SORTING FACT FROM FICTION

Independent vs. Brand Hotel Performance in Times of Sickness and Health

A White Paper from

Preferred Hotels & Resorts and PHG Consulting

Preferred HOTELS & RESORTS

P·H·G CONSULTING

EXECUTIVE SUMMARY

Top Three Takeaways:

1. In both banner years like 2019 and during times of crisis like during the COVID-19 pandemic, Independent hotels significantly outperform those affiliated with a Hard Brand or their Franchise Soft Brand counterparts – and this is not a new phenomenon

2. Since the onset of COVID-19, Independent hotels have demonstrated substantial gains over Hard Brand and Franchise Soft Brands in terms of both ADR and RevPAR – performance that would be even more significant in terms of Net RevPAR when franchise fees are taken into account

3. Data proves that the ongoing narrative of Hard Brands and Franchise Soft Brands being a “safe harbor” for hotels is a fallacy that needs correcting

Despite claims to the contrary, independent hotels significantly outperform those affiliated with a franchise brand, both in banner years like 2019 and during times of crisis such as 2009, following the economic crisis and, most recently, in 2020 due to the COVID-19 pandemic.

While executives of the Hard and Franchise Soft Brands have continued to push the narrative about the strength of their brand platforms in an attempt to instill a false sense of confidence among stakeholders and maintain an air of superiority and authority, the data proves otherwise.

At a turning point in the global hospitality industry, as hotels work through recovery plans and audit every aspect of their businesses to ensure maximum efficiency and effectiveness, now is the time to sort fact from fiction and clarify once and for all why the most profitable choice for hotels in the Upper Upscale and Luxury markets is to remain (or switch to) independent.

Utilizing statistics from industry authorities STR and HVS, this whitepaper examines why this is the case, specifically how independent hotels have been widening the gap of performance in both ADR and RevPAR metrics compared franchised properties over the past decade, and why the notion of joining a Hard Brand or Franchise Soft Brand is no longer the “safe” choice – neither in sickness nor in health.

THE TERMINOLOGY

For the sake of clarity before looking at the data, let's define the terminology that will be used throughout this article. For the purposes of this paper and ease of looking at the data referenced from STR in the same way, we will remain with the same vernacular as reported by STR:

Hard Brand – this refers to a hotel that has a franchise agreement with one of the major franchise companies such as Hilton, Marriott, or Hyatt and bare the name of that brand

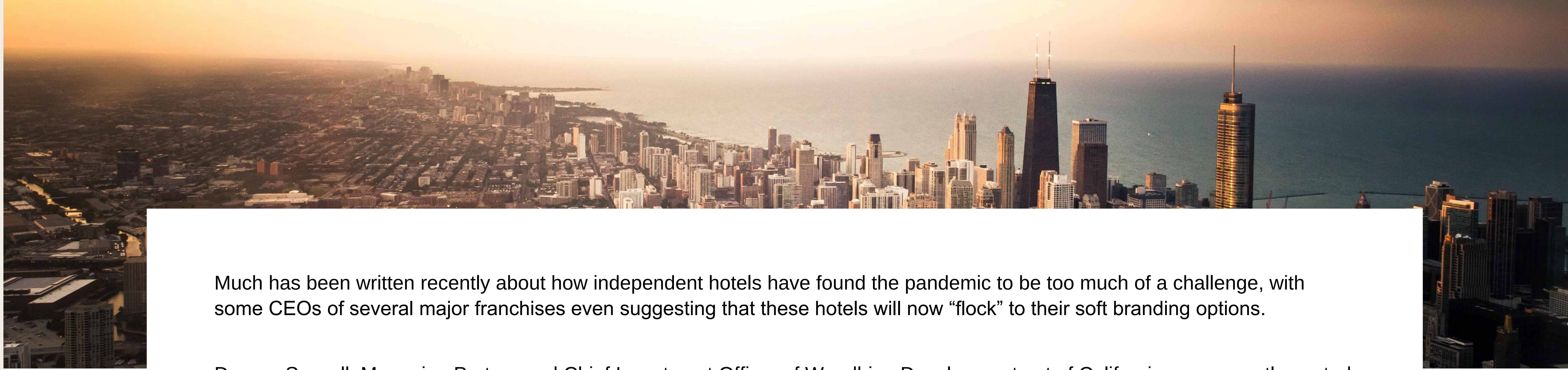
Franchise Soft Brand – for the purposes of this paper, we are using Franchise Soft Brand to describe one of the "Franchise Collections" owned by the major Hard Brands (i.e. Hilton and Marriott) but do not necessarily carry the brand's name. Examples of Franchise Soft Brands include Autograph Collection and Luxury Collection (Marriott) and Curio Collection (Hilton), as well as Alila Hotels & Resorts (Hyatt).

Independent Soft Brand – as the names suggests, these are hotels that are independent of a hard or Franchise soft brand as defined above, preferring to develop their own brand and avoid the cost, restrictions, and encumbrance of a franchise contract. Many of these Independents work with Independent Soft Brands such as Preferred Hotels & Resorts, Leading Hotels of the World and Small Luxury Hotels, amongst others.

Independent – these hotels do not hold any brand affiliation and manage and operate their resources independently

INTRODUCTION:

LISTENING TO THE DATA



Much has been written recently about how independent hotels have found the pandemic to be too much of a challenge, with some CEOs of several major franchises even suggesting that these hotels will now “flock” to their soft branding options.

