Specific Aspects of Risk Assessment in Financing Projects in the Hotel Business

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Abstract: ***This article is dedicated to exploring the specific features of risk assessment in the financing of hotel business projects. The relevance of the topic is driven by the high instability of revenues in the hotel sector and its vulnerability to external shocks, which requires lenders to apply more conservative analytical methods. The scientific novelty of the work lies in the systematization of modern approaches to risk assessment, combining quantitative models with expert qualitative parameters, as well as in identifying mechanisms for their mitigation. The study describes key risk groups affecting the sustainability of projects, analyzes methods of credit analysis, stress testing, and scoring models, and examines risk management tools, including government support programs and diversification practices. Special attention is paid to the comparative characteristics of urban and resort hotels, as well as the influence of brand reputation and operator experience on lending conditions. The study aims to identify the factors that determine the stability of hotel projects and to propose ways to improve risk management practices. To achieve this goal, methods of comparative analysis, interpretation of statistical indicators, and generalization of scientific sources were used. The conclusion emphasizes the importance of a comprehensive approach to risk assessment that ensures a balance between the interests of banks and the development of the hospitality industry. The article will be useful for researchers, financial sector practitioners, and representatives of the tourism industry.***

Keywords: hotel business, investment projects, credit analysis, risk management, liquidity, operational risks

1. Introduction

Projects in the hotel business are among the riskiest in the commercial real estate sector, which is due to the high volatility of hotel revenues and a strong dependence on external factors (tourist flows, business activity, seasonality). The importance of the topic of risk assessment in financing hotel projects has grown especially since the COVID-19 pandemic, when the global hotel sector faced an unprecedented downturn: hotel occupancy and room revenue indicators plummeted to historic lows. For banks and investors, financing the construction or renovation of hotels is always associated with heightened requirements for risk analysis and management. In Canada, which has a developed tourism sector, commercial banks traditionally take a cautious approach to lending to the hotel business, often utilizing government support programs (e.g., BDC guarantees) to mitigate risks in this sector.

The purpose of this work is to identify specific risk factors and approaches to their assessment in the financing of hotel projects, as well as to analyze modern methods of managing these risks. The research objectives include:

1) To classify the main types of risks inherent in investment projects in the hospitality industry (market, operational, credit, etc.);
2) To consider the methodology for assessing the creditworthiness and stability of hotel projects, taking into account industry specifics;
3) To summarize the experience of Canadian and international financial institutions in financing hotels, including the lessons from the pandemic;
4) To propose directions for improving risk management for the sustainable development of financing in the hotel sector.

2. Methods and Materials

For the preparation of this article, modern research and analytical materials covering risk management practices in the hotel business were used. The work of V. Baratsas examines methodological approaches to risk management in the tourism and hospitality industry (Baratsas & Tzavaras, 2023). B. Besoni conducted an analysis of the financial stability of hotel projects based on a case study of an Indonesian company, identifying factors of investment attractiveness (Besoni & Wiryono, 2025). M. Daher investigated the transformation of corporate travel after the pandemic and its impact on the hotel sector (Daher et al., 2022). A publication by the Government of Canada presents mechanisms of state support for the industry, including the HASCAP program (Government of Canada, 2021). G. Kozhamzharova characterized banking risks in lending to the hotel business during the pandemic (Kozhamzharova et al., 2022). P. Liu analyzed the impact of hotel brand affiliation on the stability of cash flows (Liu & O'Neill, 2023). P. Nedyalkova identified the stages of risk assessment as part of a general risk management system in tourism (Nedyalkova, 2023). An OCC report discusses the prospects for business travel and the related credit risks for urban hotels (Office of the Comptroller of the Currency, 2022).

The writing of this article employed the comparative method, source analysis, and systematization of empirical data. The result of the work was the integration of quantitative and qualitative approaches to risk assessment, taking into account the specifics of the hotel sector.

