (for those interested)



Source: AlixPartners Consumer Priority Study - Summer 2020

RETHINKING TRADITIONAL STRATEGIES

Given these latest developments in preferences, many hotels may need to reevaluate their traditional customer-targeting strategies. This is particularly true for operators located in the heart of traditional tourism destinations or urban hotels catering to business travelers. Such hotels will likely need to shift marketing strategies. For instance, they may develop short-visit offerings to attract new, local customers or those living a manageable driving distance away, rather than marketing to more physically distant or international legacy customers for week-long getaways that require air travel.

These trends are already playing out. We see urban hotels predominantly bearing the brunt of the pandemic, while regional leisure travel within driving distance of major cities remains relatively healthy. For example, occupancy and RevPAR have been high for luxury hotels in areas such as Lake Tahoe.

PIVOTING TOWARD LONGER-TERM STRATEGY

What does all this mean for investors? Given the overall distress in the environment, lenders may not aggressively pursue foreclosures for many properties. Although cash is king, hedge funds and activist investors have been sitting on a lot of dry powder while waiting to acquire undervalued assets. For example, the Palmer House in Chicago was recently appraised at just $305 million, a 46% drop from its sale price of $560 million in 2018. A 30% to 40% decline in asset valuations may catalyze predatory instincts in this environment. We have also seen several investment firms capitalizing on the atmosphere by extending high interest loans to financially struggling hotel owners, signaling interest in the space.

Meanwhile, numerous hotel operators continue to pull widespread levers in an attempt to thwart distress. Many have furloughed employees, reduced their service offerings, extended payment terms, or temporarily shut down sections or properties. Others have begun shifting to serve new groups of customers, such as employees seeking office space or people engaging in distance learning who need space. We've seen some large chains, including Marriott, recently report a return to profitability due to such aggressive cost-management measures.

These shorter-term moves have been necessary to support business continuity. But they may not be enough for many operators to navigate the shift from merely surviving to boosting their resiliency in the face of the expected ongoing disruption. Many hotels–such as those traditionally serving business travelers or customers journeying to locations that are difficult to access by car–may not be able to pivot quickly or effectively enough to survive. And for those that do survive, some may underestimate the challenges and investment tied to successfully navigating the rocky ramp-up period to service the changed economy.

BETTER ALIGNING THE HOTEL ECOSYSTEM

Can those involved with hotel operations manage the shift from survival to resilience? Yes – if they make more profound changes aimed at amending and aligning the hotel ecosystem to better serve future customers, while remaining relevant to current customers. They'll need to consider making a series of moves, including:

- Moving from shorter-term business continuity, including liquidity preservation and demand management, to permanent strategy shifts
- Accelerating consumer insights to rethink formats and offerings
- Using rigorous financial modeling to simulate property-level disruptive scenarios that may persist into the future and to develop site-specific business plans for mitigating these risks
- Executing portfolio plans that include tailoring workforce and customer re-engagement tactics, pricing strategies, operating models, technology enhancements, and debt structure toward new property business strategies
- Continuously tracking property-level performance and analyzing real-time data to adjust business plans as needed to preserve liquidity

As the foundation of this is improved, ongoing communication across stakeholders within the hotel ecosystem to align everyone around business plans and to maximize understanding of asset value with investors (figures 6 and 7).

FIGURE 6: STAKEHOLDERS WITHIN THE HOTEL ECOSYSTEM NEED TO BETTER ALIGN

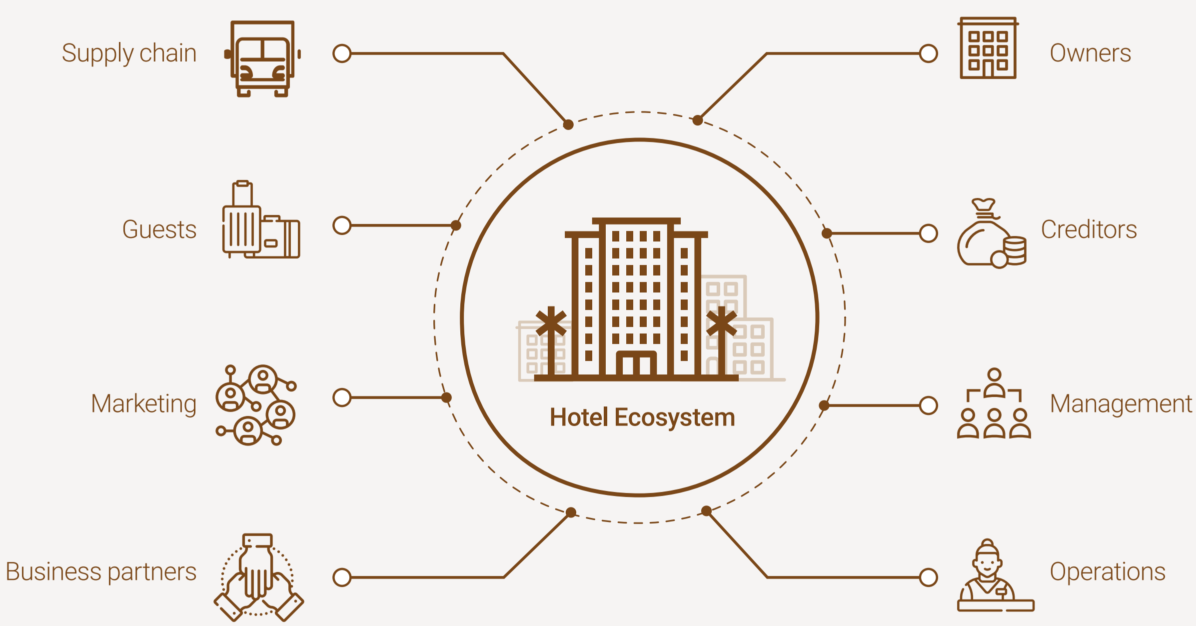
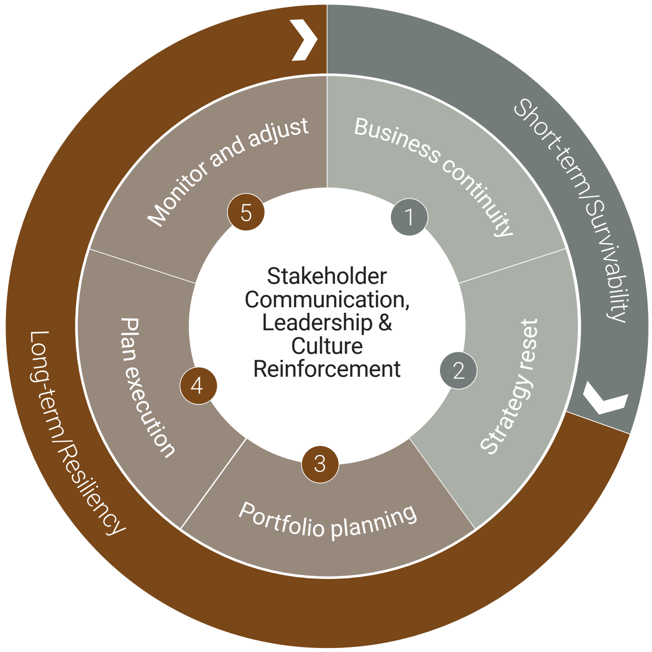


