Office of the Comptroller of the Currency

ONPOINT

ECONOMIC AND POLICY INSIGHT FROM THE OCC

Uncertain Business Travel Outlook Increases Credit Risk of Urban Hotel Loans

The pandemic caused travel to cease and hotel occupancy rates to fall significantly, as discussed in a recent edition of OnPoint, "Uncertain Future of Business Travel a Risk for Higher-End Lodging." While all hotels faced revenue challenges during the pandemic, upscale and upper upscale (higher-end) hotels that cater to business travelers were hit particularly hard as companies leveraged technology to conduct business remotely. These revenue challenges caused hotel loan credit quality to deteriorate. This deterioration in credit quality was most evident for loans secured by hotels located in office dense areas, also known as urban business districts, which tend to cater more toward business travelers. Because business-travel-related spending is expected to remain well below pre-pandemic levels through at least 2023, loans secured by properties located in more office-centric areas remain at risk.[1]

Higher-end Hotels Continue to Face Revenue Challenges

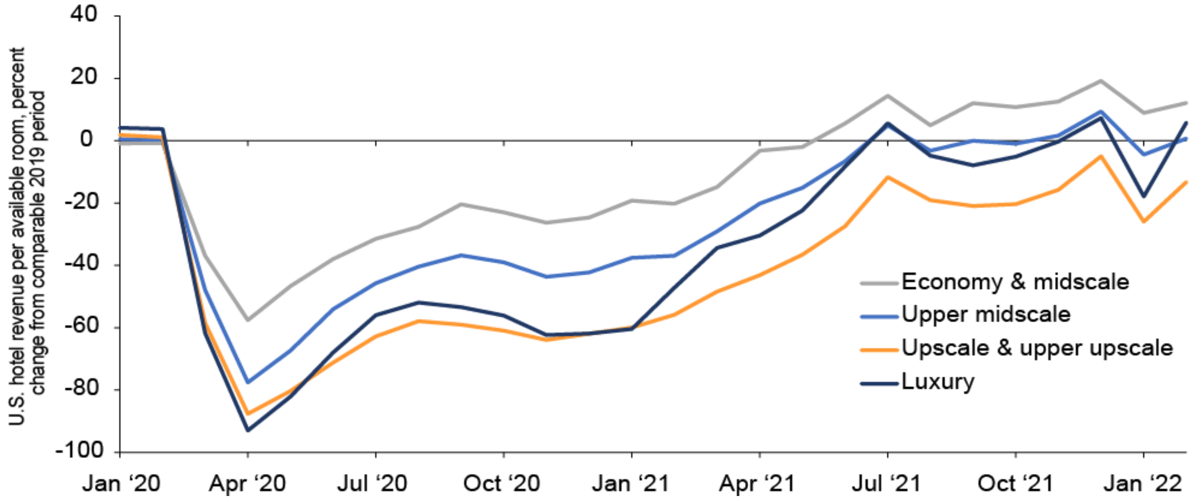
For all of 2020, U.S. revenue per available room (RevPAR) fell significantly from comparable 2019 levels for all hotel classes (figure 1).[2] Economy and midscale properties, which cater to leisure travelers, performed better in 2020 than other hotel classes, but average RevPAR was only 70 to 80 percent of 2019 levels. Once vaccines became widely available in the spring of 2021, and leisure travel restarted, RevPAR for leisure focused hotels rose above pre-pandemic levels. Upper midscale and luxury hotels also returned revenue to pre-pandemic levels by offsetting much of the lost revenue from lower occupancy with higher room rates driven by increased leisure demand. On the other hand, higher-end hotels, which tend to rely more on business travel, continue to face revenue challenges, particularly in some of the large, more business-oriented cities.[3] The revenue outlook for these hotels is uncertain as businesses continue to reevaluate their travel needs.

[1] Michael Daher, Eileen Crowley, Peter Caputo, Anthony J. Jackson, Bryan Terry, Maggie Rauch "Reshaping the Landscape: Corporate Travel in 2022 and Beyond," Deloitte, April 18, 2022.

[2] CoStar hospitality classes are grouped primarily according to actual average room rates.

[3] CoStar Portfolio Strategy (data through February 2022).

Figure 1: RevPAR has Been Above Pre-pandemic Levels for the Economy and Midscale Hotels Since July



Source: CoStar Portfolio Strategy (data through February 2022).