Dupree Scovell, Managing Partner and Chief Investment Officer of Woodbine Development out of California, was recently quoted as saying that “COVID will blur the line that exists between independent and branded hotels. The industry should prepare for an enormous shift as independents seek the safe haven of soft brands like Autograph, Curio etc…”

On the Intercontinental Hotels Group Q1 Earnings call, IHG CEO Keith Barr said that when they are able to travel again, “Customers are going to want to stay in the biggest branded hotels—this will put headwinds on home-sharing. We will also see weaker brands and independent hotels convert over to the big brands.”

These claims, however, do not correspond with verified marketplace data. Despite much evidence to the contrary, senior leaders like Barr stand to gain from the erroneous perception that Hard Brands and their Franchise Soft Brand counterparts are a “safe haven.” Below, we will explore the most recent data that refutes this claim, as well as investigate what happened in the wake of the previous financial crisis in 2008 and 2009 and how branding impacted that recovery.

To illustrate the performance gap between Hard Brands, Franchise Soft Brands, and Independent hotels, we used STR data from both the full calendar year of 2019 and in 2020 since the start of the crisis, which, for the purposes of this paper, is identified as March 7, 2020.

The data covers Hard Brand, Franchise Soft Brand, and Independent hotel performance in the United States for Luxury, Upper Upscale, and Upscale classes.

2019 PERFORMANCE

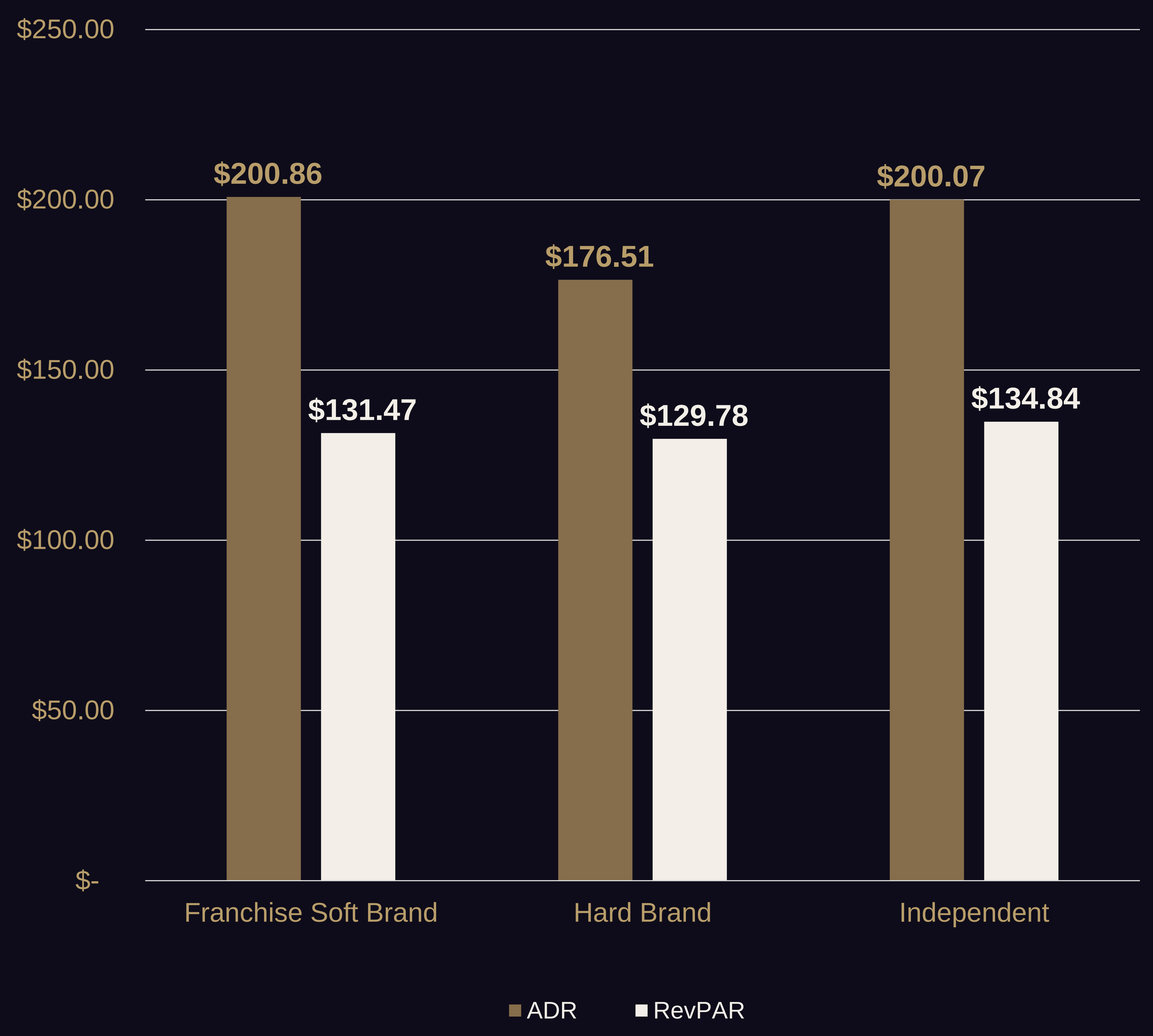
The chart opposite regarding 2019 performance shows that **Independent hotels outperform both Soft Brands and Hard Brands (significantly) in terms of RevPAR, and significantly outperform Hard Brands in terms of ADR**.

The data clearly shows that Independent hotels are in a commanding position in terms of RevPAR and ADR penetration, thereby proving that they are the leader in top-line revenue results without the encumbrance or expense of a Franchise Soft Brand or Hard Brand contract.

