

DRIVING HOTEL VALUE

Headlines

Rooms based initiatives can increase room revenue by over 10%

F&B based initiatives can stimulate outlet revenue by over 10%

Spa & recreation based initiatives can enhance net revenue by over 2%

Energy based initiatives can create utilities expense savings of up to 20%

Given the increasingly challenging environment facing the UAE's hospitality sector in recent years, attributable to both supply and demand side factors, hotel operators and owners have been looking at how to drive incremental value from their existing portfolio. While the most straightforward way of doing this is simply to cut costs – often starting with payroll – many recognise that simply eliminating headcount is not sustainable in the long term.

In order to try to bridge the gap between actual and budgeted returns, concerned stakeholders are turning to new ways of increasing the bottom line both by streamlining costs and creating new revenue streams. This paper examines a number of such practices that the team at Knight Frank has encountered over the past 24 months, their inherent risks, and ultimately what the potential impact can be on hotel value.

Rooms

Initiative 1: Managing OTA relationships – 6.5% increase in rooms revenue

Hotel operators and Online Travel Agencies (OTAs) have historically had an uneasy relationship. While operators have not been able to deny the effectiveness of such booking platforms, the fee structure – which often can go to 25 percent of the booking value – has always been a bitter pill to swallow. As these online platforms gained traction, asset owners began to question the importance of brand strength and therefore the value of well established internationally recognised hotel operators, believing that many were leaning too heavily on third parties. As a means of fighting back against OTAs, there have been several campaigns in recent years, most notably by Hilton, Marriott and IHG designed to stimulate direct bookings and regain control. Hilton's 'stop clicking around' program in particular was the largest in its history aimed at driving bookings back to the hotel website, and resulted in the operator being able to negotiate more favourable fee structures with several online sites. Hilton was not alone, and when other major operators followed a similar course of action, it became clear that operators with scale had far more leverage at the negotiating table than smaller ones.

While OTAs are a necessary tool to drive third party hotel bookings, it is important to note that they can also generate direct traffic to hotel websites. A recent study from Hitwise revealed that 5 to 10 percent of traffic on hotel websites comes directly from OTA platforms, and a slightly more dated Google survey indicated that 52 percent of guests visit a hotel website after finding them on an OTA, and 20 percent of total direct bookings occurred after guests encountered an OTA listing. What this means is that the onus is on the operators to capture this traffic with a compelling website that offers value propositions over and above what can be found elsewhere. When Knight Frank examined a sample of hotel websites across the UAE, in over fifty percent of the cases, online platforms published more competitive rates that were not available on hotel websites. Of the remaining properties, (some of which may have been compelled to have rate parity with the OTAs) many were able to add value through complementary upgrades, perks, or amenities which were only available after joining the loyalty program – subliminally also sending the messages that points are being left on the table when bookings are not done directly.

What this means is that the bargaining power and OTA reliance of an operator can have a measurable impact on net revenue. Assuming constant roomnight demand, the strategy that the operator takes in regard to OTA business can result in a difference of up to 6.5 percent in rooms revenue as shown in *Figure 1*.

Initiative 2: Pricing strategy during low season – 3.6% increase in rooms revenue

During times when demand is subdued, revenue managers typically deploy one of two measures in order to stimulate occupancy levels. The first is simply to

