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RevPAR- ADJUSTED BUDGETS:
THE ONLY ONES WORTH LOOKING AT
(PART 2 OF 3)

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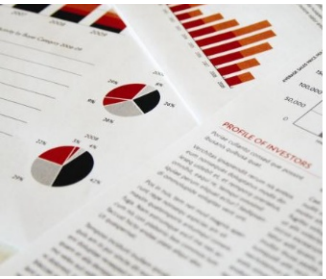



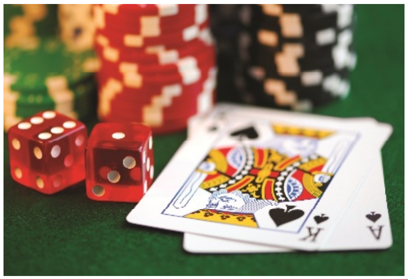


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Budgets are a good planning tool for hotel operators, owners, and other stakeholders. However, it is inappropriate to use them as benchmarks to measure a manager's performance. It is intriguing then that so many people in the industry use them as targets to measure and reward performance. Perversely, this very fact makes budgets even less reliable, as it gives everyone involved in the budgeting process strong incentives to sway the numbers to their own advantage. Budgets are, at best, educated guesses of future performance, but they are not a substitute for indicators of actual performance against the rest of the market. One of the best ways to make budgets relevant is to adjust them using actual RevPAR indexes as the year progresses. This article describes a way to make these adjustments.

PART II

This article is the second of a three-part series that explores the rationale, methodology and results related to RevPAR-adjusted budgets. Adjusting budgets for a market's RevPAR performance is proposed as a far superior tool to measure management's performance, compared with unadjusted budgets. This second article introduces an example to illustrate how to perform the necessary RevPAR adjustments. To do so, four steps are identified. The first one is covered in this piece, while the remaining three will be the subject of the third and final part of this series (the link to the first article of this series is http://www.hvs.com/article/5229/revpar-adjusted-budgets-the-only-ones-worth-looking-at/)

The following table shows what a hypothetical 2009 budget for an upper-upscale hotel in the U.S. may have looked like. It reflects what were fairly typical expectations at the end of 2009 for 2010: occupancy flat to slightly up, ADR down about 5%, operating expenses increasing with inflation (assumed at 2.0%) on a per-occupied-room (POR) basis, and undistributed and fixed expenses increasing with inflation on a per-available-room (PAR) basis.

TABLE 1: HYPOTHETICAL 2009 ACTUAL AND BUDGETED 2010 RESULTS

	2009 Actual				2010 Budget			
Number of Rooms:	**200**				**200**			
Days Opened	**365**			**Actual**	**365**			
Available Rooms	**73,000**			**Market**	**73,000**			
Occupied Rooms:	**45,260**			**2009**	**45,990**			
Occupancy:	**62.0%**			**60.0%**	**63.0%**			
Average Rate:	**$143.00**	**% of**		**$130.00**	**$135.85**	**% of**		
RevPAR:	**$88.66**	**Gross**		**$78.00**	**$85.59**	**Gross**		
RevPAR Penetration:	**141.8%**			**POR/PAR**	**144.6%**			**POR/PAR**
REVENUE								
Rooms	$6,472	68.0	%	$143.00	$6,248	69.0	%	$135.85
Food & Beverage	2,379	25.0		52.57	2,173	24.0		47.25
Other Operating Depts	476	5.0		10.51	453	5.0		9.84
Other Income	190	2.0		4.21	181	2.0		3.94
Total	9,518	100.0		210.29	9,055	100.0		196.88
DEPARTMENTAL EXPENSES								
Rooms	1,812	28.0		40.04	1,878	30.1		40.84
Food & Beverage (Hotel)	1,856	78.0		41.01	1,924	88.5		41.83
Other Operating Depts	381	80.0		8.41	395	87.2		8.58
Other Expenses	95	50.0		2.10	99	54.5		2.15
Total	4,144	43.5		91.56	4,295	47.4		93.39
DEPARTMENTAL INCOME	5,374	56.5		118.73	4,760	52.6		103.49
UNDISTRIBUTED OPERATING EXPENSES								
Administrative & General	857	9.0		4,283	874	9.6		4,369
Marketing	666	7.0		3,331	680	7.5		3,398
Prop. Operations & Maint.	476	5.0		2,379	485	5.4		2,427
Utilities	476	5.0		2,379	485	5.4		2,427
Total	2,475	26.0		12,373	2,524	27.9		12,621
HOUSE PROFIT	2,899	30.5		14,496	2,235	24.7		11,177
Management Fee	286	3.0		1,428	272	3.0		1,358
INCOME BEF FIXED EXPENSES	2,614	27.5		13,068	1,964	21.7		9,819
FIXED EXPENSES								
Property Taxes	381	4.0		1,904	388	4.1		1,942
Insurance	143	1.5		714	146	1.5		728
Reserve for Replacement	286	3.0		1,428	272	3.0		1,358
Total	809	8.5		4,045	806	8.5		4,028
NET INCOME	1,805	19.0	%	9,023	1,158	12.2	%	5,791
Mgmt Fee as % of Owner CF		**21.1**	**%**			**33.5**	**%**	

The following table shows a summary of the actual results achieved in 2010 for our hypothetical hotel. The assumed market performance is in line with the one generally experienced by upper-upscale hotels nationwide.

