

Boutique Hotels - Good For The Good Times - By Robert Mandelbaum

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Boutique hotels have been all the rage in the lodging industry. Developers want to build them. Guests want to stay in them. Travel writers want to wax on about their virtues.

But, are boutique hotels popular with their owners? How has boutique hotel financial performance stacked up to industry-wide benchmarks as the lodging industry has progressed through the ups and downs of the recent business cycle?

To answer these questions, PKF Hospitality Research (PKF-HR) has analyzed the revenues, expenses, and profits from a group of boutique hotels that provided their year-end financial statements to PKF-HR for the firm's annual Trends in the Hotel Industry survey. The sample consisted solely of properties that provided data for each year from 2000 to 2006 (most current data available).

For the purpose of our analysis, we defined boutique hotels as properties that are affiliated with, or managed by, generally-accepted boutique brands, as well as select independent properties based on our knowledge of their facilities offered and position within their respective market area. In 2006, the boutique sample averaged 166 rooms in size with an occupancy of 77.3 percent and an ADR of \$223.23. For comparison purposes, our total Trends group averaged 244 rooms, 71.8 percent in occupancy, and an ADR of \$140.84.

Performance Premiums

From 2000 through 2006, the boutique hotel sample consistently achieved occupancy, ADR, and RevPAR premiums above the overall Trends survey population. During the seven year period, boutique hotels averaged a RevPAR penetration of 162.6 percent. This was the result of a 106.1 percent penetration in occupancy and 154.4 percent penetration rate for ADR. Even during the depths of the industry recession in 2002, the boutique hotel sample maintained penetration rates above 100 percent in all three performance measurements.

In 2006, food and beverage revenues for our sample of boutique hotels averaged 23.5 percent of total revenue. This is below the industry-wide average of 26.7 percent for all Trends properties. Nonetheless, total revenues for boutique hotels have historically averaged 56.1 percent greater than the average U.S. property.

It should be noted that several boutique hotels lease out their food and beverage operations, thus lowering the contribution of food and beverage revenue to total revenue. Boutique hotel owners will frequently lease out their restaurants and lounges to a celebrity chef or locally popular operator to further promote and emphasize the overall 'trendy' image and market position desired for the property.

While boutique revenues have exceeded industry averages, so have operating expenses. From 2000 through 2006, total expenses have run approximately 55 percent greater at boutique hotels than the typical U.S. hotel when measured on a dollar-per-available-room basis. Fortunately, the boutique sample achieved unit-level profits that averaged 57 percent greater than the total Trends sample.

Very Volatile

Boutique hotel owners realized significant revenue and profit premiums during the period 2000 through 2006. However, the year-to-year performance of the boutique segment has been much more erratic than the industry as a whole. In general, boutique hotels achieved superior gains in revenue and profits during periods of prosperity, but also suffered to a greater degree during the depths of the 2001 through 2003 industry recession.

From 2000 to 2003, U.S. hotels averaged a decline in total revenue of 15.1 percent, while profits fell off 36.2 percent. Unfortunately for boutique hotel owners and operators, the declines in performance were much worse. During the industry recession, the typical boutique property in our Trends sample suffered declines of 25.0 percent in total revenue and 52.9 percent in profits.

Conversely, from 2004 through 2006 boutique hotels enjoyed a quicker pace of recovery than the industry at large. During this period boutique properties saw their revenues grow 36.6 percent, while profits increased a very healthy 75.5 percent. The recovery for the typical U.S. hotel was more gradual. Industry-wide growth averaged 26.7 percent for revenues and 45.8 percent for profits.

The volatile performance of this lodging segment can be partially attributable to the urban location of most boutique hotels. In general, urban areas, especially the major gateway cities like Boston, New York, San Francisco, and Los Angeles, suffered the most during the 2001 to 2003 industry recession. Fortunately, these same cities have recovered strongly since then.

Payback?

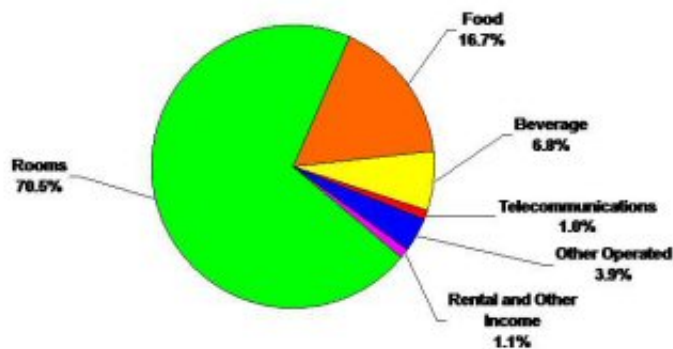
To enjoy the premium revenues and profits achieved by boutique hotels the past few years, property owners have had to stomach large swings in performance. Was this indigestion worth it?

The 'first generation' of boutique hotels had some common development characteristics. They were frequently constructed within the shell of a historic building and located just a few blocks off the prime heart of the central business district. By receiving historic structure and urban re-development tax credits, these boutique properties were able keep their overall development costs in-line, and devote a large portion of their development budgets to interior design. This moderation in development cost, along with superior market performance, combined to provide a favorable impact on the return on investment.

In recent years, most boutique hotels have been built from the ground up and don't possess the antique charm historically associated with boutique properties. Instead, they thrive on the desire to be hip, modern, trendy, and full of the latest technological and entertainment amenities. In turn, development costs have escalated, but justified by the strong historical financial performance of this sector.

PKF Hospitality Research is forecasting a relatively stable level of industry performance for the next few years. We do not foresee any dramatic swings up or down in occupancies or room rates for the overall industry. Given the historical elastic performance of the boutique hotel segment, it will be interesting to see how these unique properties perform when industry performance is basically flat. PKF-HR believes that boutique hotels will continue to enjoy the strong performance premiums they've historically achieved, but without the wild cyclical oscillations seen in the past.

Boutique Hotels 2006 – Mix of Revenue



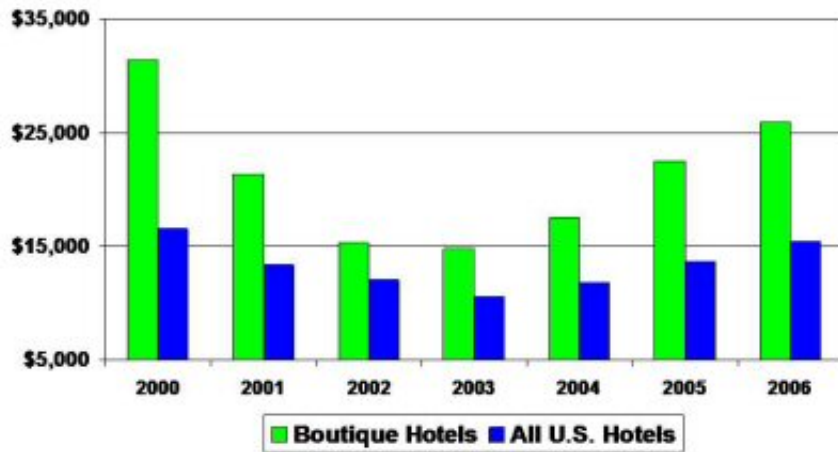
Source: PKF Hospitality Research

Boutique Hotels Comparative Performance Annual Change in Total Revenue



Source: PKF Hospitality Research

Boutique Hotels Comparative Performance Profit* Per Available Room



Note: * Before deductions for capital reserve, rent, interest, income taxes, depreciation, and amortization.

Source: PKF Hospitality Research

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