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A native Houstonian, Douglas Horn, is a 40-year veteran of the Hotel Industry. He currently is the General Manager of the Four Star 87 million-dollar High Rise Houstonian Estates Condominium.

Prior to that, Mr. Horn was the Area Manager for the 492 room Wyndham Greenspoint Hotel and the 400 room Marriott Greenspoint with annual revenues in excess of 53 million. These two assets are owned and operated by Sunstone Hotel Investors, LLC, a hotel company with 75 assets throughout the United States.

Before joining Sunstone, Mr. Horn was Senior Vice-President of Operations for Performance Hospitality, a division of Wyndham International Hotels. A nine year employee with the company, Mr. Horn was an integral part of the formation of Patriot American / Gencom Hotels the parent company for Wyndham International today. In his last position he was responsible for 50 hotels nationwide with annual income of over 350 million dollars. The brands represented were Hilton, Radisson, Crown Plaza, Sheraton, Embassy Suites, Double Tree and several independents. In this position he was responsible for the financing of, as well as the sale of, several assets valued individually up to 60 million. Mr. Horn handled renovations in excess of 25 million on individual projects and over 100 million collectively. Additionally Mr. Horn formed Gencom Advertising, which became part of his division in PHM. This agency was responsible for over 4.5 million in annual placements and was recipient of two Addies and numerous HSMAI awards.

Mr. Horn is the Immediate past chairman of the High Rise Condominium Advisory Board of Houston, and Board Member of the CAI of Houston. He serves as well on the Board of the Texas Hotel and Lodging Association as a past chair and has chaired TH&LA's Annual Short Course as well as serving as an instructor in the program. He is also a Life-Time member of the Board of the Hotel and Lodging Association of Greater Houston and its past chair in 2001-02. He serves on the Advisory Board for the Conrad Hilton College of Hotel & Restaurant Management at the University of Houston. He serves as the Co-Chairman of Hospitality On Parade's Annual Banquet since 2005 and recently as Co-chairman of the Texas Hotel and Lodging Association's Marketing Committee. He is past Chairman of the Tourism Advisory Council for the Texas Economic Development Office of the Governor of the State of Texas and past Chair of the State of Texas Marketing Committee. He served on the board of the Hospitality Educators Association of Texas in 2008. Mr. Horn served as Chairman of the Greater Houston and Convention Bureau 2005-07 and still serves on its Board of Directors. He served on the Mayor's Task Force for Marketing of

Houston 2009, and is past chair of the Mayor's China Tourism Task Force. Mr. Horn served as Chairman of the Host Committee for the Texas Bowl 2007-08.Mr Horn served as well as Chairman of the Galveston Hotel Lodging Association in 1980-82 and as such served on the Committee that initiated the Galveston Trolley and Dickens on the Strand Festival.

Mr. Horn, in 2012 was awarded the first Lifetime Achievement Award given by the Texas Hotel &Lodging Association for his work in the field of Hospitality. In 2010 was awarded The Lifetime Achievement Award for his contributions to the Hospitality Industry in Houston, Texas by the HLAGH, he is twice the recipient of Certificate's of Recognition / Outstanding Service from the Secretary of State of Texas, from the Honorable Jack Hanna, recipient of recognition for services to the Hospitality Industry From Rick Perry Governor, and from James E. "Pete" Laney Speaker of the House as well as the Texas Senate. He has received numerous wards from his past hotel companies has been recognized for his service from HEAT as well as other areas of the hotel industry.

Mr. Horn is a graduate from the University of Houston. He is married to Stephanie Haynes and lives in University Oaks.

Guest Service

What does Guest Service Mean? **Why should I care** about Guest Service? **Exceeding expectations** is a "catch-phrase"? Shouldn't I be more interested in my hotel's **Guest Satisfaction** scores? Why is it called a "**Loyalty Program**"? They get a cookie don't they?

This is a course on Guest Service. So ask yourself: "What is the business in which I am?" Hospitality? **Wrong**. Hotels? **Wrong**. Food and Beverage? **Wrong**.

You are in the "**Service**" business. If you don't want to say: "Yes Sir, No Sir, Yes Mam, and No Mam" then go drive for Uber.

So what does Guest Service mean?
- The Customer is Always Right
- There are no limits on what we can do for you
- Who is in Guest Service
- Some people just can't ever be happy
- They only want a free room
- Please, No Trip Advisor

 Let's begin by asking an essential question:
"Who is the most important person in the world?"
You Might answer; "The Guest"
But let's say you are sinking ship in the North Atlantic and there is only one more place in the last life boat, then who do you think the most important person in the world is? Of Course it's YOU!

Therefore the customer believes they are the most important person in the world, all the time. So it's your job to treat them as if they are *you*, and you are the most important person in the world.

So do we? ***Really?***

(a) Always
(b) Most always
(c) Sometimes
(d) When we feel like it

How often have you gone someplace, bought something, or tried to get something fixed under warranty only to hear the following:

- Your call will be answered in the order it is received…your estimated wait time is ten minutes
- I'm sorry you have reached the wrong department you will have to call back at the following number
- This is what our policy is and we cannot make changes
- *They* changed the procedure, I can't help you
- That's not my job
- I'll be with you in a moment when I finish my cell call

Is this the way you want to be treated? And yet we constantly treat our customers in this manner.

