Choosing Your Development Options: Limited Service or Full Service Hotel

Very often we are asked to advice on selection and appointment of a management company. However, quite often, the project is simply “not ready” or, even simpler, international operator (or regional operators) would not be needed and, in certain cases, negatively impact on the ROI.

In recent years, the global hospitality market has seen a plethora of innovative hotel concepts as a larger number and more sophisticated products become available. Already well-established in America and Europe, over the past few years, Selected Service and Limited Service Hotels have also emerged in Asian countries as very attractive investment opportunities for developers and operators.

What is a Selected Service Hotel?

In the mindset of some developers, three star categories are often erroneously identified as smaller, less interesting and budget oriented properties which fail to be an attractive development option. International Selected Service Hotels are also often mistakenly confused with three star family hotels or “two star” properties, which are the small sized family run mini hotels at the budget end of the spectrum. Indeed, the International Selected Serviced Hotel model is a well-planned lodging structure with the specific focus to maximize guest comfort with a focus on affordability and value for money. The properties within this category are often developed by experienced developers with the early engagement of operators to strictly follow design guidelines and to achieve efficiency in construction, design and operation which are the key success factors for this category. Commonly, operational efficiency is reached with at least 150 rooms, however, where the market condition allows, larger properties will reach better GOP margins. Location still plays an extremely important role into the planning of Selected Service Hotels and easy access to restaurants and retail areas is a large advantage. Selected Service Hotels could play a perfect role as complementary accommodation for midscale retail complexes, Grade B offices complexes or industrial hubs.

What about Limited Service Hotels?

The category of Limited Service is one level “skinnier” than Selected Service with more limited services, basic room features and a focus on a safe and clean environment and comfortable bed. Limited Service Hotels can deliver particularly high ROI but only in cities where the hotel rates are, on average, high and there is a market for more affordable solutions.

Design Features

The importance of design guidance is, in certain cases, more important in the Selected or Limited Service models than the full service models if the ultimate investment goal is higher GOP margin. Developers in several cases fail to understand that the true profitability of this model is not in the higher rates but in controlling operational costs, which is highly related to design features.
• Room size and type – typically 18 sm to 24 sm, depending on the chosen positioning and land cost. Resort locations require more space, in certain cases, rooms could be as large as 26 sm. We believe one single room type could save a lot of costs but, for corner rooms, an additional larger option could also be offered.
• Multitasking staff – In order to maintain profitability, the number of staff should be kept at a minimum. Because of this, multitasking staff are a cost effective solution. The check-in process is often semi-automated and reduced to a limited timeframe. Thus, the front desk staff do not simply check guests in but they also conduct housekeeping inspections and food preparation. Luggage is carried by the guest, in certain cases, or provided by trolleys in case of groups. Outsourcing staff is a common option in high occupancy periods. If the design of the property allows, front desk staff serving breakfast is also provided under certain well-known brands.
• Breakfast area only – Limited or Selected Service Hotels tend to limit F&B facilities and only provide a complimentary breakfast, which are often offered as a “grab & go” option. The selection of food is limited but oriented on quality rather than quantity. In some cases, the breakfast corner is well integrated with the reception, where the reception staffs providing serving support. If the breakfast space is located far from the reception, a separate room is used that is closed off in the late morning after the breakfast time and re-opened the following morning.
• Thin selection of facilities – Select or Limited Service Hotels cut on what is not strictly necessary. Spa and meeting spaces are usually not included; however, small meeting rooms could be added. A gym is still a must in the majority of cases, but limited space is provided. The reception and luggage room are typically much smaller compared to Full Service Hotels. Swimming pools are not an option.
• Additional facilities – automated services are often added to offer full comfort to the guests. Laundry area, for instance, with laundromat and ironing boards allow guests to do their own laundry at a lower costs. Vending machines are often utilised to offer F&B choices 24/7.

Given 10,000 sm of available gross space, below is a typical area program for a Midscale Full Service Hotel compared to a Midscale Limited Service Hotel.