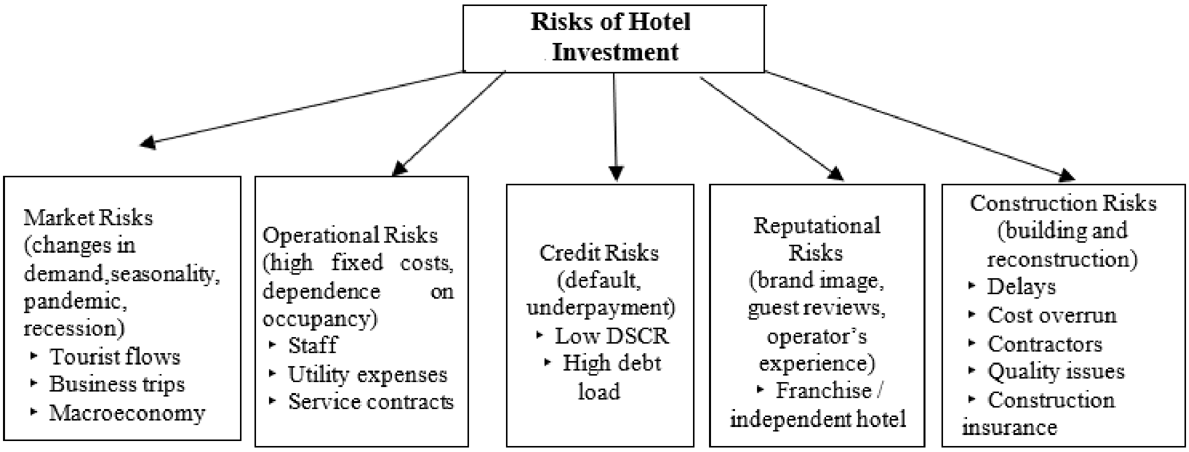
3. Results

The analysis showed that the risk assessment of hotel projects differs significantly from typical credit analysis in other industries, requiring consideration of specific industry indicators and scenarios. The key risk factors are:

unpredictability of demand (fluctuations in room occupancy and average daily rate, depending on the season and macroeconomic conditions), high operating leverage (a significant share of a hotel's fixed costs amplifies the effect of revenue decline on profit), and vulnerability to external shocks (epidemics, travel restrictions, economic crises). For example, in 2020, the revenue per available room (RevPAR) of North American hotels fell to ~70% of the previous year's level, even in the economy class segment (Office of the Comptroller of the Currency, 2022). Banks take these extreme scenarios into account when evaluating projects: financial models now include a stress test for a drop in occupancy and rates similar to the pandemic period. Furthermore, risks vary greatly depending on the type and category of the hotel. Studies show that hotels operating under well-known brands (franchises) have significantly more stable cash flows compared to independent hotels due to customer trust and the marketing support of the chain (Liu & O'Neill, 2023). Consequently, in a credit analysis of a project, the presence of a brand operator or franchise is considered by banks as a risk-mitigating factor, whereas an independent hotel will require higher reserves or guarantees. A classification of risks in the hotel business is presented below (Figure I).

Figure I. Risk Tree for Hotel Investment Projects (compiled by the author based on Daher et al., 2022; Kozhamzharova et al., 2022)

The scheme presents a hierarchical classification of hotel investment risks, divided into five main categories-market, operational, credit, reputational, and construction-with specific factors shown under each branch.