Let's go back to what business we are in….**THE SERVICE BUSINESS!**

Who is it that pays you?
Hilton
Marriott
Omni
Radisson
Best Western
Wyndham

No, it is the Customer!

Who do you work for?

Hilton

Marriott

Omni

 Radisson

Best Western

Wyndham

No, you work for the Customer!

So when you meet a customer, a guest, a representative from a group looking to stay at your hotel, realize that they pay your salary…they are not only the most important person in the world, but they are your bosses.

Beginning to End

When does the service level to your client stop….***never***.

From the time the guest drives up to the time they leave they are impressionable. Even after they leave they carry ***your*** reputation in their hands, on Facebook, Trip Advisor, Yelp, etc.

First Impressions

Having a bad day? Your room mate drank the last of the O.J., your significant other or spouse left the toilet seat up for the umpteenth time, someone cut you off in traffic and almost took out your front bumper, Your mother-in-law is coming in next weekend and will stay for two weeks, you found out there's a virus running around the day care your kids are attending, and on and on.

You bring who you are and how you feel with you when you come to work.

Going On Stage

There's a bit of a showman in each of us. That's what we like about our business. We get to entertain people. We get to show how knowledgeable we are. We seek their approval. We want them to like us. We are showmen. So if you bring the attitude you had from the freeway encounter, the fight with your significant other, the problem you're having with the plumbing at your apartment, what kind of impression will you make on your guest?

Those of you on the arrival end of the guest experience set the stage for the rest of the stay. If the van ride from the airport is not enjoyable, or the doorman/valet is surly and inattentive, then when the guest gets to the desk, their expectations will be the desk agent will be a hostile as well.

Why do you think the SWA Attendants are so popular? It's not their looks; it's their ability to make the traveler feel at home and familiar in a very uncomfortable environment. They build a level of trust as soon as you are seated. "Mi casa es su casa". We get to have people into our home. So when they come in you want to make the right impression.

Where does it start? **From the moment you put on your clothes.**

If you go to your job dressed like the party last night ended two hours ago, then that is the perception you will give.

This means presentability. I know it sounds silly…but layout what you are going to wear the NIGHT before. It saves you time, makes you sure you will look good, and starts the day off on the right foot, (in the right shoe).

When you walk in the door of your hotel, you leave everything else behind for the next eight hours. You go on stage. We'll get to more on this a little later.

Loyalty vs Satisfaction

Ask yourself; "What is the difference between loyalty and satisfaction? Are you satisfied in your job? Or are you loyal to your company/boss?

If you are satisfied, does that mean a competing hotel company cannot entice you to leave and work for them? If you are loyal, would you even consider another offer?

Now, if a Guest is *satisfied* are they **loyal?** Don't bet on it. A satisfied guest means they had no complaints of any major issue. You did your job, that's it, nothing more. When that guest visits your city again, if there's an offer down the street that's a little better, he just might take it.

A guest who develops ***loyalty*** leaves wanting to tell everyone he knows about the stay he just had, and will come back each time he comes to town.

Instead of asking your guest if they are satisfied, ask them what was ***memorable*** about your stay with us? Did we make a **memory**?

Once you have the answers to what made memories, then you have the key to that customer's loyalty. Maybe it was the greeting by the van driver at the airport. Maybe it was the how each and every employee that the guest encountered said hello. Maybe it was the chef who came out to make sure he understood the guest had special dietary needs and assured them they would be addressed. Maybe it was at check-out when the attendant said "Thank you for staying with us Mr. Smith, and can I make you next reservation for you? Please call if there is anything any of us can do", (and handed him a business card).

We spend millions of dollars to attract new customers, and we don't spend enough to teach our employees how to build loyalty.

The Customer is Not Always Right
But he is Never *Wrong*

Early on I mentioned "The Customer is *always* right!" We have all heard that, but we all know that we don't believe it.

Two things:

1. The Customer is not always right, but he is NEVER wrong.
2. It's not about Right or Wrong, it's about solving the problem and building loyalty.

When faced with a disgruntled guest you are presented an opportunity to transform a dissatisfied guest into a loyal client. Here's how:

- Apologize. Listen to the issue, really listen. Remember who is the most important person in the world? Repeat the issue back to the guest letting them know you heard them. Just because you said: "I understand your viewpoint," doesn't mean they are right. But then genuinely apologize. "I'm sorry", goes a long way.
- Offer a solution. What can *I* do to make you happy? You make the choice. If you are not empowering your line personnel to solve issues, then shame on you. Give them the authority to solve the guests concerns.
- Follow-through. Once you've heard the issue, apologized and found you can correct the problem…do it! Then call the guest and let them know you have addressed their issue.
- Check back a second time. Whether you or the next shift that comes on calls, make sure you ask the guest once more if everything is fine. It shows that information is shared between employees and that you care enough to make sure they are having a ***memorable*** experience.

What happens to angry guests:

- 91% leave and *never* return
- 96% leave without mentioning the *real* reason they left.

- 80% will return **IF** they feel that their problem had been quickly addressed and handled properly.
- Those that leave , especially if they had a very bad experience will post it on Trip Advisor, Yelp, Facebook, etc. And that will stay there *forever*.

