



How to better forecast recovery in the hotel industry

March 2021

A woman with blonde hair, wearing a vibrant red long-sleeved dress, is walking down a well-lit hotel hallway. She is pulling a dark red rolling suitcase. The hallway features white walls, a dark carpet, and a series of doors on the right side. The lighting is warm and comes from wall sconces.

34%

of pre-COVID-19 business travel could be permanently replaced by technology.*

Unprecedented times call for new ways of forecasting

The effects of the COVID-19 pandemic on the hospitality sector mean forecasting for strategic decision-making has never been more critical, yet it remains more challenging. An unprecedented demand environment has made the budgeting and financial planning process difficult. Reductions in occupancy, uneven patterns of demand, continued uncertainty around vaccine distribution and current consumer uneasiness regarding travel all present both short-term and long-run challenges.

The pandemic's effect on individual hotel performance depends heavily on market and asset type, making a more individualized approach to forecasting crucial. For example, some full-service hotels in leisure-oriented markets have observed strong weekend demand, followed by merely single-digit occupancy during weekdays due to a halt in business travel. Other full-service hotels located in gateway markets and/or exposed to corporate and convention demand are operating at record low occupancy figures.

Public distribution of the vaccine remains a critical step for restoring occupancy levels in the short term, but adjusting to the potential structural changes imposed by the pandemic will be key to long-term recovery. The future of group and business travel is in question, given the rapid adoption of virtual working methods seen during the pandemic. The Barclays Business Travel Survey published in October estimates that up to 34% of pre-COVID-19 business travel could be permanently replaced by technology, and even a fraction of this estimated loss level could have devastating consequences for group- and business-oriented hospitality properties.¹

In light of the unforeseen and uneven impacts to demand caused by COVID-19, Ernst & Young LLP believes evaluating strategic decisions for hospitality assets requires a complete re-imagining of hotel forecasting. Whether evaluating an acquisition, disposition, timing of deferred capital expenditures, lender negotiations, asset management, or valuation and highest and best use decisions, the COVID-19 pandemic has forced the hospitality sector to adopt a new perspective in estimating top-line results.

Traditional forecasting methodologies do not quantify the unique impacts of the pandemic, such as the pace of business travel recovery, product type characteristics or permanent losses from group business due to virtual alternatives. Therefore, Ernst & Young LLP believes accurately forecasting demand at an individual hotel property requires both a macro, top-down view that is then compared to a bottom-up, asset-level detailed analysis.

*The Barclays Business Travel Survey published in October estimates that up to 34% of pre-COVID-19 business travel could be permanently replaced by technology, and even a fraction of this estimated loss level could have devastating consequences for group- and business-oriented hospitality properties.

¹ "Airlines/U.S. Lodging, Barclays Business Travel Survey," Equity Research, 7 October 2020.

“

We have to completely set aside old models and rely on new forecasting factors.

Nigel Gault
Chief Economist of EY-Parthenon



Top-down macro view

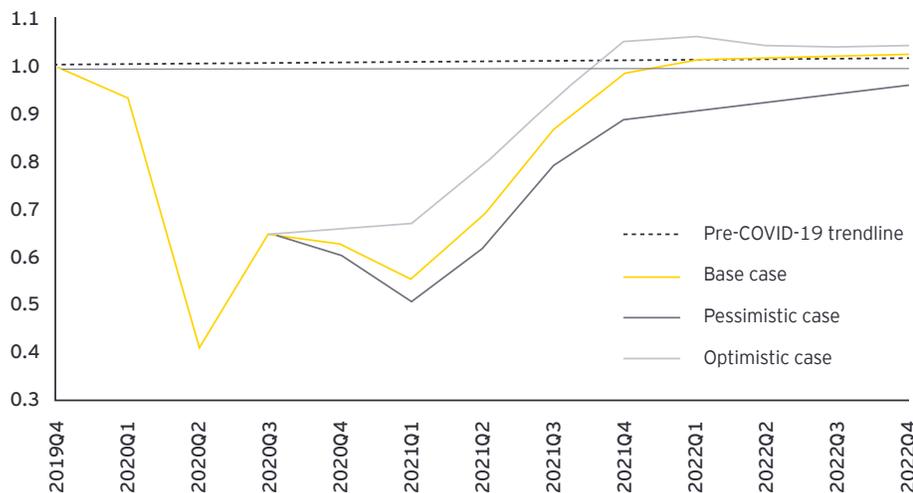
From a macro perspective, traditional forecasting models are no longer reliable, explains Nigel Gault, Chief Economist of EY-Parthenon, the EY organization’s management consulting practice that provides economic forecasting and analysis.

“Pre-COVID-19, real disposable income and real household wealth were drivers of tourism, with GDP as a proxy for business demand, and this was part of the demand forecasting model,” Gault says. “COVID-19 has changed everything and added many variables that didn’t exist before. Now, we aren’t sure people even can spend on hotels, business travel is practically zero and consumers from all demographics and markets have a general fear of traveling because of the global pandemic.”

As a result, Nigel and the EY-Parthenon team have developed proprietary economic forecasts for the hospitality sector that consider nontraditional forecasting elements, such as timing for vaccine distribution, social distancing measures and government stimulus programs.

This approach factors into Ernst & Young LLP’s latest accommodations sector recovery curve:

Accommodation GDP deviation relative to trend*
2019Q4=1.0, 2019Q4-2022Q4 projected



*Trend refers to smoothed EY-Parthenon “base case” forecast pre-COVID-19 (0.7% annualized growth rate).

The duration of time it takes for GDP to return to pre-COVID-19 level (as of Q4 2019) varies by scenario:

- ▶ Base case : Q1 2022 (~nine quarters)
- ▶ Pessimistic case: to be determined
- ▶ Optimistic case: Q4 2021 (~eight quarters)





“

The bottom line for forecasting now is that it really comes down to the individual property, and there’s no substitute at all for a detailed bottom-up analysis.

Nigel Gault
Chief Economist of EY-Parthenon

Bottom-up analysis

While important, a macro-level view only provides one perspective when making strategic decisions.

“The bottom line for forecasting now is that it really comes down to the individual property, and there’s no substitute at all for a detailed bottom-up analysis,” Gault says.

Given the uneven impact of the pandemic on individual hotels, Ernst & Young LLP has designed a data-driven forecasting model quantifying the impact of the COVID-19 pandemic on room supply and demand at asset-level hospitality investments. Hospitality players can use the model to quickly screen new opportunities and evaluate strategic decisions for their properties. The model produces a range of scenarios, including a base case, downside case and upside case, all tied to potential distribution of a vaccine.

The methodology of the model is holistic and twofold: first, the top-down, macro-level EY-Parthenon forecasts are considered in the model to produce an initial demand forecast; the top-down view considers national trends in unemployment, vaccine distribution and social distancing.

Then, a bottom-up analysis is performed to tailor the initial forecast, carefully considering local market and property-specific attributes impacting a hospitality property’s unique recovery curve.

The chart below summarizes the characteristics quantified in the model and Ernst & Young LLP’s assessment of each attribute’s role in recovery from the COVID-19 pandemic:

Characteristics	More vulnerable to COVID-19 impacts	Less vulnerable to COVID-19 impacts
Market factors		
Markets	<ul style="list-style-type: none"> ▶ Primary and gateway markets ▶ Urban and fly-to resorts ▶ Airport markets ▶ Earlier phase of reopening economy 	<ul style="list-style-type: none"> ▶ Drive-to destinations ▶ Suburban, small metro and interstate ▶ Later phase of reopening economy
Demand sources	<ul style="list-style-type: none"> ▶ Groups and conventions ▶ Inbound international ▶ Fly-to leisure and corporate travel ▶ Exposure to single sector (e.g., energy) 	<ul style="list-style-type: none"> ▶ Dependent on transient segments ▶ Major feeder markets within driving distance ▶ Recreation and nature opportunities allowing for social distancing (e.g., golf, skiing, national parks)
Property characteristics		
Hotel chain scale	<ul style="list-style-type: none"> ▶ Upper upscale or luxury 	<ul style="list-style-type: none"> ▶ Economy, midscale and upper midscale
Hotel type	<ul style="list-style-type: none"> ▶ Full-service and convention hotels, dependent on group business ▶ Independent (unbranded) properties – lack of standardized COVID-19 guidelines ▶ Newly opened hotel (in ramp-up) ▶ Requiring significant property improvement plan (may be deferred) 	<ul style="list-style-type: none"> ▶ Extended-stay and all-suite products ▶ Non-urban limited service and select service ▶ Affiliated with reputable hotel brands – standardized COVID-19 guidelines ▶ Stabilized hotel operations ▶ Drive-to resort (independent or branded)
Ownership type	<ul style="list-style-type: none"> ▶ Leasehold interest (i.e., ground lease) 	<ul style="list-style-type: none"> ▶ Fee simple interest





Long after the vaccine is available, significant changes in visitor behavior, spending power and expectations affecting both leisure and business travel are expected.

Hotel owners and operators agree that the advent of technology as a substitute for business travel and the opportunity this presents for significant savings – in both money and time – will result in some decrease in business travel post-pandemic. However, they also expect events, such as conferences and conventions, which are foundational to networking and making deals, will come back quickly and in line with prior levels.

The hotel landscape will inevitably look different when the dust settles after the pandemic, but without a clear picture of that future, forecasting for hotel occupancy remains a struggle. Despite this, few operators have changed their forecasting methodology and are still using their typical underwriting models coupled with trying to guess or qualitatively capture the influence of the COVID-19 pandemic on their assets. The EY model, on the other hand, quantifies its impact. It accounts for temporary and permanent effects from the COVID-19 pandemic by determining the position around individual hotel attributes:

- ▶ The current state of each demand source (e.g., domestic air travel levels, group business demand)
- ▶ How long it will take for each attribute and demand source to return to pre-2020 levels
- ▶ The permanent changes to demand
- ▶ The amount of weight given to each attribute (in terms of influence on the property's recovery)

The time is now: plan for tomorrow's "new normal" today

Without question, the COVID-19 pandemic has shifted the landscape of the hospitality sector. As the recovery from the pandemic evolves, many hospitality players must also shift their mindset in forecasting asset-level performance in a post-pandemic world.

Key contacts



Umar Riaz

EY Americas Real Estate,
Hospitality and Construction
Advisory Leader
umar.riaz@ey.com



Brian Tress

EY Global Future Destinations
and Tourism Advisory Services
Solutions Leader
brian.tress@ey.com

EY | Building a better working world

EY exists to build a better working world, helping to create long-term value for clients, people and society and build trust in the capital markets.

Enabled by data and technology, diverse EY teams in over 150 countries provide trust through assurance and help clients grow, transform and operate.

Working across assurance, consulting, law, strategy, tax and transactions, EY teams ask better questions to find new answers for the complex issues facing our world today.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation are available via ey.com/privacy. EY member firms do not practice law where prohibited by local laws. For more information about our organization, please visit ey.com.

EY Global Real Estate, Hospitality & Construction Sector
Today's real estate sector must adopt new approaches to address regulatory requirements and financial risks while meeting the challenges of expanding globally and achieving sustainable growth. The EY Global Real Estate, Hospitality & Construction Sector brings together a worldwide team of professionals to help you succeed – a team with deep technical experience in providing assurance, consulting, strategy, tax and transaction services. The Sector team works to anticipate market trends, identify their implications and develop points of view on relevant sector issues. Ultimately, this team enables us to help you meet your goals and compete more effectively.

© 2021 Ernst & Young LLP.
All Rights Reserved.

US SCORE no. 11981-211US
CSG no. 2102-3704152

ED None

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax or other professional advice. Please refer to your advisors for specific advice.