OPINION

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Asset managers tackle budget pain points

October 6 2015

Creating a hotel budget is a team process that needs to account for shifting market conditions, new operating philosophies and changing value-creation expectations.

(Photo: iStock)

Highlights

- The budgeting process should start in the summer to account for all market conditions.
- Labor—both costs and availability—are an ongoing challenge in creating hotel operating budgets.
- Planning for capital expenditures requires both a short- and long-term view.

By Ed Watkins
HNN contributor

REPORT FROM THE U.S.—It's budget season at many hotels. Owners, asset managers, GMs and department heads are now sitting around conference tables attempting to agree on forecasted revenues, expenses and profits for the coming year. And often it's the asset managers who drive the annual budgeting process at hotels.

"We used to say the budget is the window to the operator's soul," said Kristie Dickinson, senior VP of CHMWarnick, a consulting firm with 58 hotels under asset management. "Through a budget you can see where (operators) intend to go and, more importantly, how they plan on getting there."

According to several asset managers, creating a hotel's annual budget is a multi-month exercise that often starts during the summer.

Michelle Russo, CEO of HotelAve, said the process for many of the 150 hotels her company asset manages begins in August, when asset managers in the firm meet to discuss macro trends affecting the industry and the impact they will have on individual properties.

In September, they meet with hotel operators to talk about trends and expectations in their submarkets, including the impact of any new supply. During September and October, consensus is reached on expected

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occupancy, rates and expenses for the coming year. By then, the budgeting needs to be finalized, Russo said.

"If you wait until November 1st to nail down your budgets, properties are already pregnant with corporate negotiated rates for next year, and it's too late to do anything about it," she said. "It's the same thing with group strategy. We've been talking about 2016 and '17 group strategy since 2014 because if you wait until you have the budget done, you already have 30% to 70% of your group business on the books for next year."

The asset manager's role goes beyond driving the process, said Dickinson of CHMWarnick.

"The incremental value we can bring to the budgeting process is our ability to bridge the gap between annual operating goals and overall ownership investment objectives," she said. "We evaluate strategies not within a vacuum of a single year but how they relate to the path of optimizing value over the long term."

Dickinson said the goal is always sustainable profitability.

"We don't want to positively impact this year at the detriment to the next," she said. "It all has to tie back to asset value today, as well as tomorrow."

The pain points
Each year's budget presents new operating, revenue-generating and profit-producing challenges for operators, owners and owner representatives.

"We try to get as analytical as possible in our budget review process," said Matthew Arrants, executive VP and head of asset management for Pinnacle Advisory Group. "We just don't go to management, pound on the table and tell them (revenue per available room) has to rise 10%. We need to support our claims and justify our positions."

One challenge this year for operators as reflected in many budgets will be raising rates during a period of high occupancies.

"There's no where for occupancy to go," Russo of HotelAve said. "We're in a lot of markets where nine months out of the year the hotels run 80% occupancy and four out of seven days they are in the mid- to high-80s occupancy. As a result, you have to push rate and manage your business mix in order to maximize revenue opportunities."

She said it's important for asset managers to give operators permission to take risks and try new strategies to maximize rates and profitability.

"Giving up an account that generates 2,000 roomnights a year is scary, but it always doesn't make sense to keep it if the pattern of that account is such that those rooms are coming during mid-week days when you sell out anyway," Russo said. "I'm hoping to get operators to be a little more aggressive."

Labor—both the cost and availability—is a recurring pain point for those who create budgets and those who must execute their terms.

"There are many instances where the minimum wage is going up and that has ripple effects through an organization," Pinnacle Advisory Group's Arrants said. "When the minimum wage goes to $9 and some of your employees are already at that level, then adjustments are necessary. In addition, rising wage rates have the potential to create labor scarcities."

Costs associated with distribution, particularly commissions levied by online travel agencies, is a worry for Dickinson.

"We know from countless studies that the cost of acquisition is growing by leaps and bounds and although we can review roomnights, rate and revenue by segmentation and channel, many teams are hard pressed to ascribe a true cost or profit by segment or channel," she said. "An examination of (average daily rate) alone doesn't tell the whole story and we increasingly find more profit opportunity when we're able to identify the net value and can be more strategic in our approach to putting business into our hotels."

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Asset managers and operators also consider the impact of new supply on their operating budgets and operations.

"Although nationally supply growth is still at favorable lows, it is a very different story on a market-by-market basis, so we keep closely in tune with what's proposed, whether new development, brand change and redevelopment of existing buildings that may not have been part of the lodging inventory prior," Dickinson said. "We're seeing a lot of redevelopment and in some instances it can reduce supply, but in all instances, staying in touch with the market and evaluating your hotel's value proposition today and in the future against the changing landscape is imperative."

Managing CapEx

Concurrent with developing operating budgets for the coming year, hotel teams also determine levels of capital expenditures and how CapEx funds will be allocated.

"For all of our properties we have a long-term CapEx vision and a short-term plan," Arrants said. "We use this process as an opportunity to look at things like the effective ages of systems versus their chronological ages to see if they are holding up better than we expected."

Russo said capital expenditures generally fall into several categories: fire and life safety issues, which can't be ignored; current and proposed changes to brand standards; and items that might produce a return on investment.

"We then look at the operating budget to look for the economic benefit of (a CapEx expenditure)," she said. "Even if it is a new cooling tower, you should expect reduced operating costs. If it's new kitchen equipment, you should expect to achieve reduced maintenance man-hours allocated to the kitchen. You're constantly looking between the CapEx budget and operating budget to make sure capital investments are translating into the operating budget."

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