U.S. Lodging Industry Capital Expenditures Increasing to Record Level in 2019 – $7.3 Billion, But Smallest Increase Since 2010 – Emerging Trends will Change the Appearance of Guest Rooms the Most Since the Removal of CRT Televisions and Armoires

<u>TREND ANALYSIS REPORT</u>
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The total amount of capital expenditures ("cap ex") for the U.S. lodging industry is forecast to exceed the 2018 record level of an estimated $7.05 billion, increasing between 2.5 and 3.0 percent to an estimated $7.3 billion in 2019.

2019 capital expenditures will be approximately $1,325 per available room, slightly less than for 2018, despite general increases in the costs of labor and materials for capital projects.

Capital expenditures are costs incurred with the purchase and installation of capital assets to maintain and enhance hotels. For example, wall covering and carpeting are generally included as capital expenditures, painting generally is not. New construction, room additions, and major construction to convert a hotel to a significantly different property are not included as capital expenditures for this analysis. The cost of many new brand standards, such as redesigned lobbies, new equipment and construction for enhanced breakfast offerings, converting tub/shower combinations to walk-in showers, and equipment to increase high speed Internet capacity are capital expenditures.

Priorities for 2019 are:

- "panic buttons" for selected staff positions to alert management of a risk or incident
- software and technology upgrades to protect guest and employee information
- enhanced breakfast offerings, requiring new equipment, design, and decoration
- in-room technology including connectivity between personal devices and in-room entertainment systems
- enhanced and sometimes increased size of Fitness Centers
- increased high speed Internet capacity
- replacement of tub/shower units with walk in showers except in suites and some multi-bed rooms
- implementing new room designs, many that replace wall-to-wall carpeting with hard surface flooring
- aesthetic updates to building exteriors

As mentioned above, one of the emerging trends in guest room design is to remove or reduce the areas of wall-to-wall carpeting. In some designs carpeting is replaced by a hard surface floor for the guest room entrance area only, for others the carpeting is removed almost totally or except around the perimeter of the bed(s). This combined with the replacement of shower/tub units has a dramatic change in the appearance of a guest unit – both the bedroom and the bathroom. There has not been this noticeable a change since CRT televisions and the armoires that housed them were removed and replaced with flat screen televisions decades ago.

Several of the major lodging companies have either announced this change for one or more brands, are about to change brand standards to implement this change, or are in advanced stages of studying this.

The benefits are that the hard surfaces flooring last longer than carpeting, is generally more sanitary, is faster and easier to clean, is less prone to show stains, sections can be replaced, most guest rooms with hard surface floors look larger, and some believe creates "fresh and modern" appearance.

Many of the other initiatives are continuations of projects started in the last year or two, but "panic buttons" and protection of guest and employee information are new in 2019 at the increased level of attention and expenditures.

Other newer and more expensive capital expenditure programs required by many brands announced in the past several years, many of which are still being installed or implemented include:

- new lobby designs and concepts, including eliminating traditional front desks, creating seating and congregation areas, and adding small retail areas, large screen televisions, and workstations
- new food and beverage menu and service concepts
- replacing tub/shower units with walk-in showers, usually for king bed rooms
- increasing high speed Internet capacity – typical costs are $30,000 to $100,000 per hotel (2019 amounts)
- RFID electronic card key systems – typical costs are $250 to $1,000 per available room (2019 amounts)
- in-room technology upgrades including larger flat screed televisions, and connectivity with computers, tablets, and telephones
- upgrading audio/visual (A/V) equipment, although the trend of outsourcing this function is continuing, with hotels receiving commissions of typically 50 percent

Although there will be another increase in capital expenditures this year to a record level, the increase is smaller than for last year. Three factors are:

- Brands are recognizing that RevPAR and average daily rate per occupied room are increasing about only 1.0 percent, but payroll and related costs, real estate taxes, insurance, and financing costs are increasing at much more that the rate of inflation. Most U.S. hotels have experienced one or more months of lower profits than in 2018.
- Brands are responding to owner and manager concerns about potential decreasing profitability by generally not requiring expensive new capital expenditure requirements and permitting more time for projects.
- There have been numerous changes and increases in brand standards and record capital expenditures in recent years, therefore the U.S. hotel room inventory may be in the best condition ever, so there is less need for capital expenditures.