Creating the Right Environment

One of the biggest challenges that the Hospitality Industry faces today is defining its purpose. Are we in *hospitality*, or are we in *real estate*? Depends to whom you speak. Within the last 15 years the various brands have been condensed down to a handful. They try to be everything to everyone from Select Service to Extended Stay, to Full Service, to Resorts, to Boutique, to Five Star.
Public held companies have become a matter of how high is the stock price? This trickles down to even the independent REITS (Real Estate Investment Trusts) which own branded assets and the need for those properties to deliver high profits.

So how can *you* make a difference at *your* hotel?

Ask yourself what is the difference between a mission statement and the culture of my department?

Mission statements are generally some lofty ideal developed to sell franchises.

IHG talks about the diversity of its owners. Marriott doesn't have an official mission statement but it's vision statement is "To be the #1 hospitality Company in the World", and Hilton covers all the bases with "To be the preeminent global hospitality company-the first choice of guests, team members, and owners alike."

Did you know the only Franchise that refers to loyalty is Radisson Hotels. Their Mission statement is : "To create **loyal**, satisfied customers who will return to Radisson properties repeatedly because of the quality and value offered."

Maybe it's because Radisson is still family owned.

It really doesn't matter. It's a bunch of executives in a room with ad guys figuring out what sounds good.

Compare this to Southwest Airlines: "**dedication to the highest quality of Customer Service delivered with a sense of warmth, friendliness, individual pride, and Company Spirit…**" Now that's a mission statement. **Want to know why?** The employees wrote it. It is not just their mission statement, it is their culture.

So your mission should be not just a saying, but your ***culture***. What you live each day. Don't worry if your Flag doesn't have a good mission statement. Develop one of your own.
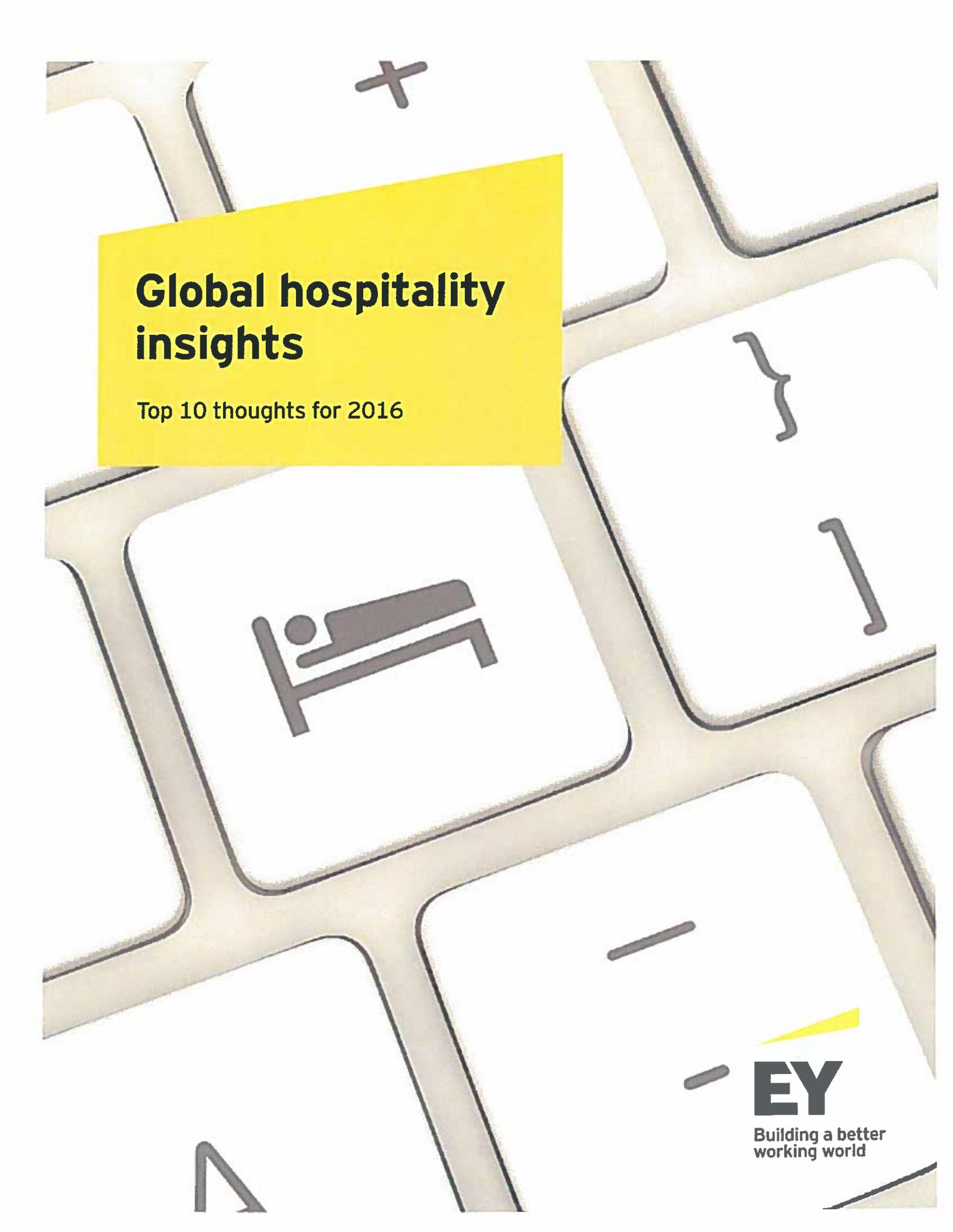
- Be Friendly – Everyone…*all the time*
- Listen to your guests- Did they have a bad day? Can you make them smile. They have just traveled away from the warmth of their home and are in a strange place or on a business trip where they may or may not want to be. Listen to them.
- Respond the way *you* would want to be responded to. You will be surprised how powerful the words are: "I sincerely apologize".
- Never say no.
- Take responsibility- It's your hotel, not someone else's. When you get a complaint, you own it, not someone else. Communicate it to those who can solve the issue and then *follow-up* to make sure it was resolved.
- Set up Training – Train your staffs in the culture you establish. Spend time with them; listen to how they interact with guests. Do this every day.