However, part of the narrative pushed by major chains and financiers in the industry is that the Hard Brands and Franchise Soft Brands offer more security and a reliable safe harbor in more troubling times. But, what does data tell about this – is that claim validated when we look at the data?

CALENDAR YEAR 2019

Total U.S., Luxury, Upper Upscale & Upscale classes



Source: STR, © 2020 CoStar Realty Information, Inc.

First, let's look at occupancy figures since the start on the crisis through to August 8, 2020.

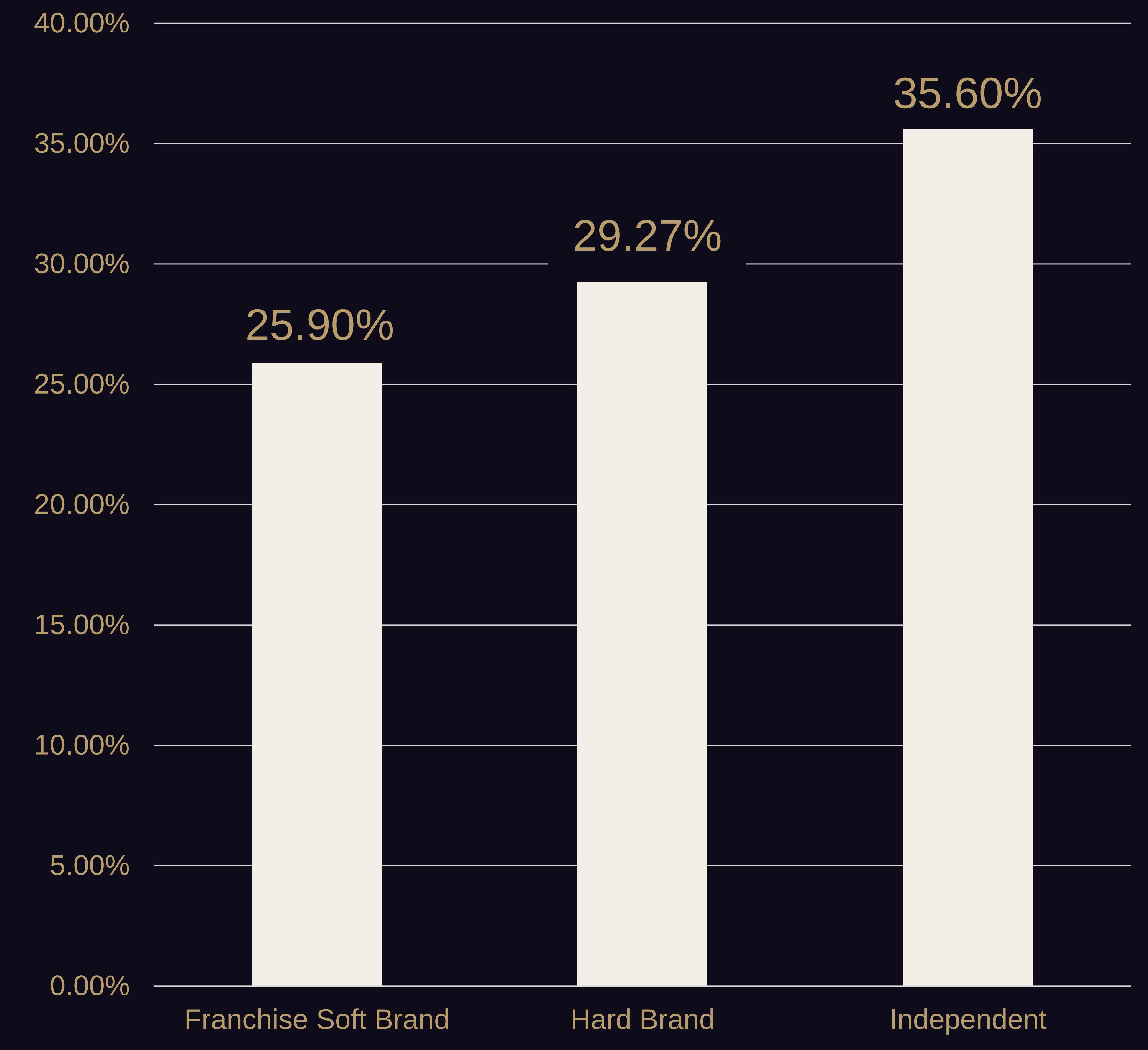
Contrary to the narrative we are hearing from executives of the major franchises, the data clearly shows that Franchise Soft Brands under-performed both their Hard Brand cousins and Independent hotels.

During the period measured, Franchise Soft Brands trailed Independents by nearly 10% in occupancy.

OCCUPANCY DURING THE CRISIS

Independent Hotels Lead in Occupancy

MARCH 7TH – AUGUST 8TH, 2020



Source: STR, © 2020 CoStar Realty Information, Inc.