A trend that became significant starting around 2012 and that is increasingly influencing capital expenditures is social media comments for individual hotels and for brands about property condition, amenities, design, competition, and services.

A larger than average amount of capital expenditure is being allocated based on owner and manager decisions about what is needed for individual hotels, and it seems that brands are more flexible about accommodating the needs of individual hotels especially for minor decoration, menu, and service requests for exceptions.

An example of the above is the closing of swimming pools, which seems to be approved at record levels with the space being converted to such uses as new meeting rooms and expanded fitness centers.

Two of the newest priorities as measured by increasing the numbers of hotels making these investments are:

- "panic buttons" – These devices are issued to employees that work alone or out-of-view of other employees, such as Room Attendants (the proper title for employees that clean guest rooms). Most of the major brands have announced system wide implementation of these devices, with implementation ranging from immediately to during 2020, with a few not specifying dates or specifying later dates. The requirement for these devices has been legislated in jurisdictions across the country and is being included in many, if not most collective bargaining agreements.
- cyber security initiatives to protect guest and employee information – The European Union's General Data Protection Regulation (GDRP), which became effective May 25, 2018, affects U.S. hotels because the legislation is intended to protect European citizens when traveling in the U.S. Also, states are promulgating requirements of these protections, including California with the California Consumer Privacy Act, which is similar to GSPR and is effective January 1, 2020. The widely-reported data breaches affecting several major U.S. lodging companies have resulted in acceleration of investment in technology related to cybersecurity.

Most brand and many major independent management company management contracts establish a percent of revenue either to be invested in a reserve for capital replacement fund or to be spent in the current year on capital items. These percentages of gross revenue are typically three to five percent after stabilization for a new hotel, generally three years for limited service hotels and five years for full-service hotels after a hotel is placed in service. Most of the increase in capital expenditures this year will be based on and consistent with the percent of gross revenue funding level at the property level.

What will guests notice resulting from this year's capital expenditures? Adding to the initiatives in prior years such as multi-electric outlets in convenient locations such as on desks and night tables, conversion from traditional bedding formats to duvet formats to modified duvet formats, of the items mentioned above this year's most noticeable changes from a guest perspective will be:

- less wall-to-wall carpeting, with hard surface flooring for some or most of the guest room area
- continued replacement of tub/shower units with walk in showers
- continued redesign of lobbies removing traditional front desks and installing podia or other front desk formats and more open retail areas
- new food and beverage formats, typically more open and more casual, and with more local items and décor
- more hotels with the ability to use a personal device or credit card to provide guest room access
- better high speed Internet service
- generally even more recently renovated guest rooms

Below is a summary of estimated U.S. lodging industry capital expenditures by year:

Year	Amount (in billions)
2019	$7.3 (forecast)
2018	7.05
2017	6.85
2016	6.6
2015	6.35
2014	6.0
2013	5.6
2012	5.1
2011	3.75
2010	2.7
2009	3.3
2008	5.5
2007	5.3
2006	5.0
2005	4.8

These estimates are based on interviews with selected hotel executives, analysis of announced brand standards, and other sources including press releases and media reports, and a literature search.

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About the Author

Bjorn Hanson, PhD, is an industry consultant and researcher. He founded the hospitality consulting practice at PricewaterhouseCoopers/Coopers & Lybrand and retired as global industry leader of hospitality and leisure with responsibility for all services to those industries for PricewaterhouseCoopers LLP before joining NYU. He was a full clinical professor and served as divisional dean of the New York University School of Professional Studies Tisch Center for Hospitality, Tourism and Sports Management. At NYU he also served as co-interim dean of the School of Continuing and Professional Studies. He is a director with Summit Hotel Properties (a NYSE REIT) and Executive Vice President of 795 Fifth Avenue Corporation. He holds CFE (Certified Fraud Examiner) and CRE (Counselor of Real Estate) professional designations.