- Learn who your clients are – Not just those that use your hotel, but the employees of other departments. When was the last time you visited another department, say Housekeeping and brought them doughnuts? Or worked in Banquets during a time sensitive events and flipped a room?

You have the ability to set the tone for your department, to make your employees develop loyal clients, to create memorable stays, but it is work and has to be lived each day. You have the ability to change someone's day for the better…that's right you!

Treat your Guest in such a memorable way that when the stay is complete, the guest will tell someone how great it was!

That is Guest Service! That builds loyalty!

Global hospitality insights

Top 10 thoughts for 2016

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Foreword

In most regional markets, hospitality is in a state of vibrant growth, and is a catalyst for economic development and job creation. From the deployment of capital fueling transaction and development activity, to the operational improvements that optimize investment outcomes, to the increasingly active role technology plays in daily operations, industry activity is dynamic and progress is evident.

Underpinning the rapid pace of growth are two transformative forces creating unique opportunities: innovation and culture. Throughout the industry, innovation is observed in the form of new and improved technologies, brands, guest experiences and business tools. In addition, organizational culture is rising in terms of focus and importance. In the years ahead, a focus on culture by market players will increasingly engage stakeholders and guide business decisions.

In this year's report, we reflect on the global trends we saw in 2015 and seek to address questions that are top of mind for industry participants in 2016, such as:

- What's the right path to accelerate your growth journey?
- Will your next investor be from another hemisphere or just a click away?
- Can peer-to-peer benchmarking help you turn up the heat on your competition?
- Have you fine-tuned your financial reporting?

The growth trajectory for the global hospitality industry in 2016 and beyond is deeply rooted in innovation, investment discipline and organizational culture. In the upcoming year, industry participants will need to react to changing market forces, find opportunity in disruption and actively engage employees and stakeholders for the cycle ahead.

We are pleased to present this year's edition of *Global hospitality insights: top 10 thoughts for 2016*. It explores top-of-mind issues and previews what lies ahead for hospitality and leisure participants over the upcoming year. It focuses on the key themes of growth, innovation and culture within the sector.

Howard Roth
EY Global Real
Estate, Hospitality &
Construction Leader

Michael Fishbin
EY Global & Americas
Hospitality Leader

1

Commercial excellence: refining your growth strategy

What's the right path to accelerate your growth journey?

The current lodging cycle has been characterized by prolonged and vibrant growth; however, the path to progress has not been uniform for all players.

In 2015, we read headlines of transformational deals dominating the M&A landscape, alongside a rising supply pipeline from heightened lodging development. For many hospitality companies, including established brands, third-party management companies, time-share divisions and online travel agencies, a race for scale and gaining market share has driven rapid consolidation. For others, such as emerging lodging brands, restaurant groups, entertainment companies and technology platforms, volume remains a secondary priority to controlling their share of a niche market.

No matter where you stand in your business plan, it is critical to adapt your commercial model to attain competitive advantage in a dynamic market. To achieve overall commercial excellence in hospitality, consider the following questions:

- What drives value for the stakeholders of your business?
- How does your business react to changing market dynamics?
- Does your current business plan position you for commercial success?