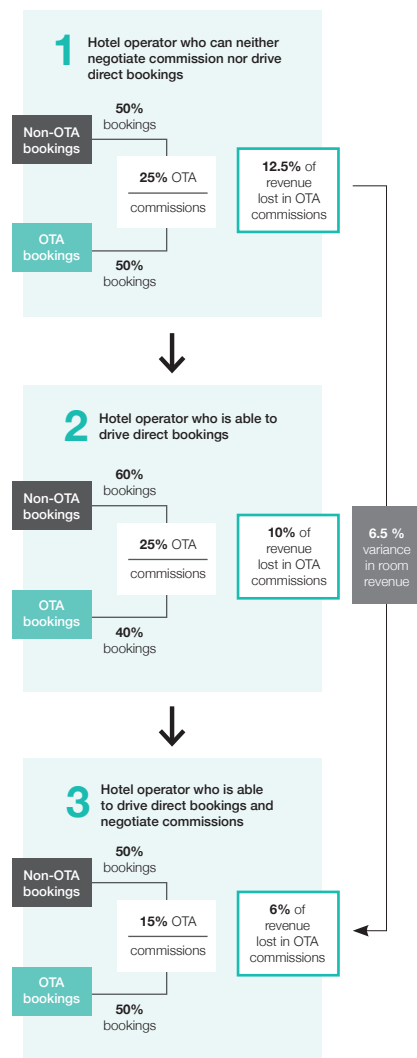


ALI MANZOOR
Associate Partner

"Through a combination of cost savings and revenue generating initiatives, hotel owners are able to increase asset value by over 20%, with nominal capital investment."

FIGURE 1

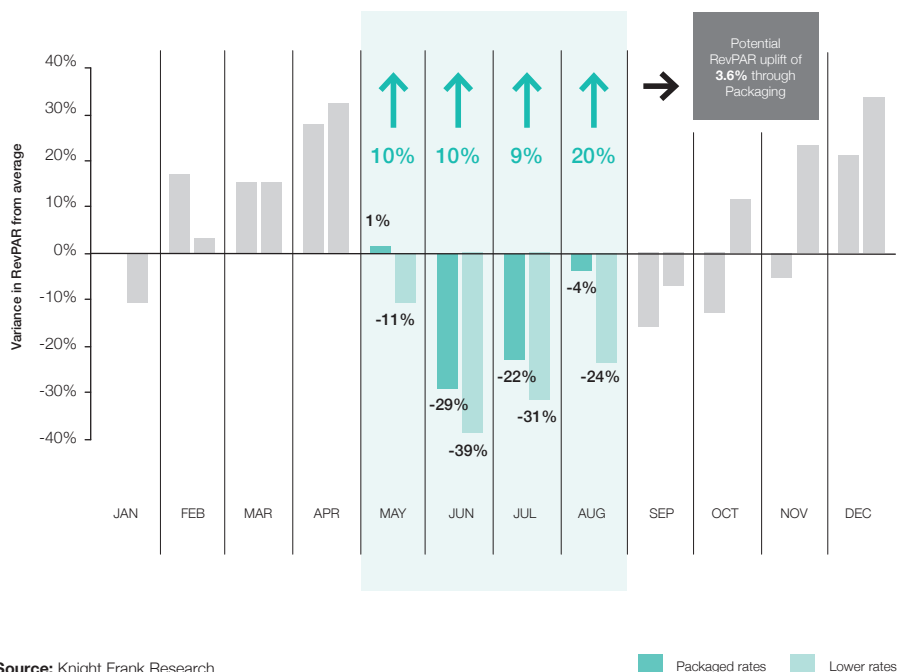
The impact of the relationship between OTAs and hotel operators



Source: Knight Frank Research

FIGURE 2

Maximising RevPAR via promotional packages during slow periods



Source: Knight Frank Research

lower rates, while the second is to keep the rate constant, but to package it with ancillary services – or in other words to create and capture value. By employing such a strategy, the understanding is that during low season, guests are not necessarily drawn to the lowest rate, but instead seek the best value for money. In an engagement undertaken by Knight Frank within the UAE, this phenomenon was studied between two hotels in the same location with a comparable product offering and different promotions between May and August. The first simply lowered rates (or offered three nights for the price of two) while the other packaged the rates with value added activities including a spa experience, a sports activity, breakfast and set menu dinner which all had marginal incremental costs. The difference in achieved room revenue (after allocations) was significant and the incremental gains in RevPAR are shown in Figure 2.

The property that packaged its rates – following a rate driven strategy over a volume driven one – was able to increase total rooms revenue by an average of over 12 percent during slower months, which increased total rooms revenue by 3.6 percent over the year. Unlike incremental occupancy, which has associated costs, strong rates go straight to the bottom line,

and in this case, maintaining rate at the expense of occupancy was a strategy that drove value.