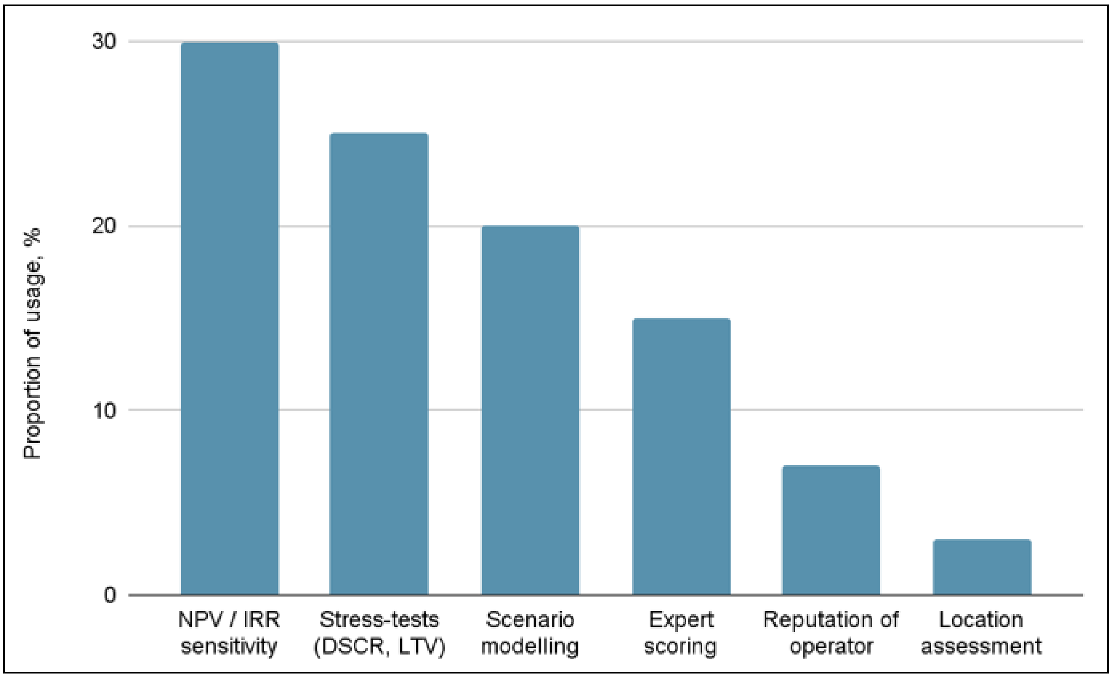


The risk profile also differs for resort hotels, which are oriented towards tourists (they are sensitive to seasonal fluctuations but can be more resilient in crises when domestic tourism replaces international), and for urban business hotels, whose revenues depend on business travel. The last two years have shown that it is the upscale urban hotels that have suffered the most due to the reduction in business travel-this factor (the share of business from corporate clients) is now invariably assessed by banks when forecasting a project's cash flows (Office of the Comptroller of the Currency, 2022).

When analyzing the risk of a hotel project, banks pay special attention to indicators that reflect the project's ability to service its debt. A key metric is the Debt Service Coverage Ratio (DSCR)-the ratio of the net operating income generated by the property to its loan payments. Given the volatility of hotel revenues, lenders typically require a higher DSCR margin of safety. Another indicator, the Debt Yield, which is the ratio of the hotel's net income to the loan amount, must also be high (in the double digits as a percentage), reflecting compensation to the lender for the increased risk. These ratios are calculated based on conservative forecasts: the bank usually models a "stabilized" year of the hotel's operation, taking into account an average annual occupancy and average daily rate adjusted for a cautious scenario. For example, occupancy figures 5–10 percentage points below the market average may be used, and additional reserves for unforeseen expenses may be included. If a project demonstrates a high DSCR under such stress assessments, it is considered capable of withstanding a downturn, and the loan may be approved with standard conditions. However, if the coverage is marginal, lenders typically either deny financing or impose additional conditions: they may require more equity from the project sponsor, the involvement of a co-investor, or the provision of guarantees. A comparison of the quantitative and qualitative assessment methods used by lenders is provided below (Figure II).

Figure II. Risk Assessment Methods in Hotel Investment Projects (compiled by the author based on Baratsas & Tzavaras, 2023; Besoni & Wiryono, 2025; Kozhamzharova et al., 2022; Liu & O'Neill, 2023; Nedyalkova, 2023)

Quantitative methods (NPV/IRR sensitivity, stress-tests, scenario modelling) are compared with qualitative approaches (expert scoring, operator reputation, location assessment).



A specific feature of risk assessment in the hotel sector is the combination of quantitative analysis and expert qualitative evaluation. Studies propose comprehensive scoring models for the tourism sector that include both financial ratios and qualitative indicators (operator reputation, location, client base diversification) (Kozhamzharova et al., 2022). For example, a scoring methodology for lending to tourism companies proposed in 2022 considers, in addition to standard financial indicators, the impact of COVID restrictions, booking dynamics, and government support measures to derive an integral assessment of the borrower's credit condition. Banks in Canada and worldwide are increasingly using such specialized scoring cards for the hotel business, recognizing that traditional methods (assessment based on past cash flow) are insufficient-a forward-looking view that considers industry trends is necessary. Qualitative factors that experts invariably analyze when issuing a loan for a hotel include: the property's location (e.g., proximity to key tourist attractions or city business centers), the experience and reliability of the hotel's management or operator, the existence of a long-term franchise agreement with a well-known chain, and the degree of revenue source diversification (the presence of conference halls, spas, and restaurants as additional revenue streams). These factors directly affect the project's risk and are therefore formalized in the financing terms: for reliable borrowers with extensive industry experience, banks may relax requirements, whereas new developers in the hotel business often have to provide additional collateral (e.g., personal guarantees from the owners, a lien on other real estate). In Canada, it is not uncommon for banks to be willing to finance a hotel project only on the condition of a partnership with a government entity-for example, a partial guarantee or subsidy from the Business Development Bank of Canada (BDC) under programs to support severely affected industries (Government of Canada, 2021). Such a scheme was implemented during the pandemic (the HASCAP program), where the government effectively shared the credit risks on loans to the hotel business to encourage banks to continue financing the sector.