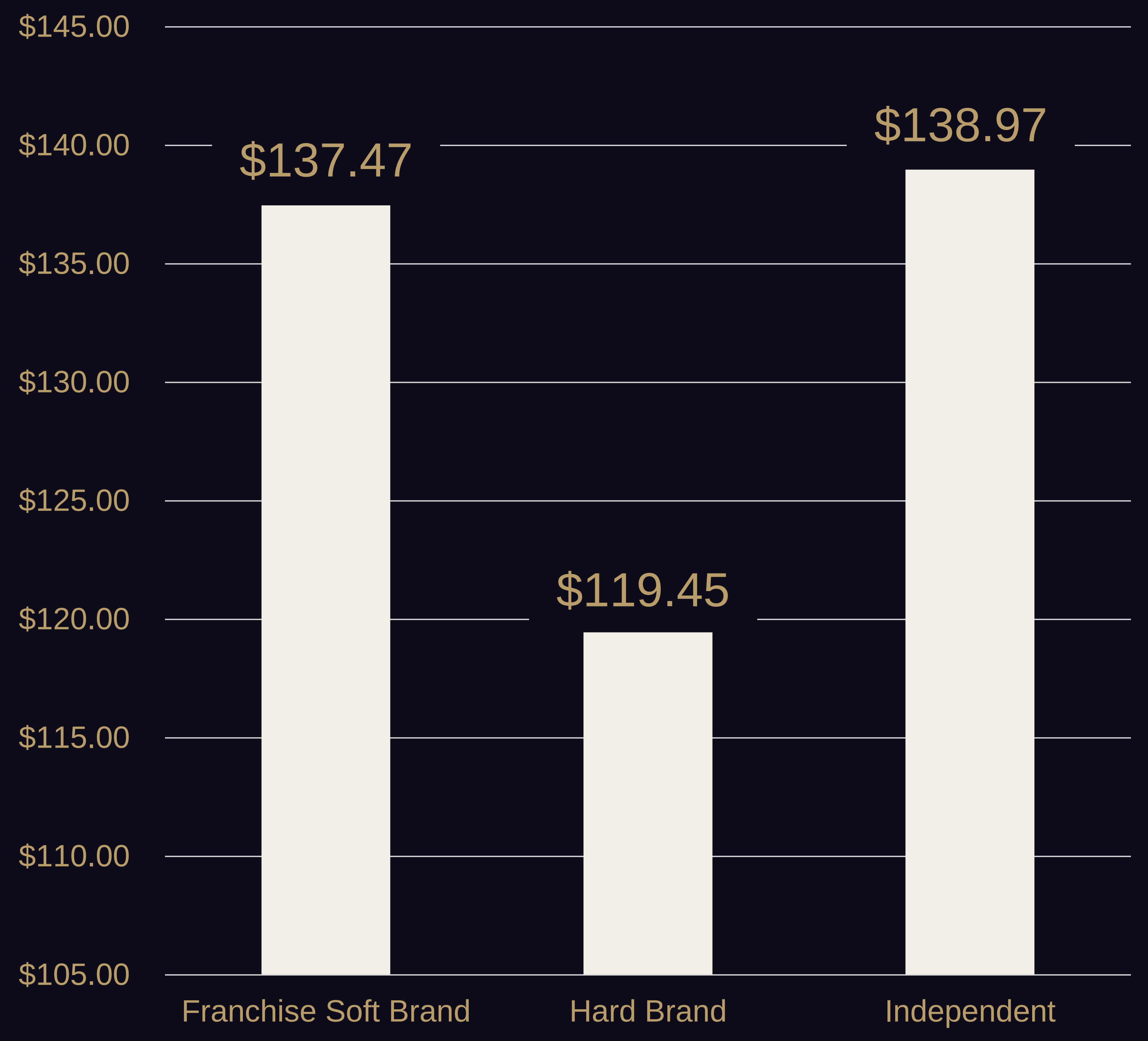
ADR PERFORMANCE DURING THE PANDEMIC

Independents still led the pack and saw a premium of nearly US$20 over Hard Brands. While Franchise Soft Brands closed the gap on Independent Hotels for the period measured, they were still ahead of their Hard Brand counterparts.

ADR DURING THE CRISIS

Hard Brands suffer while Soft Brands and Independents show resilience

MARCH 7TH – AUGUST 8TH, 2020



Source: STR, © 2020 CoStar Realty Information, Inc.

