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Revisiting Distressed Hotels: Post Covid Recovery and the Outlook on Defaults and Insolvencies
By Dennis Gemberling*

The COVID-19 pandemic brought profound impacts to the hospitality industry. Few other sectors of the economy faced the same constraints. Travel spending fell by 42% in 2020, with total losses nearing $200 billion. Occupancy declined about 43%.1

As 2021 dawned, the American Hotel and Lodging Association issued an uncharacteristically dire prediction: up to 50% of U.S. hotels could close without further federal assistance.2

Political will for further assistance quickly drained. No more help was forthcoming.

By the time of our analysis in 2021, leisure and hospitality were seeing some of the highest job gains in the country.3 Naturally, though, this was in part an effect of the deep trough the industry had suffered.

At that time, we identified some signs of recovery:

- U.S. hotel rates were keeping pace with demand.
- Average daily rates were up.
- 2021 spring and summer numbers saw improvement.

With those positive signals in mind, we noted the U.S. hotel recovery had already exceeded the outlook of many top analysts. This was in large part a result of the number of Paycheck Protection Plan (PPP) loans in the hospitality sector, amounting to about $18 billion in 2021. Hospitality was a top recipient of such loans, with the amount most properties qualified for growing during the PPP "second draw."

Another key factor – though one that, in hindsight, was soon to expire – was the generous package of mortgage and loan forbearances many properties had obtained. As it turns out, 6-12 months to fully resume payments was enough for many hotels to catch a second wind. PPP default was rare, and even the announcement of widespread PPP loan audits had little long-term effect.4,5

We also predicted investor cash would continue flowing in the industry, with more investors attracted to glimmers of recovery. Although hospitality is often considered risky among conventional lenders, many investors were aggressively expanding their hospitality portfolios. It was the arrival of high inflation, not underlying investment dynamics (circa 2021), that would ultimately prove the most troublesome.

We ended our 2021 analysis by pointing out that a distressed hotel crisis could still occur in 2022. With lenders' patience running out and federal assistance no longer on the table, financial distress had the potential to turn the tables on the industry – starting with the pivotal December 2021 travel season.

A Decisive Moment as December 2021 Travel Season Coincided with Omicron Surge

The period between November 2021 and January 2022 saw an unprecedented spike in COVID cases that were attributed to the Omicron variant. The period between December 14 and February 14 was characterized by a staggering wave of infections, peaking at 868,707 new reported cases on January 13.

Had this begun even weeks earlier, it might have had a catastrophic effect reverberating through the year. Instead, not only did Americans continue their travel plans, but global visitors returned in force – there was $10.4 billion in international inbound visitor spending in December 2021, up 108% from 2020.6

December 2021 hotel statistics held steady, with slight performance increases in average daily rate and revenue per available room compared to December 2019.7 U.S. demand, ADR, and RevPAR recorded all-time highs, but even the market with the highest occupancy levels (Oahu, Hawaii) was still down nearly 10%.

Despite underwhelming bivalent booster uptake (amounting to about 16% of Americans aged 5 and older), Americans have made it clear they no longer consider COVID-19 a factor in their travel plans.8 This may bode well for hospitality, especially as the COVID-19 emergency is set to expire in May.9

Pent Up Demand Fueled a Major Hospitality Resurgence by Q3 2022

As winter gave way to spring, it became clear there were further reasons for an optimistic outlook. Travel restrictions, masking, and other mitigation measures were increasingly sidelined, having the effect of giving an “all clear” signal to millions of Americans who may still have been leery while the Omicron surge took its course. This exuberance was reflected in performance throughout the year.

Global consultancy PricewaterhouseCoopers (PwC) noted strong performance in hospitality, including record-breaking RevPAR levels exceeding the pre-pandemic high by 6.4%.10 Annual demand was, however, suppressed to a degree by the introduction of anti-inflation measures from the Federal Reserve.

High Inflation and Interest Rates Continue to Drive Hotel Distress

Despite these positive signs, a growing number of hotels face the possibility of loan default due to the macroeconomic situation. As recently as January 2023, advisors from Pryor Cashman LLP emphasized that hotel owners’ funding of working capital when expenses exceed revenue is no longer guaranteed.11

Inflation and rising interest rates are cited as present threats that costs could outpace revenue gains in 2023.12 This is unlikely to trigger the “wave of foreclosures” previously foretold, instead creating a smaller but pronounced industry impact, especially in hospitality markets outside the U.S. top 25.

PwC predicted the growth in demand from business travelers and groups retained the potential to offset softening leisure demand. However, a number of factors could still slam the brakes on growth, including inflation, future COVID variants, and the war in Ukraine. Ambiguity may linger for years to come.

2023 Hospitality Industry Outlook in a Nutshell and What Lies Ahead

While there was an expectation last year that conditions would give rise to more defaults and insolvencies, it was due in part to where the hotels are located geographically. However, the upcoming year could see an uptick in distress nationwide given the factors now in play including:

- Many hospitality properties are already facing the prospect of loan defaults in Q2 2023.
- Inflation and high interest rates will continue to place pressure on the hospitality industry.
- Cooling domestic demand may only be partially offset by international and business travel.
- Dwindling lender patience and diminished loan support threaten to make the pain acute.

• As properties fail, investor flight and foreclosures could lead to widespread bankruptcies.
If the hospitality sector does take a hit this year, whether in specific geographic regions or nationwide, lenders and investors should be mindful of the benefits that receiverships may afford as alternatives to bankruptcies and other workout options.

1 Impact of COVID-19 on the Hospitality Industry and Implication for Operations and Asset Management – By A. J. Singh and Bing Wang, Boston University Hospitality Review – June 2021

2 A New Era for U.S. Hotels – American Hotel & Lodging Association – 2023 State of the Hotel Industry Report

3 Distressed Hotels: The Balloon That Never Popped… or Will It? – By Dennis Gemberling, Receivership News – Issue 74, Winter 2022

4 Virtually all PPP loans have been forgiven with limited scrutiny – NPR – October 12, 2022

5 Small business loans above $2 million will get full audit to make sure they're valid, Mnuchin says – CNBC – April 28, 2020

6 ITA Data Release: December 2021 International Inbound Visitor Spending – International Trade Association

7 U. S. December Hotel Metrics Hold Steady – By Jena Tesse Fox, Hotel Management – January 24, 2022

8 Why Is Covid-19 Bivalent Booster Uptake So Low? – U. S. Pharmascist – February 1, 2023

9 Fact Sheet: COVID-19 Public Health Emergency Transition Roadmap – Department of Health and Human Services – February 9, 2023

10 RevPAR to finish 2022 at record highs, but economic headwinds strengthen for 2023 – US Hospitality Directions, PWC – November 2022

11 United States: Considerations for Operators Of Distressed Hotels – By Todd E. Soloway, Pryor Cashman LLP, Mondaq – January 20, 2023

12 Proactive Strategies for Distressed Hotels – By Todd E. Soloway, Bryan T. Mohler, and Itai Y. Raz, New York Law Journal – November 29, 2022

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