The research results also indicate that for a comprehensive risk assessment, it is necessary to analyze the project's sensitivity to changes in key parameters (Nedyalkova, 2023). A sensitivity analysis of the NPV (Net Present Value) and the debt service coverage ratio to deviations in the main drivers-hotel occupancy, average daily rate, and the loan interest rate-is typically conducted. A practical case study of such an analysis demonstrated that a decrease in revenue (due to a fall in prices or occupancy) and an increase in the interest rate are the most "painful" factors for a hotel's economics: in a scenario of a simultaneous 10% decrease in the average rate and a 2 percentage point increase in the financing rate, the internal rate of return (IRR) of a hotel project fell from 16% to below the break-even threshold (Besoni & Wiryono, 2025). This indicates the high sensitivity of the hotel business to macroeconomic shocks and the need to incorporate significant safety margins. Nevertheless, there are measures to mitigate the identified risks. For example, to compensate for a possible revenue decline, the implementation of a dynamic pricing strategy (flexible management of rates depending on demand) and an increase in operational efficiency are recommended-these steps can improve debt coverage even in unfavorable periods (Besoni & Wiryono, 2025). Furthermore, construction risks (in the project financing of a new hotel) are reduced by engaging experienced general contractors and concluding fixed-price contracts, as well as by obtaining construction insurance. Banks pay special attention to the presence of a "liquidity cushion" for the project sponsors-a reserve of cash or available credit lines that can be used to service debt in case of a temporary cash flow gap at the hotel. A systematization of risk mitigation tools in hotel financing is presented below (Table I).

Table I. Tools for Managing and Mitigating Risks in Hotel Project Financing (compiled by the author based on Government of Canada, 2021; Liu & O'Neill, 2023)

This table systematizes mechanisms for reducing the vulnerability of hotel projects-from flexible pricing to the use of government guarantees and an increased share of equity.

Tool	Application Content	Expected Effect
Dynamic Pricing	Flexible adaptation of rates to demand.	Revenue stabilization, occupancy growth.
Insurance and Fixed Contracts	Construction insurance policies, fixed-price contracts with contractors.	Reduction of construction risks.
Government Guarantees	BDC programs, interest rate subsidies.	Sharing of credit risks.
Increased Equity Share	Increasing the borrower's own capital.	Reduction of credit risk.
Liquidity Reserves	Availability of cash funds for the project initiator.	Ensuring solvency during a crisis.

Finally, another requirement within risk management is ensuring a certain capital structure: the share of the project initiator's own funds in hotel financing is usually higher than for other types of real estate. A high level of equity reduces credit risk and improves the borrower's motivation for the successful implementation of the project. Thus, a comprehensive risk assessment of a hotel project combines quantitative modeling with industry-specific expert assumptions, and the results of such an assessment directly influence the financing conditions-the loan amount, interest rate, covenants, and collateral requirements.

4. Discussion

The results obtained indicate that when financing hotel projects, lenders are forced to apply a more thorough and conservative approach to risk assessment than in other real estate segments. The hotel business combines the properties of real estate and an operating enterprise, which complicates the analysis: the bank is effectively lending not only against the value of the building but also against the future income from its operation. This requires an interdisciplinary perspective-bank financial analysts must consider tourism development forecasts, competition in the hotel market, hotel management, and even marketing strategy. In discussing the identified principles of risk assessment, it is important to note that their implementation in practice often leads to a reduction in the availability of financing for the industry. For example, the requirement for a higher DSCR and a larger share of equity identified in the study means that many hotel projects do not meet the "entry threshold" set by banks. Empirical data confirms this: during the pandemic, banks significantly reduced their lending volumes to the tourism sector due to the deteriorating financial condition of borrowers (Kozhamzharova et al., 2022). Even as the industry recovers, financial institutions continue to impose heightened requirements-in essence, the price of risk (in the form of interest rates and conditions) for the hotel business has increased. This encourages borrowers to seek alternative sources of capital or to attract government support. The Canadian experience has shown that timely state intervention (BDC guarantee programs) can partially compensate for the market failure in hotel lending, keeping many businesses in the sector afloat.