FIGURE 7: A CYCLE OF CONTINUOUS ACTION IS NEEDED TO WITHSTAND THE NEXT 6 TO 12 MONTHS TO BE BETTER POSITIONED FOR RECOVERY



CYCLE STATE	KEY LEVERS
1 Business continuity	• **Preserve liquidity** (i.e. 13-week cash forecast, optimize available subsidies, payment plans/extensions) • **Temporary cost reduction** (i.e. demand management tactics, mothballing properties and/or sections/services, renting/re-purposing space, halt non-critical investments)
2 Strategy reset	• Instill strong **focus on health & safety** • **Accelerate consumer insights** to re-evaluate go-forward customer targets • **Re-think** service **offering, formats** and new partnership opportunities • M&A: evaluate **business divestitures** and investments
3 Portfolio planning	• Develop **dynamic financial model** to simulate increasingly disruptive scenarios to the portfolio • Create point of view by geography, region, site (i.e. re-format, mothball, exit, hybrid, etc.) • Build **clear property-level business plans** to maximize **communication of asset value**
4 Plan execution	• **Reset critical partner arrangements** (i.e. franchisee/franchisor/property management, etc.) • **Close/exit** loss-making **locations** to optimize use of resources • **Right-size debt and cost** structure (i.e. marketing, advertising, etc.) to match portfolio needs • **Set pricing/discounting strategy by location** to match new business plans • Implement work-force and customer **re-engagement plans**, new **operating models** and required **technology adjustments** to support plans • **Optimize mothballing** approach to limit restart challenges and asset depreciation
5 Monitor and adjust	• **Track real-time** performance • **Update assumptions** based on real-time environment (i.e. pricing models, etc.) • **Adjust plans** as necessary

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PREPARING FOR AN UNCERTAIN FUTURE

Consumer travel remains at an all-time low in the US, and the sector is still struggling to navigate in a landscape that may long be disrupted by fear and recessionary belt-tightening. All this has inflicted major damage on the hotel sector.

To stave off further hardship, those involved in hotel operations must take a more progressive approach to re-evaluating their business. While many have rightfully invested heavily in modifications to ensure the safety of both their guests and workforce as well as taken steps to protect their own financial viability, they will need to think more broadly. That means crafting the right business plans for each property in their portfolio and devising strategies for effectively serving the customer of the future. Of course, hotels will need to successfully weather the next 6 to 12 months to be around in that future. Shifting from survival tactics to resilience tactics will prove crucial in this effort.

OUR PEOPLE

We deploy teams of highly experienced and qualified experts with profound situational and operational insight to support our clients in times of crisis.

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ABOUT US

For nearly forty years, AlixPartners has helped businesses around the world respond quickly and decisively to their most critical challenges – circumstances as diverse as urgent performance improvement, accelerated transformation, complex restructuring and risk mitigation.

These are the moments when everything is on the line – a sudden shift in the market, an unexpected performance decline, a time-sensitive deal, a fork-in-the-road decision. But it's not what we do that makes a difference, it's how we do it.

Tackling situations when time is of the essence is part of our DNA – so we adopt an action-oriented approach at all times. We work in small, highly qualified teams with specific industry and functional expertise, and we operate at pace, moving quickly from analysis to implementation. We stand shoulder to shoulder with our clients until the job is done, and only measure our success in terms of the results we deliver.

Our approach enables us to help our clients confront and overcome truly future-defining challenges. We partner with you to make the right decisions and take the right actions. And we are right by your side. When it really matters.