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How to Add Value to Your Hotel Asset

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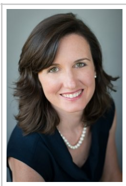


At the most basic level, the value of a hotel is based on the property's net income divided by a capitalization rate. As such, one has two possible levers to adjust as a means of increasing a property's value: either increase the property's net income or decrease the capitalization rate.

The capitalization rate, which is a factor that represents both the risk and the desired return associated with a given asset, is in actuality difficult to influence. Firstly, returns are market driven, which means that the capitalization rate is determined by market forces, not the will of owners. Secondly, it is the buyer's perception of risk that influences the capitalization rate, meaning that external factors are again the determining factor. As such, the only meaningful way of putting any kind of downward pressure on the capitalization rate is to keep the property well maintained and regularly updated with properly kept maintenance records, thereby providing a buyer with a greater degree of certainty about what they are buying. This decreases some of the risk that is baked into the implied capitalization rate; however, the most benefit this can yield is that the resulting capitalization rate is as low as market forces will allow. In other words, proper maintenance is more a means of keeping the capitalization rate from increasing than a way of actually lowering the capitalization rate.

Given the intractability of capitalization rates, net income is the only viable lever that a hotel owner or manager can use to drive a significant increase in value. There are two mechanisms that an operator can employ to increase a hotel's net income: increase revenues and decrease costs.

Summary

Although it may seem that a hotel's value is fixed and determined solely by external forces, in actuality there are hundreds of opportunities to make adjustments that result in value enhancements.

Comments

Revenue

At a root level, a hotel's revenues depend on accommodated demand and rates charged (occupancy and ADR). Today, however, computerization and data analysis are creating efficiencies that were undreamed of even a decade ago. With yield-management programs, a skilled revenue manager is now able to assess a hotel's optimal pricing structure on virtually an hourly basis. To drive value, an operator does not need to know all the intricacies of how these programs work; once installed, the tools for maximizing a hotel's revenue are in place. Regular discussion and review of the strategy with management should serve to keep everyone's eye on the ball.

The same yield-management discipline can be used in the food and beverage department and in other operating departments. Is the menu meeting the needs of guests? Can the market pantry or the gift shop provide items that will not only enhance the guest experience but also drive additional revenue? Are there spaces in the building that might be leased out that could generate revenue and provide additional services to guests? When it comes to maximizing yield, small changes can produce powerful results, and creativity can be rewarded.

Departmental Expenses

Labour accounts for a large component of departmental costs, so a savvy hotelier is always on the lookout for ways to efficiently manage the labour cost of the operation. Efficiencies can often be found in the staffing of the front desk and housekeeping departments—staffing levels should be tied to hotel occupancy. Efficiency gains can also be realized by cross-training staff between departments. For example, training the same staff in front desk and food and beverage or laundry operations can create a more flexible, streamlined workforce, allowing the management to shift some front desk staff to other functions during slow periods, instead of having an overstaffed front desk and bringing additional staff in to complete other hotel functions.

The supplies in the hotel should also be given careful consideration. Do the guestroom amenities add to the guest experience, or are they just an incremental cost to the daily operation? Anything that costs money but which does not add meaningful value to the guest experience should be excised.

The laundry department also represents an opportunity for reducing costs. An operational review will ensure that the proper equipment is in place to efficiently handle the volume of laundry. Alternatively, the laundry contract should be reviewed to ensure that the most cost-effective rates are still being achieved since the time of tender.

On the food and beverage side of the business, it is important that food costs are closely monitored and effectively controlled. Tweaking the hours of the establishment to better mirror guest demand is one way of limiting the cost of labour associated with operating this department.

These are just a few areas to consider when looking at reducing departmental costs. A closer look at any of them could reveal other opportunities to drive value.

Undistributed Operating Expenses

Administrative and general expense has a large component of the management and accounting staff, so looking at the payroll in this category is important. Are the functions and procedures that take place in the accounting department necessary for smooth operations, or are there redundancies or inefficiencies that can be eliminated to reduce labour costs? It is also a good idea to examine management incentives/bonusses—they should be effectively tied to the hotel's income performance so that the GM's compensation is aligned with the goal of driving asset value.

Marketing is also a major expense where there are opportunities to institute controls. Marketing initiatives should be carefully monitored to ensure that marketing dollars are generating a good return on investment. In this era of digital marketing, fairly modest spending on marketing can often translate into big returns. PR strategies can also be implemented to broaden the reach for the hotel with very little incremental cost.

Property operations and maintenance is a key area of the hotel that a sophisticated buyer will pay particular attention to during their due diligence process, so the maintenance team needs to be involved as a key part of any strategy to increase the value of a hotel. For many buyers, deferred maintenance is a red flag signalling a risky purchase, which reduces the number of offers that might be made. To get the highest possible offer for an asset, it is essential to keep good maintenance records and a tidy maintenance shop, in addition to well-cared-for public spaces and guestrooms.

The final undistributed operating expense to consider for improvement is utilities. Technological innovation is constantly creating new ways to substantially reduce the energy costs associated with hotel operations. An energy audit can identify areas where key savings can be made—this is essential for hotels with energy-consumption costs that are above industry norms.

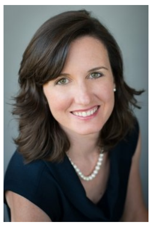
Fixed Expenses

By their nature, fixed expenses offer little opportunity for adjustment, but the few channels that are available for intervention can yield considerable gains. A tax professional can determine if there is an opportunity to appeal an asset's property assessment, which can be highly lucrative. The insurance coverage also deserves a proper review to not only assess any potential savings but also confirm that appropriate insurance is in place to mitigate risk to the operation.

Conclusion

Although it may seem that a hotel's value is fixed and determined solely by external forces, in actuality there are hundreds of opportunities to make adjustments that increase the profit margin, resulting in an exponential improvement in value.

About Carrie Russell



Over the course of her 20-year career with HVS, Carrie has been involved with appraisals and/or feasibility studies for over 2,000 hotel properties throughout Canada and the United States. She speaks regularly at industry conferences and has authored several articles on various topics relevant to the industry. As a member of the Appraisal Institute of Canada and the US Appraisal Institute, Carrie combines her hotel industry experience and education with her real estate credentials to assist clients in making informed hotel investment decisions. Phone: (604) 988-9743 Email: