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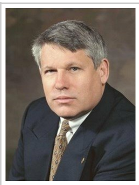
Hotel F&B - To Lease or Not to Lease?

January 1, 2007 / By Kirby D. Payne



You hear it all the time, particularly from new hotel owners and operators: Food and beverage operations do not make a profit.

"Hotel F&B should be leased out" is the mantra I keep hearing. This philosophy, of course, begs a number of questions, the most obvious of which are these three:

- How will an F&B tenant make money if the "landlord" can't - especially when the tenant is paying rent?
- Why would a heavily invested hotel owner want an inter-related business with different business goals (and, possibly, incompatible clientele) in the building - especially when the owner would have minimal control over that other business?
- Here is the really big question - What, exactly, is profit?

While some people claim that hotels should include F&B facilities because they can, in theory, be profitable, I believe the profit motive should be secondary. The way I see it, the primary role of an F&B facility is to enhance the potential revenues of a hotel's Rooms Department, particularly in the case of convention and resort properties.

A good F&B operation, whether it's hotel-operated or leased out, allows more marketing flexibility - and believe me, this helps sell rooms in off season or slow days of the week. The mere presence of an F&B operation allows a hotel to appeal to more market segments, thus giving it a broader, more secure income base. A hotel F&B operation should be conceptualized with three goals in mind: first, to maximize room revenue; second, to do that profitably; and third, to appeal to non-hotel patrons.

To ensure that these goals are reached, a hotel needs to follow up with the same kind of F&B marketing and management effort in which a lessee would invest.

Case in point

My company, HVS Hotel Management, recently took on an assignment to do an operational overview of a mid-priced, full-service hotel. Generally speaking, this hotel is operated as a limited-service, mid-priced property with a leased F&B operation. The hotel is affiliated with a well-known national brand, it's in a major metropolitan area and it's managed quite competently. Following are excerpts from our report on the leased F&B operation, its problems, their impact on the hotel, and some changes that we felt should be implemented in order to minimize detriment to the hotel:

Our experiences in the restaurant, recently leased to a new operator, have been mediocre at best. On several occasions we noticed one gentlemen walking around dressed in a jacket - we assume he was either the manager or the lessee - while none of the employees were wearing uniforms. This creates the impression that the restaurant is a less-than-professional operation.

On one occasion we charged the bill to our room—and there was no attempt to verify that we had indeed registered or that we had credit available for a restaurant charge. Had we been cash-paying guests who had left a minimal deposit for telephone charges, we apparently would have been allowed to charge in the restaurant even though the hotel had no ability to capture the charge. This should never happen. The restaurant should be provided with a list of guests (and their room numbers) who have not established credit

Summary

The primary role of the F&B department is to enhance the overall profits of a hotel. Many claim hotels with F&B should maximize the department's profit or lease income. Instead, maybe the departmental profit motive should be secondary.

1 Comments

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at check-in; the list could be produced by the night auditor and updated for afternoon check-ins. Many property management and point of sale systems interface to provide this informaiton automatically.

On two separate occasions, we observed kitchen staff talking on the phone near the parking-lot entrance to the hotel. They were wearing dirty kitchen uniforms, were loud and obviously were on lengthy calls - they clearly had planted themselves there because they had beverages and were sitting down. This should not be allowed. Brief calls (no longer than three minutes) can be permitted as long as they are unobtrusive and the employees are neat in appearance - which wasn't the case in this instance.

Suggested Solutions

Our recommendations for improving this hotel's F&B operation could well be applied to a great many leased hotel F&B operations that neither enhance the hotel's image nor its bottom line.

It is crucial that a restaurant operation not detract from the rest of the hotel.

Guests and other restaurant patrons, understandably enough, believe that a hotel restaurant is run by the hotel - therefore, ownership and management should demand that the F&B lessee follow the property's standards for behavior and appearance. Restaurant employees should wear uniforms (with footwear and accessory standards and with professionally done name tags that carry the hotel or restaurant's logo), be well-groomed and be held to behavior standards that contribute to - rather than detract from - the hotel's image.

Sometimes, the F&B tenant's lease includes the right to use the landlord's liquor license - thus, it would be the liquor-license owner and fee-simple owner who would be sued in a dram-shop liability action. With this is mind, the restaurant lessee should be required to conduct server training for all current and future employees on a regular basis and provide the landlord with documentation of that training. The documentation should include the course name, content and instructor, as well as the signature of every employee in attendance.

The lease payment for the restaurant space is often predicated on the tenant's revenues. In order to maximize these revenues - and, in turn, the hotel's income - some joint marketing efforts should occur. These might include:

- Distribution of restaurant discount coupons by the front-desk staff at check-in and with management's compliments.
- Guestroom tent cards promoting the restaurant, its hours and room-service items that include fast-food items such as pizza.
- Hotel/restaurant package promotions during traditionally slow periods.
- Penetrating commercial business by including a hot, cooked-to-order breakfast in the room rate.
- Availability of professionally done menus for food-and-beverage service in meeting rooms.
- Inclusion of a restaurant representative in executive committee meetings.

The restaurant should not be viewed as a space to lease out in order to collect minimal rent and avoid the hassles of running an F&B operation. Rather, it must be developed as an asset that contributes to the overall profitability of the hotel enterprise. While F&B leasing is a common practice among limited-service operators, the full benefit of the restaurant's presence will *never* be realized unless the two businesses are marketed together using a well-planned, positive strategy. However, most of these ideas incur expenses and the sharing of these costs must be determined by a determination of the extent to which each party benefits from the project. And, everyone needs to be fair and every month there would be a financial analysis of the allocation of these expenses. It can get complicated.

An Analysis of F&B and Hotels

Let's go back to the first of the three questions I referred to at the top of this article: How will an F&B tenant make money if the "landlord" can't - especially when the tenant is paying rent?

It's my opinion that the tenant doesn't have as much revenue potential as the owner simply because the tenant has no way to get the full potential out of the hotel's marketing staff. For instance, how would the hotel's sales staff be commissioned for the banquet business they book? Would the banquet commission also be based on rooms business associated with the event? Whose money - the hotel's or the tenant's - would be used to pay the commission?

On the expense side, efficiencies of scale are missing. Before the tenant pays the rent, for example, the tenant must pay the same expenses the owner would have had to pay (regardless of how those expenses might be allocated on the hotel's financial statement), plus separate accounting, insurance, etc. Many items might cost substantially more because of the lesser purchasing power, some of which can be mitigated with a lessee with multiple locations. Labor-cost efficiencies also are lost: Why should hotel staff clean up a room-service spill in the hall or remove trays from a room?

The most common conflict between the two businesses lies in the area of banquet bookings. The leased F&B operator cares only about F&B revenues - and will book any event, any length of time in advance to maximize those revenues. Hotel management normally would hold back on booking banquets without associated rooms business - mainly to have that space available as an enticement to various forms of group rooms business that includes meeting and banquet needs. Clearly, there must be cut-offs, depending on business patterns, when the space is released for banquet business - but never to the detriment of a lucrative group booking. A hotel will earn far more in revenue from group-rooms business than from even the biggest wedding banquet - but an F&B lessee doesn't think in those terms.

Similarly, an F&B lessee may well limit the extent of time for, say, room service to be available - the thinking being that room-service orders slow down between certain hours, so why stay open and waste those labor costs? From the hotel's perspective, though, room-service availability even during normally slow hours - say, between 10 p.m. and 1 a.m. - is a marketing advantage that may lose money during those slow hours, but compensates by being a major marketing hook.

In short, if the F&B tenant's targeted clientele and philosophy are incompatible with the hotel's clientele and philosophy - and they often are - the arrangements either will be difficult to settle on to everyone's satisfaction or the hotel will suffer.

Defining profit

Finally, let's answer the "really big question" I referred to earlier: What, exactly, is profit? To a hotel owner, it's cash-on-cash return. It doesn't make any difference what department is or isn't making money - that information is simply used as a tool to analyze ways to improve cash flow. An internally managed F&B operation might have a combined departmental profit of between 10 percent and 35 percent of F&B revenues. Some F&B expenses such as credit card commissions, accounting, marketing, and maintenance, for instance, are allocated to other departments, thus eroding the true departmental margin without actually depicting it on the P&L. On the other hand, there is no accurate way to measure how much additional room revenue - which, after all, is *the* crucial element in a hotel's financial success - a well-managed F&B operation contributes.

Here's my bottom line on this topic: In the abstract, I would recommend that hotel owners never give up even partial control of the hotel's profit potential, and that they manage the entire hotel - including F&B facilities - with the goal of maximizing cash flow. Well-managed hotel F&B operations can make a profit, but even if they don't, they can be an asset and a contributing factor in a hotel's overall profitability - and that is more easily accomplished when the hotel's management has complete control. However, there are circumstances, markets, and properties where there is substantial marketing benefit to be gained by the hotel from outsourcing the F&B operation to a very well-known local or national operator via a lease or management contract due to the immediate credibility and value of the brand name. However, if this route is pursued, it is critical that the operational and marketing issues addressed earlier in this article be unequivocally detailed in the contract to ensure that the owner derives a net benefit from the arrangement. Certainly, the owner would be giving up some of the profit potential from the F&B operation but there could be greater profit derived from the rooms and other areas of the operation and all that truly matters is the net from the property as a whole.

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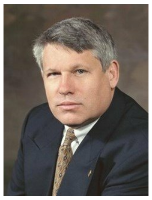

Kirby D. Payne, CHA, President of HVS Hotel Management and HVS Asset Management - Newport, has over 40 years of hotel operations, consulting, and development experience. He was the 2002 Chair of the American Hotel & Lodging Association (AH&LA) and a former Director of the National Restaurant Association. He is a frequent speaker and author. His hotel experience began as a four-year-old living in a hotel on the Amazon River in Brazil, which was managed by his father for InterContinental Hotels. He never lived in a house until he was 13. Payne previously served on the Certification Commission of the AH&LA's Educational Institute. HVS Hotel Management has operated hotels throughout the United States and has served a multiplicity of clients, including lenders, airports and other government entities, and individual investors. HVS Asset Management - Newport oversees upscale and luxury hotels on behalf of clients who use branded management and major independent management companies. Both companies undertake various consulting assignments including, but not limited to, development consulting, brand and management company selections and contract negotiations, Hotel Performance Analysis and litigation support (expert witness). Mr. Payne is frequently appointed as a Receiver for hotels and resorts. Contact Kirby at +1 (401) 625-5016 or .