REVPAR DURING
THE PANDEMIC

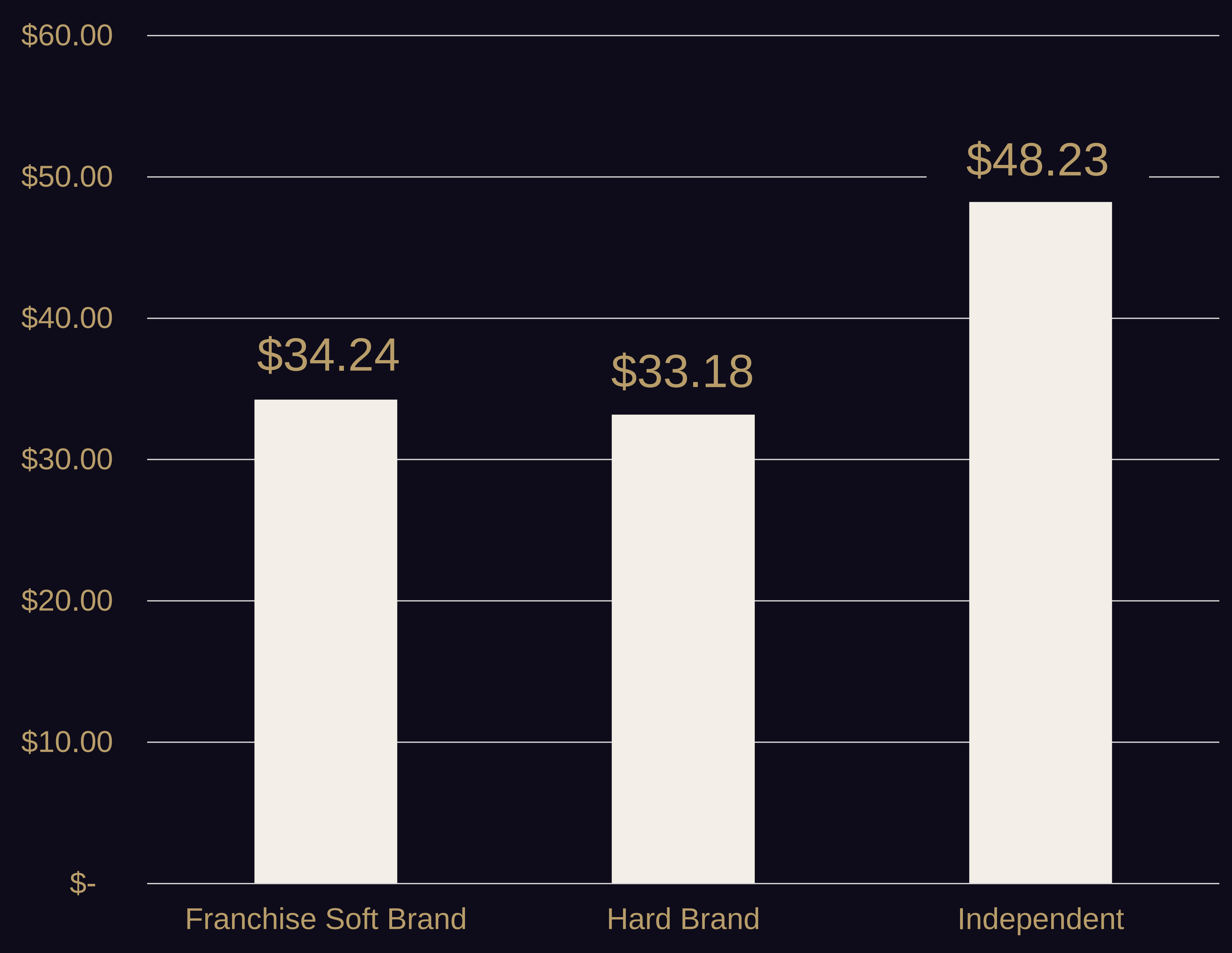
Based on what we have already seen, it is not surprising that Independent hotels have ***significantly*** outperformed both the Hard Brands and Franchise Soft Brands when looking at the RevPAR figures for the same timeframe.

For the period of March 7 through August 8, 2020, Independent hotels saw a US$14 RevPAR premium over Franchise Soft Brands and more than US$15 over Hard Brands.

RevPAR DURING THE CRISIS

Independents show a significant Premium RevPAR

MARCH 7TH – AUGUST 8TH, 2020



Source: STR, © 2020 CoStar Realty Information, Inc.