<table>
<thead>
<tr>
<th>Category</th>
<th>Midscale Full Service Hotel</th>
<th>Midscale Limited Service Hotel</th>
</tr>
</thead>
<tbody>
<tr>
<td>No. of Keys</td>
<td>185</td>
<td>250</td>
</tr>
<tr>
<td>Standard Room Size</td>
<td>26 sm</td>
<td>24 sm</td>
</tr>
<tr>
<td>Circulation &amp; Corridors</td>
<td>5,265 sm</td>
<td>6,420 sm</td>
</tr>
<tr>
<td>Total Room NFA</td>
<td>6,845 sm</td>
<td>8,025 sm</td>
</tr>
<tr>
<td>Total Room GFA</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Why these models can be good investments?

From a performance point of view, Selected or Limited Service Hotels have fundamental differences in operating costs. A typical operating strategy for Selected or Limited Service Hotels would make use of:

- Outsourcing
- Multitasking staff
- Limited room amenities, no minibar and no room service

F&B is also reduced to breakfast only, which will largely contribute to delivering higher operating margins compared to full service models, considering that F&B costs could be as high as 50% - 60% of the F&B revenues. The typical revenue sources of Selected Service Hotels vs. Full Service Hotels are below:

<table>
<thead>
<tr>
<th>Category</th>
<th>Revenue Mix (SS Hotel)</th>
<th>Department Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rooms</td>
<td>80% - 90%</td>
<td>18% - 25%</td>
</tr>
<tr>
<td>Food &amp; Beverage</td>
<td>10% - 15%</td>
<td>55% - 65%</td>
</tr>
<tr>
<td>Other</td>
<td>0% - 5%</td>
<td>25% - 40%</td>
</tr>
</tbody>
</table>

Below is a simulation of stabilized performance of a Midscale Full Service Hotel and a Midscale Limited Service Hotel with the same number of keys.
Operational profitability is the key success factor for Selected Service and Limited Service Hotel properties. Profitability could reach the level of 60% GOP margin which is much higher compared to the heavy fully serviced properties. This allows Selected and Limited Service Hotels to have greater adaptability to volatile markets as they are able to lower prices when the market is in a downtrend or during low season and raise rates quickly during a good market.

The limited number of staff per room results in significant savings in manpower costs. In extreme cases, this model only requires to hire the core front office staff, GM and reservations while the marketing and accounting departments can be outsourced to a central operator office and housekeeping can be outsourced to a specialist service provider.

The Net Operating Profit is not the only reference for IRR as construction costs also play a very important role in the choice of Full Service Hotel vs Selected Service or Limited Service Hotel. Full Service Hotels are generally more expensive per room basis, considering all the facilities, public space and back of house required by the business model. On the other hand, with the strong performance metrics and lower
investment costs, Selected or Limited Service models can generate a very attractive return.

What about a Double Brand?

In some cases, when there is a generous amount of buildable GFA but the market conditions may not be ready for large scale full service hotels, the developer may consider to fit more hotel types in a given building. Such hotels are typically operated under one single operator using multiple brands. The trend seems to be the combination of upscale and midscale brands in the same building. Another common structure is the addition of a serviced apartment with a short stay hotel.

The trend toward dual-branded hotels to capture different client types at different price points is gaining developer interest. In addition, sharing back of house facilities is an interesting value proposition as well as sharing building maintenance costs. Each hotel type usually has a separate entrance and reception and check-in desk, in certain cases, recreational areas and meeting facilities could also be shared. The problems related to this kind of structure are in the design, where the planning stage has to be well executed. Also to be carefully considered is the market positioning, where the lower category could negatively affect the price point of the upper category, especially in the case of shared facilities.

Conclusion

We believe the category of Selected and Limited Service Hotels are an extremely interesting development proposition for real estate developers. The simplicity in execution and management allows non-experts in hotels to be able to enter the hospitality market with a product that could be very competitive and potentially solve the market volatility problem. The key success factors still lie in the proper business planning, facility mix, design and professional management. Developers will need to engage the right execution team right from the start.