Other areas worth examining

Given that a significant amount of rooms expense is related to housekeeping, there is often a balance to be struck between permanent and casual staff. Often properties will staff their housekeeping department for the median occupancy, and engage a third party operator to service rooms in peak periods. This means that properties can keep their departmental expense down; however, pitfalls to consider when employing casual staff include quality, language barriers, the inability to impress brand culture and standards amongst the workforce. Nevertheless, these pitfalls can be offset by establishing agreements with third party companies to ensure that the casual labour provided is the same throughout the contract period, which helps reduce training costs and maintain the quality of service and standards. Furthermore, a hotel can also mitigate the risk related to quality and service delivery by gradually introducing and integrating leased labour into the team, rather than employing a large number at once.

Please refer to the important notice at the end of this report.

Food & beverage

With the potential to drive up to 50 percent of total hotel revenues (or more in some cases) the F&B department is often one that asset owners look to in order to drive value. That said, there are certain factors that are essential to bear in mind:

- 1. Accountability can drive productivity.** In a situation where a restaurant is managed by the hotel operator, poor performance can be absorbed by the success of the wider property, whereas when a restaurant is leased to a third party operator, poor performance may result in the inability to pay rent which will result in the outlet being closed.
- 2. Allocations can lead to a distorted picture.** In times in which top line performance is under pressure, operators sometimes apportion a very small percentage of packaged rates to outlets in order to paint a picture of strong performance. For this reason when looking at hotel P&L statements it is important to analyse and unravel the package allocations in order to gain a more accurate understanding of hotel performance.

Initiative 3: Outsourcing an outlet – 10% increase in outlet revenue outlets

When dealing with an outlet that is not delivering the profitability or net revenue

desired, there is often a tendency to treat them as a necessary burden that is covered by the wider business. In cases where remedial courses of action do not take hold, hotels have been increasingly willing to outsource their F&B operations to a third party. Identifying and formulating the optimal operating model for an underperforming outlet is subject to each owner's and / or operator's objectives and the positioning of the hotel. The primary operating models available include:

- 1. Straight-lease agreement**
The outlet is leased out to a restaurant operator with its own team and a base rental fee is charged. Well negotiated agreements will also include a termination clause and a profit sharing mechanism (in some cases if a stipulated goal has been achieved), which can range between 5 and 10 percent of total revenue / profit. The owner significantly benefits from this model as it provides a guaranteed base income stream with further upside in the case of a successful outlet. Select agreements may involve the owner providing financial assistance with the fit out or offering discounts on rental fees for the first year of operation.
- 2. Management agreement**
A specialised third party food and beverage operator is appointed to manage an outlet. In this agreement, the third party would assign its own key personnel (e.g. general manager

and chef de cuisine), with the remaining staff coming from within the hotel team. In this setup, the hotel owner would pay a management fee to the operator, which would typically range between 2 and 5 percent of total revenue. An incentive structure may also be included that permits the third party operator to collect additional fees subject to certain pre-agreed financial milestones being accomplished.

- 3. License / Franchise agreement**
Through license or franchise agreements, hotel owners pay fees to obtain the rights to operate outlets under a particular brand. This fee typically consists of an upfront license fee and / or an incentive fee based on a percentage of total revenues or net profits. The hotel management team is responsible for the day to day operations and fit-out costs as stipulated by the restaurant brand standards. In return, the engaged entities provide key personnel training, support with the initial operational setup and guidance on certain design elements.

These operating models are the most common to be incorporated by a hotel owner; however, in select cases, a mix of both the management and license agreement have been adopted to address the objectives of all parties. Establishing a successful agreement that benefits both parties involved requires strong

FIGURE 3
The pros and cons of food and beverage outsourcing models

Operating model	PROs	CONs
License / Franchise agreement	<ul style="list-style-type: none"> Most control over operations compared to other business models, however brand standards still need to be followed Expertise support and training provided from a reputable operator Potential to increase hotel awareness in the market 	<ul style="list-style-type: none"> Responsible for fit-out costs and any other brand requirements Fully exposed to the financial risks associated with operating the outlet space
Management agreement	<ul style="list-style-type: none"> Capitalise on the strength, capabilities and local knowledge of third party Terms of agreement more flexible compared to straight-lease Owner continues to benefit from the profits generated 	<ul style="list-style-type: none"> Owner takes the full financial risk Confidential data likely to be shared with third party operator Complexities involved with agreement considering the hotel is already operated by a hotel brand.
Straight-lease agreement	<ul style="list-style-type: none"> Guaranteed income streams, limited risk involved Capitalise on operator's upward performance Leverage from restaurant operator / brand marketing Reduce fixed costs 	<ul style="list-style-type: none"> Often consist of longer-term agreements – potentially reducing pool of buyers upon asset disposal Lack of management control Capital requirements

↑
Property degree of control

collaboration, creativity, research and flexibility throughout the entire process.

