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ULI PERSPECTIVES

Service, Business Travel May Be Key Driver of Hotel Recovery

Independent Hotels May Suffer Most from Downturn

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We've all been wondering about the future of work since quarantine began. But among the biggest casualties of coronavirus lockdowns and international travel bans has been business travel – virtually all of which has been completely halted, replaced by Zoom calls and conference calls or, in many cases, just canceled altogether.

It's having a major impact. Before the pandemic, business travel reliably represented roughly a quarter of every dollar spent on tourism globally, a figure roughly triple what it was in the mid-1990s. Even the Sept. 11 attacks only caused business travel to fall 3 percent. The segment has consistently represented about 25 percent of all tourist revenues in North America and roughly 0.6 to 0.7 percent of GDP.

Hotels, on the other hand, had generally received 60 to 80 percent of their revenue from business travelers. For the urban hotel in particular, the business traveler represented their most stable cash generator. Business travelers typically spend more per-person than leisure customers – especially on food and beverage. Indeed, as hotel yields compressed during the economic expansion before lockdown, we saw hotels increasingly relying on food and beverage to bump up profits. A major component of that revenue stream was the business traveler, who booked in advance, spent money on parties and catering and was more loyal and less price-sensitive than the average leisure customer.

As the COVID threat grew, we forecasted a 5 percent drop in business travel between 2019 and 2024, even as global GDP could rise 10 percent over the same period. That was before we began factoring in behavioral trends, like the adoption of video conferencing, resulting from the pandemic. As companies now see profits shrink, they will reduce incentive travel and group meeting expenses, while cutting travel, food and entertainment line items. The ripple effect will be felt across industries, from airlines – who reap approximately 55 percent of their revenue from business travel – to the service workers these sectors employ.

Quick Ramp-Up Likely

So, will business travel return? And what will drive it?

In China, business travel has ramped up to 60 percent of pre-COVID levels. It is believed the U.S. is lagging behind China by 6 or more months. As a result, hotels, airlines, restaurants and convention centers are bracing for a more protracted recovery from business customers. A recent survey showed that two-thirds of business travelers felt that they needed to be back on the road within the next six months for their businesses to be viable. Will we have a vaccine by then? Will we be traveling with masks? Service businesses, in particular, are already challenged managing their relationships and customer needs remotely. As such, we can look to service industries to jumpstart business travel.

Once travel does begin, it is likely to ramp up quickly, as companies follow the lead of their peers and competitors who will also be under pressure to protect sales and serve clients. We should have a pretty good idea of the recovery in business travel by mid-2021 or sooner if there is a path to a vaccine before the New Year.

The long-term ramifications are severe for the hotel industry. Our expectation is that the global hotel supply will shrink about 2 percent permanently as a result of coronavirus – and that this will be heavily skewed toward independent hotels who lack their brand counterparts' access to revenue streams and expedited reservation systems.

Ongoing stimulus will play a role too. The Payroll Protection Program (PPP) has ironically lowered branded hotels' breakeven occupancy from 30 to 40 percent to 15 percent because it covers the major cost of labor. As a result, brands like Holiday Inn Express have a breakeven occupancy of only 6 percent before mortgage and principal payments, which are expected to be waived. Even still, while hotel REITS are giving unlimited forward guidance, they are announcing capex reductions of 50 percent or more for 2020. With U.S. occupancy currently hovering around 23 percent, many of the limited service hotels can probably survive the current crisis, with continued support of PPP and mortgage forbearance.

Ultimately, we won't know enough until we see strong 2021 data pointing to the acceleration of the recovery and business travel. But business travel is the big factor for urban hotels and urban tourism. Once we see a few companies start traveling and the dam begins to break, expect the rest to follow quickly. The surge in business will raise the hotel sector, tourism and our economy more broadly.

Michael Fallon is president of The Fallon Co., a privately held commercial real estate owner and developer headquartered in Boston.