Understanding what drives value

In November 2015, Marriott International announced its proposed acquisition of Starwood Hotels & Resorts Worldwide Inc. While other lodging companies were rumored as merger candidates for Starwood during Starwood's strategic review of the acquisition, changing market dynamics ultimately determined the value proposition offered by Marriott to Starwood investors, customers and employees.
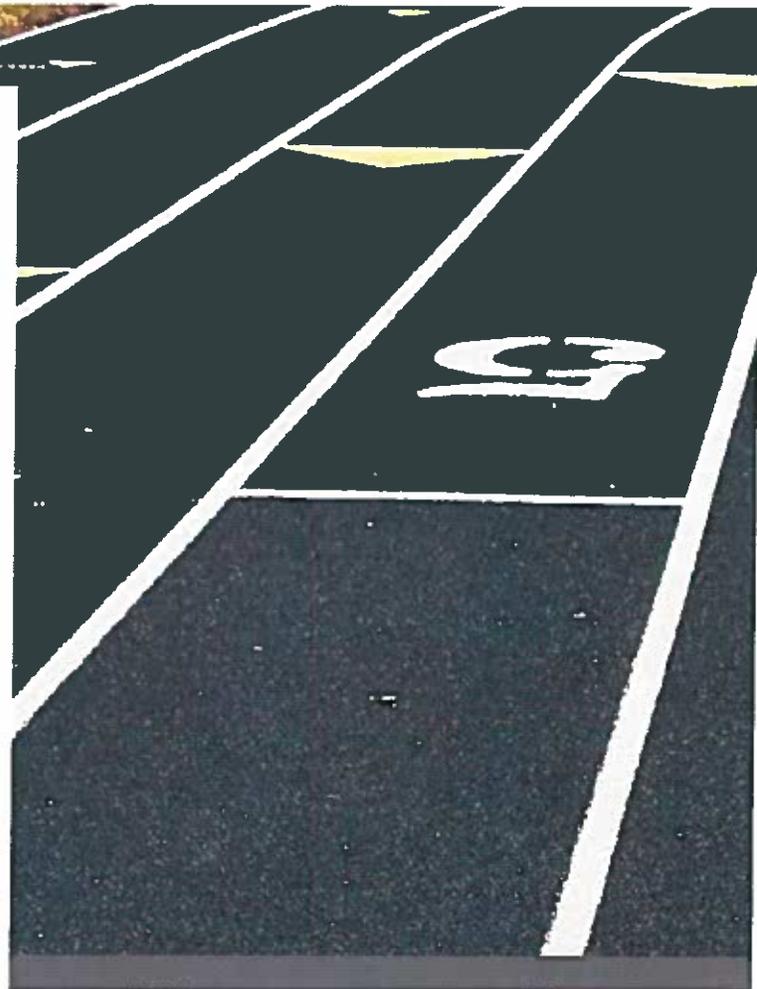
Another news headline in 2015 came from Danny Meyer, CEO of restaurant company Union Square Hospitality Group. Upon evaluating the impact of voluntary tipping and the rising cost of living, Meyer eliminated tipping at his restaurants, implementing a simultaneous price increase to customers to ensure higher employee wages.

As some hospitality companies refresh their current business plan for the market at hand, as illustrated in these examples, or build entirely new business models, they must do so in a highly "stakeholder-centric" way. They need to develop offerings that are not only economically viable, but that also address the value requirements of their customers as well as their investors and employees. Then — and continuously — they must learn: learn to identify, monitor and map these rapidly evolving value drivers for their stakeholders and markets.

Taking an agile approach to the market

In a dynamic business environment, commercial excellence requires providing robust, individualized value propositions, and addressing and responding to needs as they evolve.

Online travel agency Expedia, Inc.'s acquisition of apartment-rental site HomeAway, Inc.'s in 2015 illustrated the company's rapid response to its changing customer demand, while offering the opportunity to expand market share outside of its core competencies. Other examples of market agility are found in product relaunches, such as the recently announced brand refresh initiatives undertaken by Best Western International, Inc., and Starwood's Sheraton brand.

Regardless of your business focus, taking an agile approach to the market involves the interplay of four components:

1. **Business model development:** create value proposition and an associated business model through product development or acquisition

2. **Market access:** optimize your relationships and assets to best enter the market and build a sustainable presence

3. **Concept launch (or relaunch):** optimize your business model through value proposition and communication channels during market entry or reentry phases

4. **Commercial investment portfolio optimization:** conduct analytics to drive transparency around informed investment spend, aligning and synchronizing such activities cross-market, cross-brand, cross-channel and cross-stakeholder group

Developing a strategic business model

Over the past decade, the value proposition within hospitality has evolved from a pure product play (e.g., hotel room, management service) to an experiential proposition, offering a customized level of service and information demanded by stakeholders.

Whether your objective is to achieve growth through scale, capture market share or fulfill unmet customer demand, dynamically developing and refining your business plan – with key stakeholders in mind – remains crucial to achieving success.

The following represents a five-step approach for developing your business model:

1. **Intention:** set framework for your business model; identify themes that fit strategically, define goals and agree on criteria and metrics for filtering ideas; commit resources, including engaging senior stakeholders, and establish a framework for early governance

2. **Investigation:** analyze the market thoroughly; seek insights along customer pathways to better understand the customer environment and inform further decision-making

3. **Conception:** prescreen ideas to determine the most promising and realistic ones; develop a business case and a business model to pilot your new concept or service

4. **Test:** test your new concept or service on the basis of developing strategic partnerships; adapt business models on the basis of customer and partner feedback, and identify projects for scaling up

5. **Implementation:** scale up successful pilot projects and deploy across selected markets

As hospitality companies understand what drives value for their stakeholders – then align their value propositions and commercial models to changing market dynamics – they will achieve commercial excellence.

2

Capital flow from Asia

How does global investment impact your local portfolio?