Knight Frank studied a hotel in Dubai where the decision was made by the management team to pursue a straight-lease agreement of an underperforming outlet. The fee was in the form of a fixed rental rate and did not have any profit sharing component. As showcased in *Figure 4*, the switch from an operational outlet to a leased one resulted in a 10.6 percent increase in the outlet's contribution to the bottom line.

If the operator was to continue operating the outlet, they would have needed to increase the average cheque by 11 percent or decrease food and beverage cost by three percentage points, which were both not deemed to be possible by the operations team. The sensitivity analysis in *Figure 5* depicts the decision making process undertaken by the team.

A straight lease agreement typically includes a base rental fee, and rates vary subject to the allocation of indoor, outdoor and kitchen areas. Nevertheless, average rates range between AED 200 to AED 400 per square foot per annum subject to the positioning, size, location of the outlet within the hotel, availability of direct street access, quality of catchment market, etc. Service charges including utilities and services provided by the hotel operator (e.g. cleaning, valet, etc.) typically are charged directly to the tenant.

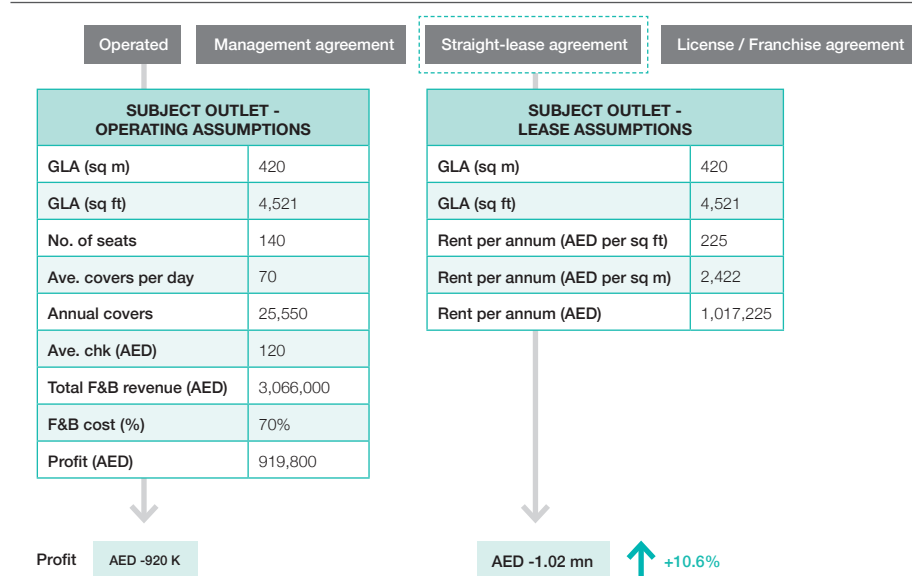
Nonetheless, despite the potential upside of outsourcing F&B outlets, owners should first ensure that pursuing such a course of action is permissible under the HMA (Hotel Management Agreement).

Pop-up restaurants during meal periods

F&B outlets in properties tend to have some meal periods that attract strong visitation and others that do not. While the tendency may be to shut the outlet for the less popular meal periods, more recently this issue has been combated through the creation of a third-party meal-specific 'pop-up restaurants' as a means to stimulate demand. Under this framework, outlets are shut down, 'soft decorations' are put in place, and the outlet is reopened as a different concept. By doing this, properties can increase their net returns in an effective manner with marginal incremental investment.

