

STEPHEN RUSHMORE

MILESTONES

## Holiday Express Celebrates 500th

In less than six years, Holiday Inn Express has advanced from an idea to the opening of its 500th property. The chain opens a new property about every four days.

The milestone was reached in the fall, with the debut of a 90-room property in Goodyear, AZ.

The product was initially conceived as a way to accomplish two goals: capitalize on the booming limited-service field, and convert some old Holiday Inns for which continued upgrading no longer made economic sense.

The chain began opening outside the U.S. two years ago; by the end of this year, 16 hotels will be open in Europe, four in Asia and one in Africa.



## The Ups and Downs of Operating Leverage

During 1996, hotel values in some parts of the U.S. increased by as much as 60 percent. To someone unfamiliar with the concept of hotel operating leverage, this enormous rise seems impossible. Let me try to explain what actually happens.

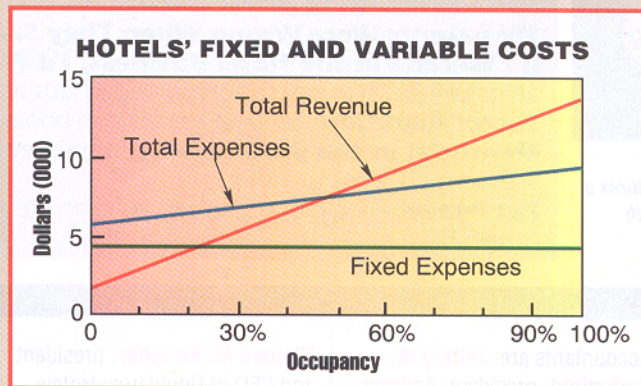
Hotels are unique in several ways. On the revenue side, lodging facilities have the ability to continually adjust room rates to take advantage of occupancy cycles. In periods of escalating occupancies, hotels are usually able to increase room rates faster than inflation.



On the expense side, hotels sustain a large number of fixed costs. Whether a hotel is operating at a 10-percent or 100-percent occupancy, it must maintain a front desk staff, manager, heating and normal maintenance. In addition, property taxes, phone service and insurance need to be paid. Fixed expenses can range from 40 percent to 90 percent of any individual expense category.

Positive operating leverage occurs at the point at which revenue exceeds total amount of fixed costs; when this level is achieved, the only additional expenses of selling a room are the variable charges such as maid service, laundry and guest supplies and so forth. As occupancies rise above the fixed expense breakeven point, profitability increases significantly.

The graph here illustrates this fixed and variable relationship. The fixed expense component is the horizontal line showing a constant level of expenses for all occupancies. The total expense line is comprised of the fixed horizontal component, plus a diagonal component representing variable expenses.



When total revenue is overlaid on the graph, the breakeven point at 51-percent occupancy becomes apparent. Profitability is the expanding area below the total revenue line and above the fixed expense line, which increases rapidly as occupancies escalate above 51 percent. The table shows how a hotel's operating leverage is enhanced when occupancy improves. At 55-percent occupancy, every dollar of revenue generates four cents in profit. At 85-percent, a dollar of revenue means 24 cents of profit.

Applying an 11-percent cap rate to the profit shows how value is enhanced by operating leverage. This rapidly rising level of profit is then directly transferred to changes in value. For example, when occupancy rises from 70 to 75 percent, the hotel's value rose 26 percent. Additional profitability and value gains can be achieved if room rates increase concurrently or the cost of financing declines.

Positive hotel operating leverage has certainly benefited hotel owners in recent years. However, what goes up will eventually come down. In a down cycle, leverage is reversed and the value gains can be quickly eliminated. Proceed with caution. ■■

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### HOW OCCUPANCY AFFECTS OPERATING LEVERAGE

Occupancy	Total Revenue (\$000)	Profit (\$000)	Percentage Profit	Value (\$000)	Percentage Increase Revenue	Percentage Increase Profit/Value
100%	\$12,979	\$3,907	30%	\$35,518	4.8%	11.5%
95	12,385	3,504	28	31,855	5.0	13.0
90	12,385	3,102	26	28,200	5.3	14.7
85	11,203	2,704	24	24,582	5.6	17.4
80	10,611	2,303	22	20,936	5.9	21.1
75	10,020	1,901	19	17,282	6.3	26.7
70	9,428	1,500	16	13,636	6.7	36.4
65	8,836	1,100	12	10,000	7.2	57.1
60	8,243	700	8	6,364	7.7	57.1
55	7,651	297	4	2,700	5.1	
51	7,213	0	0	0		