

A Fresh Look at Feasibility Studies

By Stanley Turkel

As the economy enters the next phase in the business cycle, new hotel proposals will require feasibility studies to measure market demand and to prove that projects are economically viable. In order to avoid the problems of overbuilding, these new studies should focus on one major question - is there a market for this hotel at this location?-and several related question - if so, where is that market, how large is it, what are its needs, how is it currently being served and what share can be captured?

To make these studies more realistic, I recommend we take a fresh look at their methodology, including the following important issues:

- Occupancy and average daily rate projections should reflect the real volatility in the marketplace. There should be a genuine analysis of the tradeoffs inherent in the yield management decisions as they pertain to both market penetration and revenue maximization.
- There should be a serious analysis of the relative profitability of the food and beverage outlets beyond the misleading departmental profit margins provided by the Uniform System of Accounts. The feasibility study analysis should enable owners to decide whether to manage, lease or franchise the food outlets.
- Marketing expenses are usually projected as four to six percent of gross revenues. In a new hotel, this is about half of what is needed in the first few years of operation.
- In a recent excellent report, the International Society of Hospitality Consultants advocated that "three percent of gross revenue isn't even close to being enough in terms of the true amount of capital spending which will be needed in the future to keep a hotel competitive." New feasibility studies should review this report and take special note of the recommendation that estimated future capital expenditures range from 7.5 to 8.8 percent of gross revenues for three most common types of hotels.
- The feasibility study needs to analyze the cost/benefit value of the franchise. A good feasibility study should also discuss the dangers of encroachment by additional franchises in the marketing area and how protected territories and objective impact studies can preserve owners' equity.

- There should be constructive criticism of the management contract regarding basic and incentive fees. In the current economic environment, a good study will discuss the benefits of performance standards as a basis for incentive fees and termination clauses.
- One of the most critical subjects in determining the success of the new project is the level of debt and interest rates. The feasibility study should report on the relationship between projected bottom-line results and the level of debt service for the subject hotel and its competitive set.
- Finally, sensitivity analyses should be undertaken to enable owners to understand the range of alternatives under various assumptions of reasonableness and uncertainty.

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