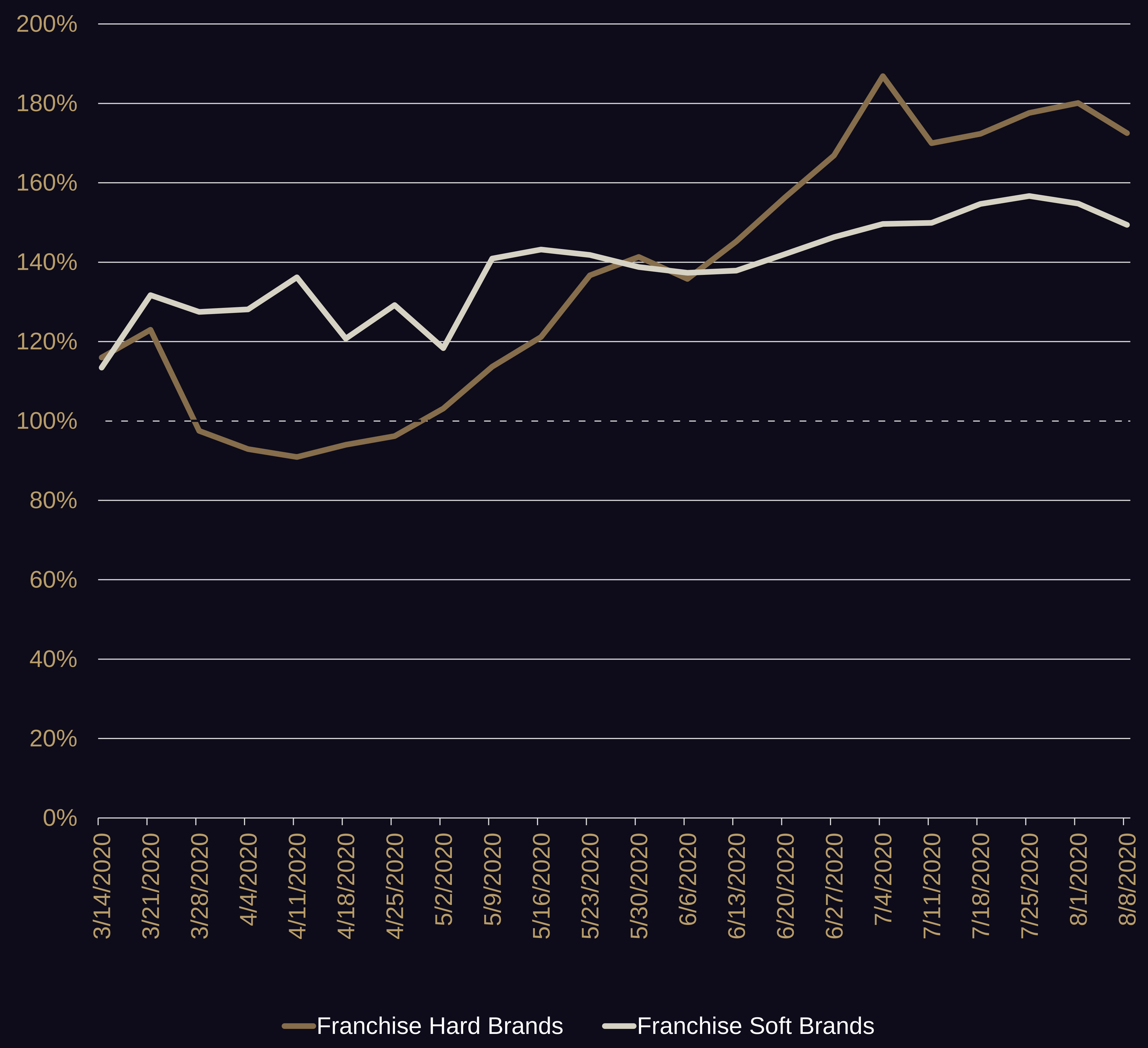
THE INDEPENDENT
REVPAR PREMIUM

When looking at the RevPar Premium for an Independent hotel, they have maintained their position above 100% for nearly the entire duration of the pandemic to date, peaking at **157% Premium over Franchise Soft Brands and a massive 187% premium over Hard Brands**.

INDEPENDENT HOTEL REV PAR PREMIUM OVER FRANCHISE SOFT AND HARD BRANDS

During the Pandemic

MARCH 14TH – AUGUST 8TH, 2020



The topline figures clearly show that Independent hotels are ahead of the pack during the COVID-19 pandemic, but what happens when we consider other factors, such as the cost of the branded contract or the encumbrance on the asset?

As a guide, the table opposite, from the 2019 HVS Franchise Fee Guide, illustrates the costs associated with signing a franchise contract with a Soft Brand versus a contract with an Independent Soft Brand such as Preferred Hotels & Resorts.

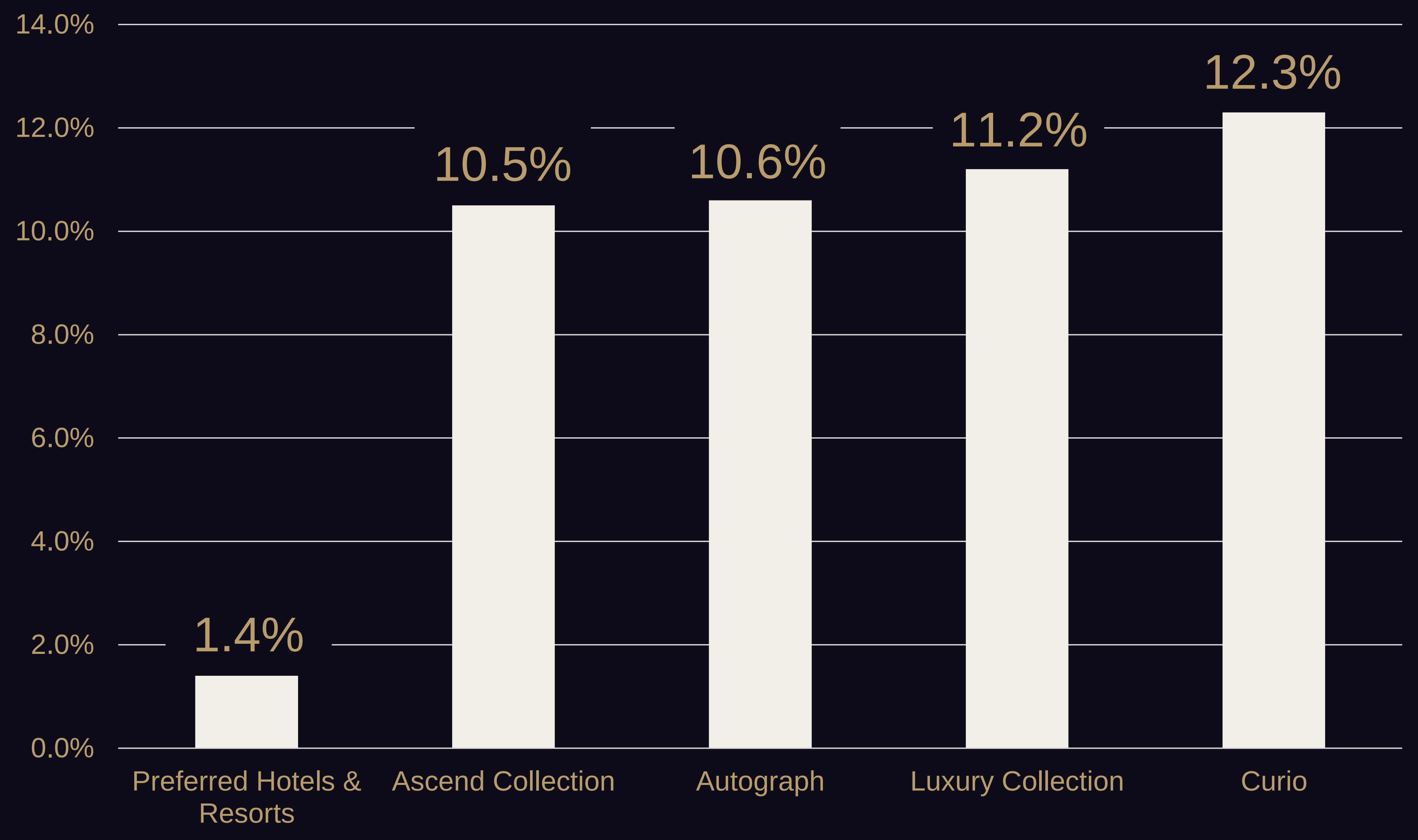
To put it into real figures, as an example, a hotel with US$10M in Gross Rooms Revenue would **pay a Franchise Soft Brand up to US$1.23M in annual fees vs US$0.14M with a company like Preferred Hotels & Resorts – an 88% difference**. During the pandemic, as an example of one potential crisis when there are greater financial burdens being placed on hotels, these additional fees charged by the Hard Brands and Franchise Soft Brands are a significant drain on a hotel's finances and could factor into a hotel's ability to survive.