Another aspect for discussion is the change in approaches to risk assessment based on the lessons learned from crises. Before 2020, many banks underestimated the scale of possible shocks: stress tests assumed moderate deviations, but the reality of the pandemic surpassed these scenarios. As a result, methodologies were adjusted-now, risk analysis includes extreme scenarios up to an almost complete shutdown of business for several months. Banks began to pay more attention to the analysis of borrower liquidity: the presence of a cash reserve or access to capital has become a decisive factor. In addition, lenders are reconsidering the role of covenants in loan agreements for the hotel sector. For example, covenants on a minimum debt service coverage level or restrictions on profit distribution before loan repayment may be established-all of which are intended to increase risk control during the project's implementation. It should be emphasized in the discussion that the hotel sector remains risky even with the strictest approaches: its cyclicality and dependence on external conditions do not disappear. Therefore, banks often additionally seek to diversify their credit portfolio by limiting their exposure to the tourism industry. International experience confirms this strategy: according to researchers, an excessive concentration of loans in the hotel segment correlates with increased systemic vulnerability for banks. Thus, at the portfolio management level, banks set internal limits on the volume of financing for hospitality projects, which reduces risks for the bank, although it may limit the sector's own access to long-term capital.

The influence of qualitative risk factors, which are difficult to formalize, must also be discussed. These include, for example, reputation and management experience. Two projects that are similar in terms of financial metrics-one managed by a global hotel chain and the other a startup with no experience-will be perceived very differently by a bank. The former may receive a loan at a lower interest rate and with more lenient conditions, thanks to the trust in the brand and the team's experience (which is confirmed by the aforementioned research on the lower income volatility of branded hotels) (Liu & O'Neill, 2023). The latter, however, will likely face strict requirements or even a rejection. This underscores that classic quantitative models must be supplemented by expert judgment. In banking practice for assessing hotel investment projects, credit committees play a significant role, where project details are considered: the hotel's marketing plan, competitive advantages, contracts with tour operators, and projected ratings on online platforms. Although these aspects go beyond traditional financial analysis, they genuinely affect the project's success and, consequently, the risk for the lender.

Separately, long-term changes that can affect the risk profile of hotel projects should be discussed. The pandemic accelerated several trends-the development of domestic tourism, an increase in demand for "nature-based" resort destinations, the widespread adoption of contactless technologies in hotels, and increased attention to sanitary measures. These factors influence the future revenues of hotels and therefore must be considered when evaluating projects launched after 2021. For example, a luxury business hotel project in the center of a metropolis is now assessed with the risk of a prolonged, incomplete recovery of international corporate tourism in mind (Daher et al., 2022). Conversely, boutique hotel projects in natural resorts may receive more optimistic demand forecasts under the new conditions. Furthermore, another component of risk has appeared on the horizon-environmental and social sustainability. Investors and banks are beginning to analyze projects from an ESG (environmental, social, and governance) perspective: the hotel's energy efficiency, measures to reduce its carbon footprint, and labor conditions for staff. While these aspects currently have little influence on financing decisions, the trend is that projects not meeting new sustainability requirements may be considered riskier in the future due to potential regulatory and market consequences (e.g., "green" hotels may receive preferential financing, while ecologically outdated properties will face higher credit costs).

5. Conclusion

Financing projects in the hotel business requires a comprehensive and cautious approach to risk assessment from banks. The analysis conducted allows for several conclusions. First, hotel projects are characterized by heightened uncertainty in cash flows, which is why banks impose strict quantitative selection criteria: a high margin of safety for debt coverage indicators and a significant share of equity investment have become mandatory conditions for obtaining a loan. Second, risk assessment is multifactorial-in addition to financial ratios, qualitative aspects are considered: the operator's experience and reputation, the hotel's business model, the structure of demand, and even the development plans for the tourism industry. It is the combination of quantitative scoring with expert evaluation that allows for a more accurate prediction of a project's ability to withstand stressful situations. Third, the practice of recent years has confirmed the importance of stress testing and sensitivity analysis: banks have implemented scenarios that model extreme drops in occupancy and revenue and require borrowers to have mechanisms to overcome such crises (liquidity reserves, flexible management of expenses and prices, etc.). Fourth, to mitigate risks, banks widely use additional tools-covenants, guarantee schemes involving the state, and insurance-which increases the stability of financing for the industry as a whole.

The scientific novelty and practical value of the results obtained lie in the systematization of approaches to the analysis and management of risks in the hotel sector. The conclusions drawn can serve as a basis for developing methodological recommendations for lending to the tourism industry and for improving credit risk models. Ultimately, a more accurate and in-depth assessment of risks in financing hotel projects contributes to making well-founded decisions that allow banks to support the development of the hospitality industry without jeopardizing their own financial stability.

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