



## O'NEILL ON VALUATION

### BRANDING WORKS

**Branded hotels fare better than independently operated properties in economic downturns**, according to research recently completed at The Pennsylvania State University School of Hospitality Management. A study of the performance of hotels during both economic recessions and expansions indicates that brand-name hotels are more profitable than independent hotels under all economic conditions, but the difference is particularly significant during recessions.

There's been a lot of debate in the hotel industry about the advantages of brand affiliation and independent hotels. Along with Mats Carlback, a doctoral student at the University of Gothenburg in Sweden, I set out to study how these hotels performed in a range of economic conditions. We studied data from Smith Travel Research on the financial performance of 51,991 hotels in the U.S. during the previous economic cycle since 2001. A total of 29,418, or 56.6 percent, were brand-name hotels—members of chains of three or more hotels operated under a single brand name, such as Marriott or Holiday Inn.

We examined four core revenue and profit indicators—a hotel's occupancy percentage, average daily rate, revenue per available room and net operating income—that measure the financial performance of both independent and branded hotels. To see how these hotels performed in recessionary and expansionary periods, we compared these figures with economic indicators provided by the U.S. Bureau of Labor Statistics and the U.S. Bureau of Economic Analysis.

While there wasn't a significant difference in the net operating income of the branded and independent hotels during economic expansions, branded hotels registered significantly higher NOI than independent hotels during the recessionary years of 2002 and 2008.

The costs and fees associated with belonging to a hotel chain, such as franchise and royalty fees, tend to negatively affect the NOI of an operation. However, the intangible benefits of a brand appear to compensate for these costs through increased occupancy, especially during recessions. What we found is the lion's share of a branded hotel's intangible asset value is in the brand itself.

During the recession of 2002, the occupancy rate of branded and independent hotels was 58.2 percent and 52.4 percent, respectively. In 2008, another recessionary period, branded hotels posted a 59.1-percent occupancy

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#### Penn State Index of Hotel Values

| Overall                                     | Value Per Room | Annual Percent Change |
|---|----------------|-----------------------|
| 2007  | \$ 98,264      | 9.3%                  |
| 2008  | \$ 93,752      | - 4.6%                |
| 2009  | \$ 76,457      | -18.4%                |
| 2010  | \$ 78,326      | 2.4%                  |
| 2011 (forecast)                             | \$ 84,973      | 8.5%                  |
| <b>Luxury</b>                               |                |                       |
| 2007  | \$ 351,351     | 7.5%                  |
| 2008  | \$324,204      | - 7.7%                |
| 2009  | \$253,083      | -21.9%                |
| 2010  | \$263,762      | 4.2%                  |
| 2011 (forecast)                             | \$ 285,931     | 8.4%                  |
| <b>Upper Upscale</b>                        |                |                       |
| 2007  | \$ 177,203     | 6.6%                  |
| 2008  | \$ 165,032     | - 6.9%                |
| 2009  | \$134,460      | -18.5%                |
| 2010  | \$ 136,893     | 1.8%                  |
| 2011 (forecast)                             | \$ 148,993     | 8.8%                  |
| <b>Upscale</b>                              |                |                       |
| 2007  | \$ 121,624     | 7.6%                  |
| 2008  | \$ 113,957     | - 6.3%                |
| 2009  | \$ 92,028      | -19.2%                |
| 2010  | \$ 92,721      | 0.8%                  |
| 2011 (forecast)                             | \$100,760      | 8.7%                  |
| <b>Midscale With Food &amp; Beverage</b>    |                |                       |
| 2007  | \$ 72,178      | 6.7%                  |
| 2008  | \$ 68,329      | - 5.3%                |
| 2009  | \$ 56,900      | -16.7%                |
| 2010  | \$ 56,719      | - 0.3%                |
| 2011 (forecast)                             | \$ 59,596      | 5.1%                  |
| <b>Midscale Without Food &amp; Beverage</b> |                |                       |
| 2007  | \$ 77,972      | 9.8%                  |
| 2008  | \$ 74,645      | - 4.3%                |
| 2009  | \$ 62,870      | -15.8%                |
| 2010  | \$ 63,370      | 0.8%                  |
| 2011 (forecast)                             | \$ 67,157      | 6.0%                  |
| <b>Economy</b>                              |                |                       |
| 2007  | \$ 28,204      | 6.9%                  |
| 2008  | \$ 25,6174     | - 9.2%                |
| 2009  | \$ 17,793      | - 30.5%               |
| 2010  | \$ 17,137      | - 3.7%                |
| 2011 (forecast)                             | \$ 19,389      | 13.1%                 |

Source: The Pennsylvania State University

O'NEILL ON VALUATION Continued

rate, while independent hotels posted a 56.2-percent occupancy rate.

Also, the average NOI of branded hotels in 2002 was \$2.07 million, while the NOI of independent hotels was \$1.31 million. In 2008, branded hotels brought in an average NOI of \$2.53 million, and independent hotels had NOI of \$2.49 million. One area where independent hotels outperform branded hotels is in ADR. One reason independent hotels can charge higher prices for their rooms may be the perceived uniqueness and exclusivity of independent hotels among clientele.

This research study suggested several explanations for the improved performance of brand-name hotels during declining economic periods. In addition to large marketing campaigns, the global distribution systems of hotel chains offer centralized reservation systems, guest loyalty programs and access to online travel agencies such as Expedia and Travelocity.

Brands also offer potential guests the perception of dependable service and experience. There's an

emotional share with branded hotels. It appears in bad economic times people return to the security of brands. The study could help owners decide whether the benefits of belonging to a franchise outweigh the costs of a brand.

Now, on to the Penn State Index of U.S. Hotel Values: Overall, hotel values are expected to grow by 8.5 percent on average in 2011. Luxury hotel values are expected to grow by approximately \$22,000 per room, a significant increase, but still bringing values nowhere near the peak of 2007.

Upper upscale, upscale, midscale and economy hotels are all expected to register healthy increases in value in 2011, with economy hotels expected to record a particularly notable 13.1-percent increase. Again however, these values are all expected to be below their 2007 peaks. While at this stage, it isn't possible to project 2012 hotel values with any acceptable degree of confidence, current trends suggest that the potential exists for significant increases in 2012.

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