FIGURE 4

The profit comparison between an outlet being operated by a hotel operator and a straight-lease agreement



Source: Knight Frank Research

FIGURE 5

Sensitivity analysis – total F&B costs vs average check

AVERAGE CHECK					
	-10%	-5%	0%	5%	10%
	108	114	120	126	132
60%	1,103,760	1,165,080	1,226,400	1,287,720	1,349,040
65%	965,790	1,019,445	1,073,100	1,126,755	1,180,410
70%	827,820	873,810	919,800	965,790	1,011,780
75%	689,850	728,175	766,500	804,825	843,150
80%	551,880	582,540	613,200	643,860	674,520

Source: Knight Frank Research

Spa & recreation

Traditionally accounting for only 3 to 5 percent of total revenue, the spa and recreation departments are often overlooked, particularly as they tend to have low profitability ratios. Nonetheless there are several ways to boost the revenue potential of these departments that create a meaningful impact on the bottom line.

Initiative 4: Membership programs – AED 1,000,000 contribution to revenue

There are a number of third party membership programs in Dubai which

offer members the opportunity to utilise recreational facilities at selected hotels in exchange for monthly fees. Programs such as GuavaPass, ClassPort and ClassDive offer members access to a variety of health and wellness classes (both in stand-alone and hotel gyms) such as yoga, pilates, circuit training, and aqua cycling among others. Other programs such as Privilee are more leisure focused, and offer benefits such as beach club access, hotel gym utilisation rights, spa treatment discounts, F&B discounts and tennis/squash courts access across participating hotels in Dubai.

In return, hotel operators are able to charge these companies participation fees for negotiated amounts that

can, in some cases, exceed a million dirhams depending on the agreed terms. Furthermore they are able to ring fence the engagement parameters (e.g. blackout dates, the level of access granted, the level of F&B/spa discounts and most critically the number of guests that can be admitted on any given day). Naturally the terms of each engagement have a direct impact on the attainable fee.

Over and above the fees payable by such membership programs, participating hotels benefit from cost-free marketing and coverage across third party platforms. Furthermore members tend to engage in ancillary spending at the property level in many cases, usually in the form of F&B or Spa spending.

Initiative 5: Spa operating model – 2% increase of total revenue

Often neglected, it is not uncommon to see hotel spas situated in unintuitive locations that are not visible from high traffic public areas. In practice, of the operating departments, it is most common to see the profitability of the spa fall into negative territory.

While outsourcing the spa is often a means through which profitability can be driven, operators are reluctant to do so with less well-known spa operators as doing so often entails losing control of the guest experience. Instead they prefer to partner with high profile health and wellness thought leaders either through leases or management agreements knowing that a specialist offering would not only have a greater chance of success but also enhance the value proposition of the rooms.

Hotels have two primary operating models available when outsourcing spa operations:

- leasing out the entire area to a reputable operator or;
- appointing a spa management company.

While the former is typical for salons, the latter is more common when dealing with fully fledged spa operations, as hotels can retain control of the overall spa experience while benefitting from the training, knowledge and expertise introduced by the specialist operator. If leasing out the space, hotels would typically charge a

base and incentive fee which would have a built-in profit sharing mechanism. If by contrast hotels chose to appoint a third party spa operator, the hotel usually is compelled to commit to an operating term (typically 10 years) and is charged a management fee consisting of both fixed and variable components.

Initiative 6: Leasing gym – revenue in excess of AED 400,000

Hotel gyms are traditionally cost centres and are seldom a meaningful source of revenue. Given the initial capital investment requirements, staffing costs (especially with the inclusion of personal trainers) maintenance and replacement costs, the various expenses can add up. As hotel gyms are often obligatory (subject to a hotel's classification) many properties offer the bare minimum facilities in order to tick the box. Without third party membership programs the revenue potential of the majority of gyms are limited; however where opportunities lie are through entering into partnerships with fitness-centric companies. These partnerships are more common in Europe and the US, and are a means of offering more engaging fitness activities to guests beyond simply running on a treadmill. By engaging third party fitness operators through straight lease agreements, operators have the option to generate incremental revenue streams, minimise operating costs and enhance the value proposition of the hotel. While difficult to quantify with precision (due to differences in locations and the brand strength of operators), it is not unreasonable to assume that a 700 sqm space would have the capability to generate in excess of AED 400,000 in annual revenues in parts of Dubai that have an attractive catchment market.