Cross-border capital flow from Asia into global lodging markets is anticipated to continue to increase. For the 11 months ending November 2015, overseas capital accounted for 35% of global hotel investments, with Asian investors representing approximately 33% of these transactions.[1] Investors are attracted by the higher property yields and safe investment environments abroad, such as those in North America, Europe and Australia, as opportunities in their domestic markets have declined due to demand and supply issues. This trend has resulted in Asian cross-border hotel transactions reaching US$11.0 billion by the end of November, a 24.0% increase from the same period last year.[2]

Asia's sovereign wealth funds and insurance companies, particularly those from China, have invested heavily in high-profile assets in gateway cities. As of November, China remains the most active Asian hotel buyer in 2015, accounting for 44.7% of total invested capital from Asia, followed by Singapore at 16.7% and South Korea at 15.6%.[3] In four years, China's cross-border hotel investment volume increased from US$240.5 million in 2011 to US$4.9 billion as of November.[4] Much of this growth is attributed to high-profile investments, such as Anbang Insurance Group's US$1.95 billion acquisition of the Waldorf Astoria Hotel in February 2015 and Sunshine Insurance Group's US$230.0 million acquisition of the Baccarat Hotel in May 2015, both located in Manhattan.[5] This trend

is anticipated to continue into 2016 as Chinese insurers are far from reaching their 15% overseas investment ceiling for all asset types, which was set in 2012.[6] According to a statement from the China Insurance Regulatory Commission in 2015, capital invested in overseas markets accounted for just 1.4% of the total assets in China's insurance industry.[7]

Due to intensifying competition in gateway markets, such as Manhattan, San Francisco and Sydney, Asian investors are beginning to enter other markets in search of higher yields. In 2015, a variety of companies in China, Thailand and Singapore have acquired large global hotel portfolios, many of which are focused on the limited-service sector and located in secondary and tertiary markets.[8] Asset acquisitions remain the primary hotel investment vehicle for Asian investors, with hotel development or redevelopment rarely a stand-alone strategy into overseas markets.
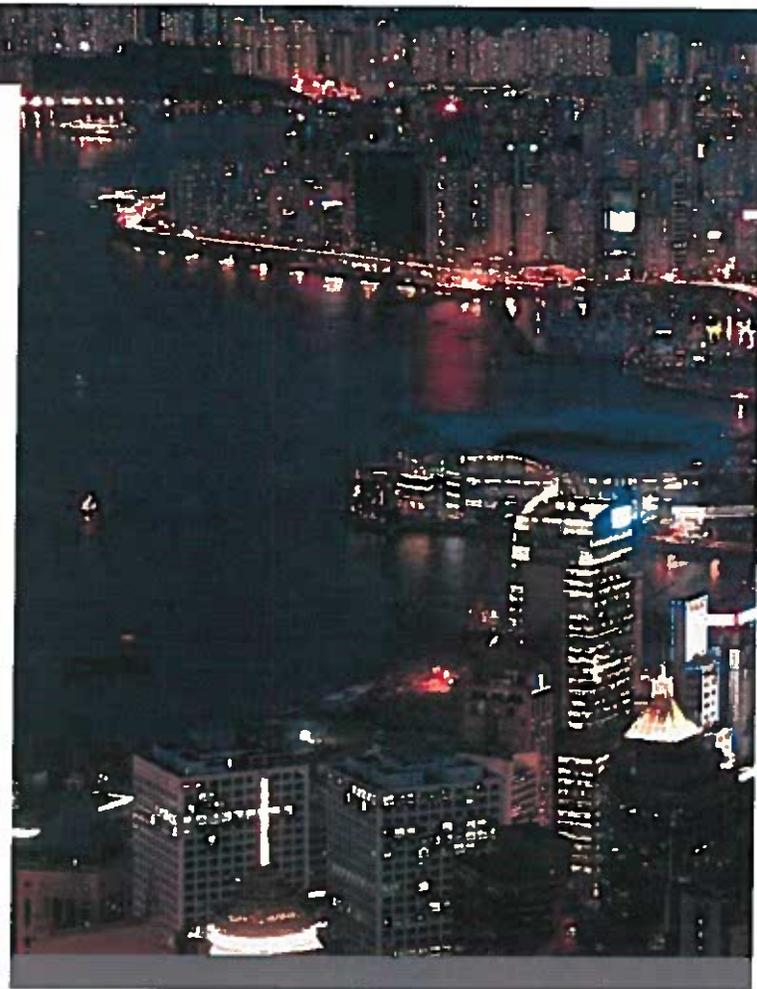
1. "Trends & Trades, Fourth Quarter 2015," *Real Capital Analytics*, 8 December 2015.
2. "Cross-Border Capital Tracker," *Real Capital Analytics*, November 2014, accessed 8 December, 2015; "Cross-Border Capital Tracker," November 2015, *Real Capital Analytics*, 21 December 2015.
3. "Cross-Border Capital Tracker," November 2015, *Real Capital Analytics*, accessed 21 December 2015.
4. "Cross-Border Capital Tracker," November 2011, *Real Capital Analytics*, accessed 21 December 2015; "Cross-Border Capital Tracker," November 2015, *Real Capital Analytics*, 21 December 2015.
5. "Property Details – Baccarat Hotel," *Real Capital Analytics*, 5 November 2015; "Property Details – Waldorf Astoria," *Real Capital Analytics*, 5 November 2015.