It is worth pointing out that a hotel that is purely independent (i.e. not part of a Hard Brand or Franchise Soft Brand nor a company such as Preferred Hotels & Resorts) would still incur connectivity and transactional costs, equating to approximately 0.75% of GRR.

In addition to these fees, **Franchise Soft Brands bring an encumbrance of 15- to 20-year contracts to hotel owners**. The contracts are watertight, which means that owners essentially lose control of their properties for the duration, as they are expected to maintain all brand standards regardless of economic conditions or performance.

Franchise Soft Brands vs. Preferred Hotels & Resorts

Average Total Cost of Brand Affiliation
as a Percentage of Gross Rooms Revenue



Source: HVS 2019 Franchise Fee Guide. Percentages denote total fee percentages

RESULTS FROM THE PREVIOUS CRISIS

In 2013, Preferred Hotels & Resorts commissioned HVS to investigate the comparative performance of its independent hotel members through the 2009 financial crisis.

Again using STR data, the study found that the hotels affiliated with the Preferred brand outpaced their peer properties, the U.S. Major Markets, and the U.S. Lodging Industry as a whole through the recovery, recording strong positive trends in terms of both the amount and the pace of RevPAR growth.

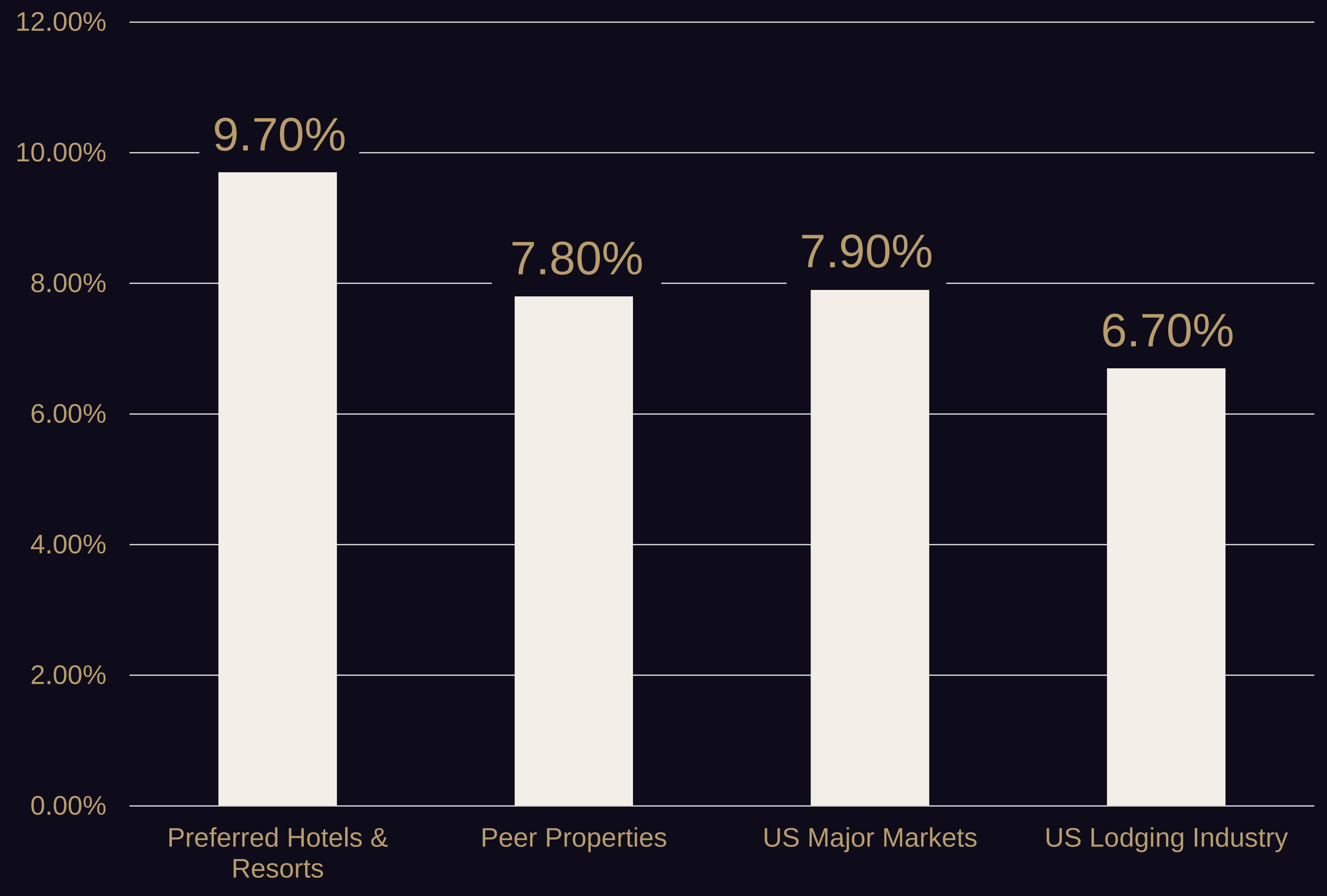
As a result, the RGI levels achieved by member hotels of Preferred Hotels & Resorts against their peer properties increased by more than five points – from 99.1% in 2009 to 104.5% in 2012.