Other operating departments

Initiative 7: Chauffeur services – uplift in revenue of AED 500,000

Given the success of peer-to-peer travel, the majority of hotels in Dubai have been facing continuously declining demand for chauffeur services to the point at which break-even profitability is often



the expectation. When considering the costs of purchasing / leasing and maintaining a fleet of cars coupled with the staffing requirements, many properties have decided to outsource the function altogether. In a number of cases, third party entities are willing to pay fixed fees for the exclusive right to operate a fleet of luxury cars and have them on standby outside hotel properties without any obligations or guarantees from the hotel operator. The hotels benefit from a cost-free income stream while ensuring that guests always have transportation capabilities at hand. The transportation companies by contrast benefit from being able to park their fleet and have access to a captive market.

Up to
20%

of utilities expense can be saved through energy saving initiatives.

Initiative 8: Energy cost savings – savings up to 20% of utility expenses

Hotel owners and asset managers often search for ways to promote sustainability, reduce their carbon footprint and ultimately lower the property's utility costs. Within a hotel's undistributed operating expenses, utility costs can account for 6 percent of total revenue and any savings realised directly flow through to a hotel's bottom line. Hotels in Dubai consume vast amounts of energy as a result of environmental and weather conditions, particularly during the summer. During this period, energy costs are at their highest, at a time where hotel income is typically at its lowest. As a result, a range of tools and sustainability practices can be implemented to realise the benefits of reduced energy costs. Innovative engineering and advanced technological equipment is likely to reduce energy costs and consumption by an average of 15 to 20 percent. Furthermore, properties doing so are likely to achieve sustainability awards and participate in programs, such as LEED (typically implemented in new-builds), Green Key, etc. as a result of implementing such measures. This can provide positive exposure, and in an indirect manner can positively influence guests' perception, translating into roomnight demand.

Potential areas for investment to upgrade and increase energy efficiency are showcased below:

1. Lighting and electrical

- Use of LED lighting or fluorescent bulbs rather than incandescent bulbs.
- Include the use of dimming lighting controls.
- Use of reflectors, reducing the total required wattage.

2. Heating Ventilation and Air Conditioning (HVAC)

- Select energy efficient motors to operate HVAC system and include variable frequency drives, which vary the fan speed to control the output of AC systems, and demand controlled ventilation reducing the amount of air distributed and cooled.

3. Building envelope

- Replacement of windows to more energy efficient glazing, albeit this can incur significant costs. A less costly alternative would be to install solar glazing or reflective films inside existing windows.

4. Technology / control devices

- Invest in energy management systems, which enable personnel to operate and program a wide range of functions from a central point in the hotel and detect any operational issues.
- Introduce smart thermostats, which allow for pre-settings and provide greater accuracy.
- Install occupancy sensors in certain areas recognizing the presence of guests, either via temperature change or motion.
- Carbon dioxide sensors that adjust ventilation subject to the number of people in a room.



Anantara The Palm Dubai Resort

Integrating such retrofits and various energy solutions can require weighty capital investment. However, a select number of focused energy service companies (ESCO) in Dubai are prepared to absorb the cost of investment associated with upgrades, installation and retrofits. In return for the investment risk, the ESCO is rewarded by taking a percentage of the energy savings implemented over a specified contract term.

Typically ESCOs perform a property inspection to identify energy efficiency measures, which will then be shared with the owner, who can select which measures should be implemented. For both parties it is a win-win solution – the hotel benefits from state-of-the-art equipment implemented at no cost

which has wide ranging economic benefits rooted in energy costs savings. These savings also extend to the cost of Property Operations and Maintenance (POM) as the equipment installed or upgraded will be the most up-to-date and maintained by the ESCO team. Conversely, ESCO secures a long-term contract with pre-agreed returns over an extended timeframe.

In a situation where the owner is seeking to sell the hotel, this strategic alliance not only increases the value of the asset but also provides a level of assurance to potential investors that mechanical, electrical and plumbing equipment is up-to-date, and efficient maintenance is being carried out by a professional company.