Low Hotel Revenue Caused a Deterioration in Bank Hotel Loans

The drop in revenue caused by the pandemic has had a negative impact on hotel loan credit quality. Unfortunately, publicly available call report data do not provide information specifically on loans secured by hotel properties. Credit quality of hotel loans, however, can be examined using the Federal Reserve's nonpublic quarterly Capital Assessments and Stress Testing information collection, Commercial Real Estate (CRE) Schedule H.2 report (FR Y-14Q)[4] that collects data from bank holding companies with consolidated assets greater than $100 billion on loans over $1 million secured by CRE properties. The FR Y-14Q data include CRE loans secured by hotel properties and bank-assigned internal risk ratings for these loans.[5] These ratings are used to identify classified loans.[6] Thus, it is possible to track the financial performance of loans secured by hotels before those loans enter nonperforming status.[7]

[4] Supplemented with the OCC's large bank CRE data from the fourth quarter of 2010 through the third quarter of 2012. One caveat with the FR Y-14Q's data is that, because it is only reported by large bank holding companies, the loans in the FR Y-14Q dataset may not be representative of the types of loans made by community banks.

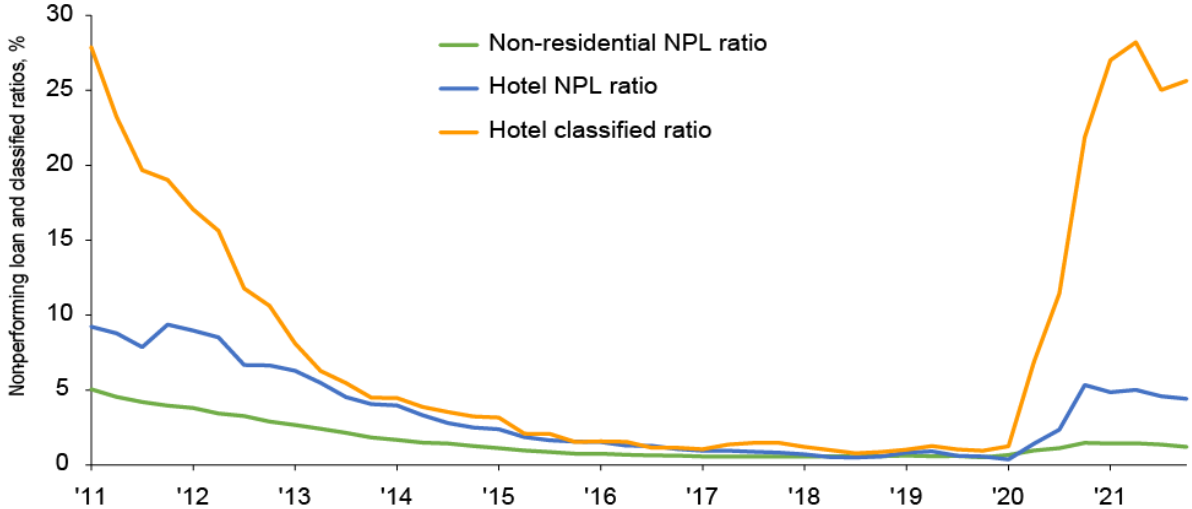
[5] The FR Y-14Q Schedule H.2 data used for this analysis only covers loans secured by CRE properties (hotel properties), where the primary source of repayment is derived from third party, nonaffiliated, rental income associated with the property (i.e., any such rental income is less than fifty percent of the source of repayment) or the proceeds of the sale, refinancing, or permanent financing of the property. Banks may have other exposure to CRE such as loans to finance CRE that are not secured by real estate, unsecured lending to Real Estate Investment Trusts (REIT) as well as loans secured by owner-occupied non-farm, non-residential properties that are part of the FR Y14-Q Schedule H.1 data on corporate loans. Data for other types of CRE exposures do not include information about the specific property type being financed or the location of the underlying property type and are excluded from this analysis.

[6] Classified loans are those rated substandard, doubtful, or loss.

[7] Nonperforming loans are defined as loans 90 or more days delinquent or on nonaccrual.

As shown in figure 2, classified hotel CRE loans as a share of total commitments secured by hotels (classified ratio)[8] rose sharply at the onset of the pandemic and peaked at a level that is in line with the level at the beginning of 2011 after the 2008–09 global financial crisis. On the other hand, nonperforming hotel loans as a share of total commitments secured by hotels (NPL ratio)[9] rose from near zero before the pandemic to a peak of 5.3 percent in the fourth quarter of 2020. While this increase is significant, the peak is far less than the largest banks saw immediately after the 2008–09 global financial crisis.