6. "Chinese Insurers Expected to Make $73B in Cross-Border Real Estate Deals," *Mingtiandi*, http://www.mingtiandi.com/real-estate/china-real-estate-research-policy/chinese-insurers-expected-to-make-73b-in-cross-borderreal-estate-deals/, accessed 8 December 2015.
7. "State Council Routine Policy Briefing," *State Council of the People's Republic of China*, 23 January 2015, www.scio.gov.cn/32344/32345/32347/20150123/index.htm, accessed 5 November 2015.
8. "Bestford Capital," October 2015, *Real Capital Analytics*, 5 November 2015.
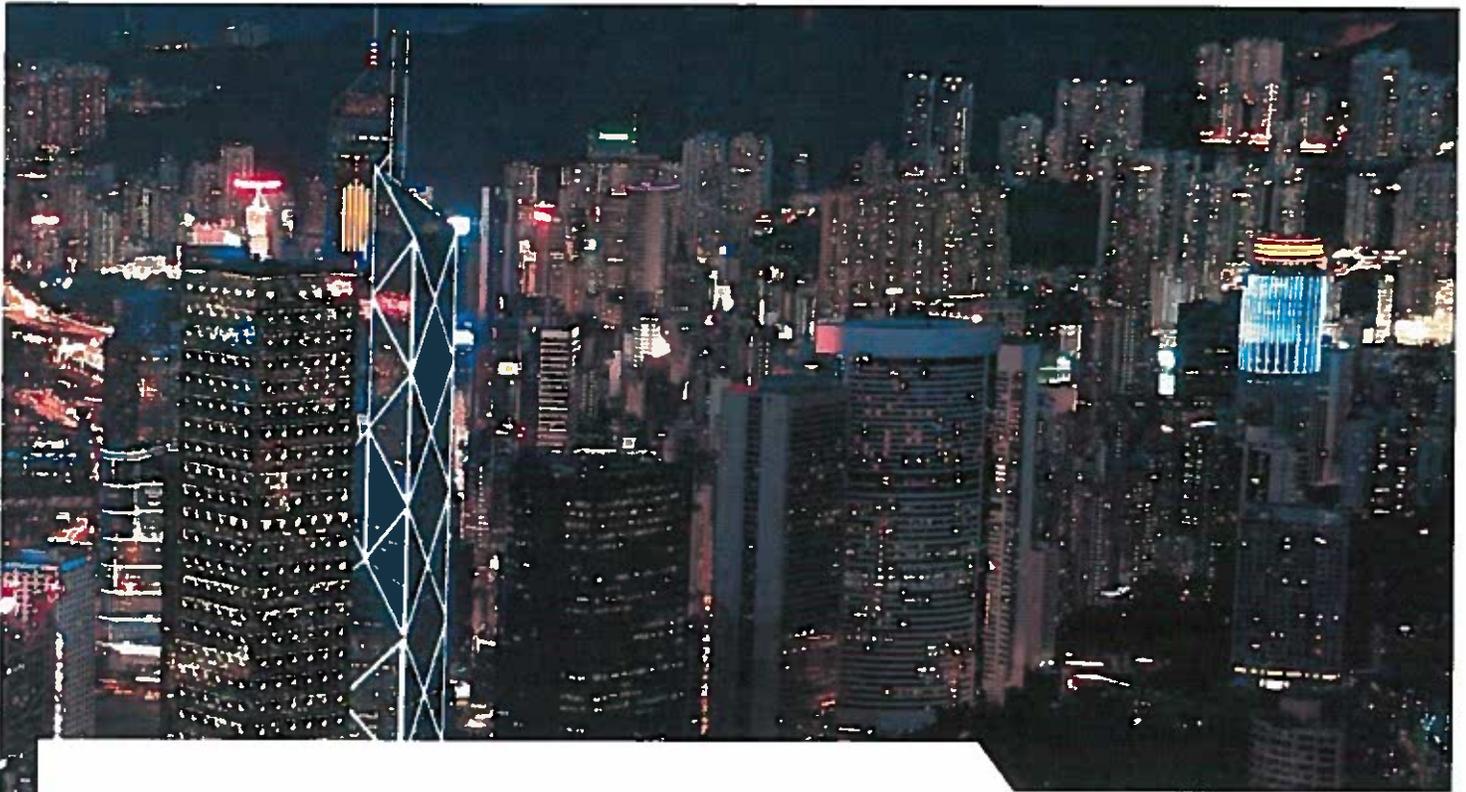
In addition to asset acquisitions, Asian companies have entered into joint ventures and platform-level investments to maximize expansion resources and build immediate brand recognition. During 2015, two Shanghai-based companies made European acquisitions. Fosun International Limited acquired the remaining interest in Club Med that it did not already own, which is valued at US$1.1 billion, and Jin Jiang International Hotels (Group) Company Limited acquired Louvre Hotels Group, Europe's second-largest hotel group, for US$1.4 billion.[9] Meanwhile, Wanxiang Group Corp., a Chinese auto-parts maker, formed a joint venture with US-based Geolo Capital to acquire more than US$1.0 billion of US hotels.[10]

While transaction activity remains strong, a key concern is how China's recent currency devaluation will affect outbound investment,

not only from China, but also from other Asian countries. China's unexpected policy change resulted in neighboring countries, such as South Korea and Singapore, to adjust their exchange rates as well.[11] A weaker yuan makes acquiring businesses in the United States and other Western countries more expensive, which some claim may potentially slow cross-border transactions. In spite of this risk, many experts conversely believe that a declining yuan will boost outbound investment. This is because investors are expected to continue buying overseas properties as a hedge against slowing domestic demand, which makes foreign low-risk assets with stable returns increasingly attractive.