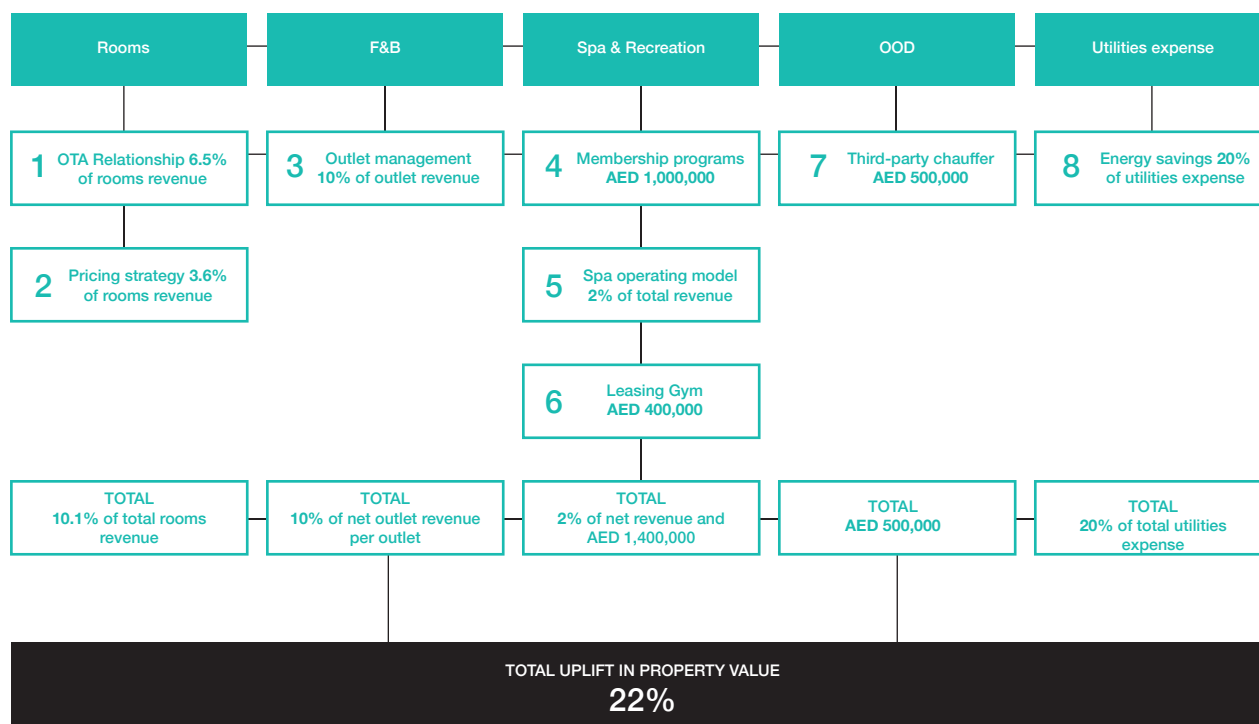
There is the potential for a

22%

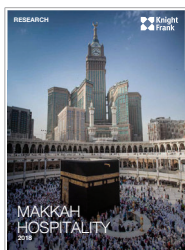
uplift in hotel value through a combination of initiatives aimed both at increasing revenues and decreasing expenses.

Conclusion

If many small changes are implemented to the way hotels operate, net revenue can be stimulated in a meaningful way. The implications are clear as increasing net revenue leads to increased hotel value and as shown below, this can result in hotel values increasing by up to 22 percent with nominal capital investment.



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HOSPITALITY & REAL ESTATE

Ali Manzoor

Associate Partner
+971 56 4202 314
ali.manzoor@me.knightfrank.com

VALUATION & ADVISORY SERVICES

Stephen Flanagan, MRICS

Partner
+971 50 8133 402
stephen.flanagan@me.knightfrank.com

CAPITAL MARKETS / INVESTMENT

Joseph Morris, MRICS

Partner
+971 50 5036 351
joseph.morris@me.knightfrank.com

RESEARCH

Taimur Khan

Senior Analyst
+971 56 4202 312
taimur.khan@knightfrank.com

MEDIA & MARKETING

Nicola Milton

Head of Middle East Marketing
+971 56 6116 368
nicola.milton@me.knightfrank.com



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