Since then, Preferred's member hotels have maintained this market position through to the start of the COVID-19 pandemic in March 2020. Given that the independent hotels affiliated with Preferred Hotels & Resorts are included in the data for Independent hotels in this paper, we would expect to see a similar, increased rate of growth coming out of this current crisis.

Average Annual Compound Growth

RevPAR Growth 2009 to 2012

Preferred vs. Peer properties



Source: 2013 HVS Market study using STR data

CONCLUSIONS

Demographic and psychographic shifts mean that the traveling public favor Independent hotels over the generic alternatives of Hard Brands and Franchise Soft Brands

Data confirms that over the past decade, in good times and in bad, hotels in the Upper Upscale and Luxury segments **are better off remaining independent rather than joining a Hard Brand or Franchise Soft Brand** due to their significantly better performance. And this is not a fleeting trend. When considering NetRevPAR (revenue per room after brand fees are deducted), the performance for independent hotels would be even more significant. While there is no exact reasoning for why independents are so much more resilient during this crisis and others, here are three takeaway theories:

1. **Independents have more freedom to execute creative strategies without cumbersome brand restrictions** – and pivot quickly in every regard when the landscape changes demand it

2. **Independents have more freedom to achieve higher ADRs**, as Hard Brands and Franchise Soft brands force rank the rate hierarchy for in-market hotels, putting restrictions on their own hotels' profitability and leaving no room for the flexibility or inventiveness needed to succeed. Therefore, hotels affiliated with Hard Brands and Franchise Soft Brands in the Upper Upscale and Luxury segment will continue to struggle to compete with their Independent counterparts – especially in times of crisis – due to the financial and branding limitations put upon them.

3. Demographic and psychographic shifts – as noted in recent readers' awards by global authorities such as *Conde Nast Traveler, Travel* + *Leisure*, and TripAdvisor – highlight that the **traveling public favor Independent hotels over the generic alternatives of Hard Brands and Franchise Soft Brands**

CONCLUSIONS

Hotels affiliated with Hard Brands and Franchise Soft Brands… will continue to struggle to compete with their Independent counterparts – especially in times of crisis.

What is certain is that hotel owners – especially in the Upper Upscale and Luxury segments – are better off without a restrictive agreement with a Hard Brand or Franchise Soft Brand – regardless of the timing, market conditions, or any other factors – and that the ongoing narrative pushed by executives of these brands is nothing more than misled propaganda to falsely reassure stakeholders.

Where does this leave us? It is time to change the narrative and force a dialogue based upon data. It is time expose the fallacy of Hard Brands and Franchise Soft Brands as a “Safe Harbor” in a down market and recognize that Independent hotels have been on the rise in both popularity and performance over the past decade. It is time Independent hotels get the respect they have worked so hard to deserve.

JONATHAN NEWBURY

Executive Vice President
Preferred Hotels & Resorts

Jonathan Newbury serves as Executive Vice President of Asia Pacific for Preferred Hotels & Resorts. Originally from the United Kingdom, Jonathan now lives in Chicago, but has previously lived in New York and major travel markets across Europe.

Jonathan joined Preferred Hotels & Resorts in 2008 as Vice President of Brand Development. After a year in that position, his strategic expertise and expert planning skills were called upon to oversee the company's newly created e-commerce department as Vice President of E-Commerce & Technology. In that role, he implemented a completely customized global CRM, managed 20 websites, launched two new branded websites and implemented a new website dedicated to the MICE market.

Prior to his current position, he served as the company's Senior Vice President of Strategic Development for seven years, where he spearheaded a variety of global development initiatives that helped solidify a strong platform for the Preferred brand among hotel owners, operators, asset managers, and management companies globally and fostering impressive retention in North America. Throughout his tenure with Preferred, he has helped fuel a 20% growth in the brand's hotel portfolio.

Prior to joining Preferred Hotels & Resorts, Jonathan served as Vice President of Global Development for Small Luxury Hotels of the World, based in New York. Fluent in French, Newbury holds a B.A. (Hons) in Politics & Government from London Guildhall University.

KATHLEEN CULLEN

Senior Vice President
PHG Consulting

Kathleen Cullen brings more than 25 years of diverse experience in the hospitality industry. Previously, her responsibilities ranged from holding strategic senior leadership positions in the corporate offices of dynamic, fast-paced, global hotel companies and owning her own consulting firm to authoring professional publications and working in varied operational departments on the property level.

Prior to joining PHG Consulting, a sister division to Preferred Hotels & Resorts, Kathleen was Senior Vice President of Revenue & Distribution for Two Roads Hospitality. In that role, she was responsible for the overall revenue strategies and increasing hotel market share for a portfolio of more than 75 hotels, as well as optimizing the company's revenue management foundation for all brands, including organizational set up, expert human resources and deployment, technology platform, tools, and connectivity.

During her tenure Two Roads Hospitality, she was a key leader and held cross-discipline responsibilities for all new hotel openings and transitions.