TABLE 2: OCCUPANCY, ADR, AND REVPAR PERFORMANCE

	2009 Actual	2010 Budget	2010 Actual	Actual vs. Budget
Occupancy	62.0%	63.0%	63.8%	1.2%
ADR	$143.00	$135.85	$137.07	0.9%
RevPAR	$88.66	$85.59	$87.42	2.1%
NOI ($'000)	$1,805	$1,158	1,250	8.0%

At first glance, it looks as though management performed pretty well. Occupancy increased, the hotel beat ADR expectations, and RevPAR came in 2.1% ahead of budget. The property's NOI triumphantly beat the budget by 8.0%. However, a closer inspection reveals a different picture. Occupancy increased, but at a slower pace than market occupancy. ADR at the subject hotel dropped by 4.1%, while that of the market decreased by only 1.0%. In order to provide the right context, it is useful to look at the competitive penetration indexes, as summarized in the following table.

TABLE 3: OCCUPANCY, ADR, AND REVPAR PENETRATION INDEXES

	2009 Actual	2010 Actual	% Change
Occupancy	62.0%	63.8%	2.9%
ADR	$143.00	$137.07	-4.1%
RevPAR	$88.66	$87.42	-1.4%
Market Occupancy	60.0%	63.1%	5.2%
Market ADR	$130.00	$128.71	-1.0%
Market RevPAR	$78.00	$81.27	4.2%
Occupancy Index	**103.3%**	**101.0%**	
ADR Index	**110.0%**	**106.5%**	
RevPAR Index	**113.7%**	**107.6%**	

While our hotel still attained an occupancy and ADR higher than the market average in 2010, it became less competitive than it was in 2009. Its occupancy, ADR, and RevPAR indexes all declined in 2010. Since the market performed better than was contemplated by the budget, how can we judge NOI results without giving management credit for increased NOI that resulted from the more favorable market performance?

The answer is to restate the budget, adjusting for actual market performance. The following are the steps involved to accomplish that.

1. Adjust the budgeted occupancy and ADR (and, therefore, RevPAR) for actual market performance using penetration indexes.
2. Adjust other departmental revenue based on the revised RevPAR assumptions.
3. Adjust departmental expenses based on new revenue levels.

4. Adjust undistributed operating expenses, and fixed expenses based on adjusted RevPAR.

Each step is described in detail in the following paragraphs.

Step 1: RevPAR Adjustments

The premise behind RevPAR adjustments is simply to restate the budget occupancy and ADR in terms of target penetration indexes.

Managers seldom provide market penetration expectations as part of their budgets (in properties HVS asset manages, we always advocate for managers to do so; it encourages operators to focus on maintaining and/or increasing the competitive position of the hotel throughout the year, rather than on meeting an arbitrary budget number). For our example, we will assume a base expectation that penetration levels should remain constant with 2009 levels. We note that there are many factors that may warrant an expectation of changes in penetration levels, such as new competitive hotel openings or closings, major renovations or rebrandings at competitive hotels or the subject property, and major changes in demand generators.

The following table shows the 2010 occupancy and ADR that our hypothetical hotel would have needed to maintain in order to keep its penetration indexes stable. This is accomplished by multiplying the market occupancy and ADR in 2010 by the respective 2009 index.

TABLE 4: ADJUSTED 2010 OCCUPANCY, ADR, AND REVPAR

	2009 Actual	2010 Actual	2010 Adjusted
Occupancy	62.0%	63.8%	**65.3%**
ADR	$143.00	$137.07	**$141.58**
RevPAR	$88.66	$87.42	**$92.38**
Market Occupancy	60.0%	63.1%	
Market ADR	$130.00	$128.71	
Market RevPAR	$78.00	$81.27	
Occupancy Index	103.3%	101.0%	**103.3%**
ADR Index	110.0%	106.5%	**110.0%**
RevPAR Index	113.7%	107.6%	**113.7%**

The final four steps to adjust operating budgets for actual market performance will be covered in the third and final section of this three-part series of articles.

About HVS

HVS is the world's leading consulting and services organization focused on the hotel, restaurant, shared ownership, gaming, and leisure industries. Established in 1980, the company performs more than 2,000 assignments per year for virtually every major industry participant. HVS principals are regarded as the leading professionals in their respective regions of the globe. Through a worldwide network of 30 offices staffed by 400 seasoned industry professionals, HVS provides an unparalleled range of complementary services for the hospitality industry. For further information regarding our expertise and specifics about our services, please visit www.hvs.com.

About the Author

Miguel Rivera is SVP of Asset Management & Strategic Advisory at HVS. He advises clients on maximizing real estate value and aligning a property's operations with its investment goals. He has more than 14 years of experience in real estate finance, including asset management, brokerage, financing, credit ratings, and appraisals. Prior to joining HVS, he was SVP at Jones Lang LaSalle Hotels, where he worked on more than $880-million worth of hotel real estate transactions while leading that group's Latin American operations. He holds an MBA from Yale and a BS in Hotel Administration from Cornell.

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