Figure 2: Asset Quality of Loans Secured by Hotel Properties Held by the Largest OCC-Supervised Banks Deteriorated During the Pandemic



Source: Call reports from the OCC's Integrated Banking Information System, and Federal Reserve FR Y-14Q Schedule H.2 data for commercial real estate (OCC supervised institutions, data through 4Q:2021).

Slow Return of Business Travel Hurt Bank Loans Secured by Hotels in Urban Business Districts

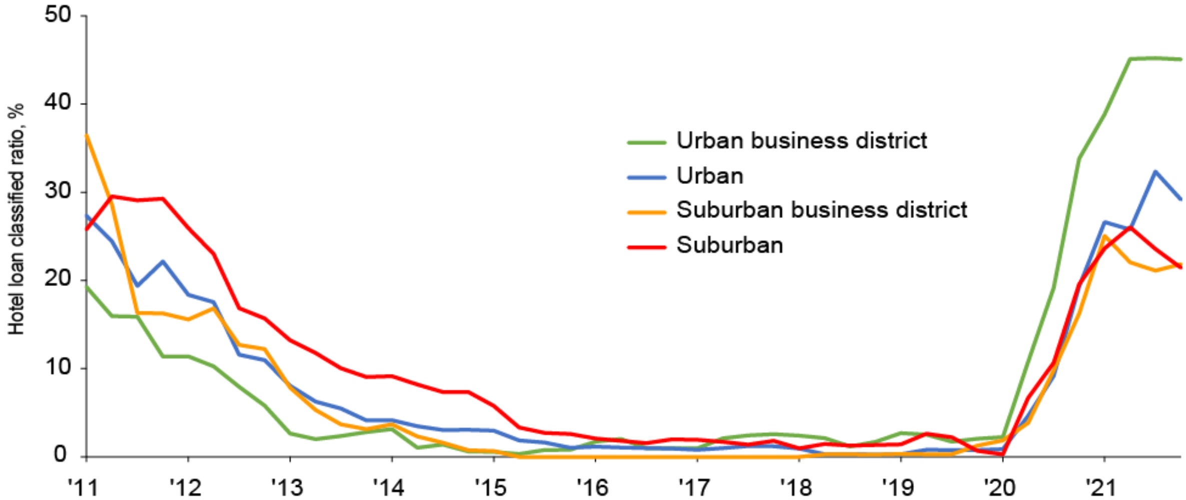
Because business travel has been slower to recover than leisure travel, the performance of loans secured by hotel properties reliant on business travel is of particular concern. To evaluate the performance of these loans, the data are segmented into submarkets defined by CoStar Portfolio Strategy (CoStar) by mapping the zip code of the collateral listed by the bank to the zip codes contained in CoStar's office submarket designations. CoStar divides markets into mutually exclusive submarkets based on office space density and overall population density. Office space density is used to define urban and suburban business district submarkets while population density is used to define urban and suburban submarkets. Hotels located in office dense areas such as urban business districts are assumed to be more heavily reliant on business travelers than areas that have lower office density.

[8] Loan commitments are the maximum amount that can be drawn on a loan. The classified loan ratio calculation is based on loans collateralized with single-location, single-property type collateral (hotel properties) and does not include construction loans. To calculate classified loan amounts across banks, internal loan ratings are mapped to a common regulatory scale for substandard, doubtful, or loss classifications.

[9] The nonperforming loan ratio calculation is based on loans collateralized with single-location, single-property type collateral (hotel properties) and does not include construction loans.

While the classified loan ratio for hotel loans rose significantly across all geographic submarket types, the increase was most acute in urban business districts (figure 3). The classified ratio for hotel loans in urban business districts now exceeds levels seen after the global financial crisis. The underperformance of loans secured by hotel properties in urban business districts relative to the other geographic submarket types is not surprising given that these hotels likely cater more to business travelers.

Figure 3: Asset Quality of Loans Secured by Hotels in Urban Business Districts Held by the Largest OCC Banks Deteriorated More than Other Submarkets



Source: Federal Reserve FR Y-14Q Schedule H.2 data for commercial real estate (OCC supervised institutions, data through 4Q:2021).

Note: Loans secured by multiple properties are excluded from our analysis, since the property types and locations of collateral underlying these loans is not fully known. While the number and commitment value of loans secured by multiple properties is not immaterial, our analysis showed that assigning these loans to the property type and location based on the predominant property underlying them does not materially alter the classified loan ratios of loans of specific property types secured by single properties.

The Point?

The uncertain business travel outlook increases the credit risk of loans secured by hotels catering to business travelers, particularly those in urban areas.