With their greater focus on cross-border investment, Asian investors are likely to continue being major players through 2016. Although the past five years have witnessed capital disbursed primarily into major gateway cities, the crowded nature of these markets is now steering interest toward secondary markets. This broadening reach is not only a sign of growing maturity in Asian investors, but an indication of a movement from strategic to financially motivated acquisitions. With higher investment from Asia anticipated, both domestic and international investors must evaluate the impact of increased competition in both primary and secondary markets in years to come.

9. "China's Fosun Wins Bidding For Club Med After Two Years," *BBC*, , www.bbc.com/news/business-31432322, 11 February 2015, accessed 5 November 2015; "Shanghai Jin Jiang to Buy France's Louvre Hotels Group," *The Wall Street Journal*, 15 January 2015, www.wsj.com/articles/shanghai-jin-jiang-to-buy-frances-louvre-hotels-group-1421298939, accessed 5 November 2015.
10. "Geolo Capital, Wanxiang Group Corp. to Invest in U.S. Hotels," *Hotel Management*, 17 August 2015, www.hotelmanagement.net/investment/geolo-capital-wanxiang-group-corp-to-invest-in-us-hotels-3230, accessed 5 November 2015.

11. "China's Yuan Move Could Reignite Asian Currency Wars," *Bloomberg*, 11 August 2015, www.bloomberg.com/news/articles/2015-08-11/china-s-devaluation-shock-seen-reigniting-currency-wars-in-asia, accessed 5 November 2015.

3

Capital markets: trends in equity, debt and emerging financing platforms

Will your next investor be from another hemisphere, or just a click away?

Supported by strong hotel operating fundamentals, an abundance of capital and rising investor confidence, global hotel investment continues to accelerate. In November 2015, EY's *Global Capital Confidence Barometer*, a biannual survey of global industry executives, indicated that confidence in the global economy is robust, with 50% of hospitality companies likely to pursue an acquisition in the next 12 months. With increased hotel investment anticipated in 2016, investors must evaluate the current transaction landscape, as well as the equity, debt and emerging and alternative financing platforms available, to achieve their growth strategy in the year ahead.

Equity financing

In 2016, prominent sources of equity capital and transaction activity will be generated by private equity and cross-border investor groups.[1] After raising capital early in the current cycle, these US and European investor groups will continue to transact on large portfolios and high-quality assets in gateway markets in the United States, United Kingdom and Europe.[2]

Cross-border investment reached record levels in 2015. Led by outbound capital originating in the United States, China and the Middle East, cross-border hotel investment in 2015 was estimated to exceed US$32.0 billion compared with US$26.0 billion in 2014.[3] Recent currency shifts, however, have affected the direction of cross-border capital flows. A strengthening US dollar, which reached its highest level against the euro since 2003, has contributed to increased

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1. "Hotel Investment Outlook 2015," *Jones Lang LaSalle*, January 2015.
2. Ibid.
3. "Cross Border Capital Tracker," *Real Capital Analytics*, 4 January 2016.

investment in Europe among US hotel players.[4] Over the past three years, US investment in European hotel assets increased from US$2.0 billion in 2013 to an estimated US$6.7 billion in 2015.[5]

Debt financing

Commercial mortgage-backed securities (CMBS) continued to be the largest source of debt for the US hotel sector, comprising 39% of originations in 2015, followed by large balance sheet lenders with 30% of new hotel loans.[6] However, in the fourth quarter of 2015, CMBS lending began to be impaired by widening spreads and increased regulation. In response, balance sheet and nonbank private equity lenders, or debt funds, are anticipated to increase origination in 2016. In Europe, balance sheet lenders remain the primary provider of hotel lending, followed by debt funds and investment banks.[7]

For market participants focused on development, regulatory changes should be kept top of mind in 2016. As lenders implement new capital requirements mandated by the international Basel III standards, the availability and pricing of hotel land acquisition, development and construction financing may be negatively affected in the coming years.[8] Under the new rules, banks are required to hold additional capital for such "high-volatility commercial real estate" loans unless certain equity and leverage requirements are met.[9] In the United States, the so-called "risk retention" rules required by the Dodd-Frank Act may also lead to increased CMBS borrowing costs.

Emerging and alternative financing

As a result, emerging and alternative sources of debt capital such as private equity, hedge funds and even peer-to-peer lending, or crowdfunding, are expected to increase activity through flexible structures and higher loan-to-value ratio loans.[10] Facilitated by recent US legislation and the increased use of technology, crowdfunding is anticipated to increase to US$2.5 billion worldwide in 2015 compared with US$396.0 million in 2013.[11]

Buoyed by the continued expansion of equity, debt and emerging financing platforms, the climate for global hospitality investment activity is forecasted to remain favorable in 2016. Whether your growth strategy calls for acquisitions, development or divestitures, the optimal combination of capital must be evaluated to achieve your investment objectives in the year ahead.

4. "Historical Exchange Rates," *Oanda Forex Trading*, www.oanda.com/currency/historical-rates/, accessed 16 November 2015.
5. "US Federal Reserve Bank, Cross Border Capital Tracker," *Real Capital Analytics*, 4 January 2016.
6. US Capital Trends, Real Capital Analytics, Third Quarter 2015.
7. "European Real Estate Lending Market," *Cushman & Wakefield*, February 2015.

8. *Basel III's implications for commercial real estate*, Financial Services, EY, August 2013.
9. "Bank rules affecting big project loans," *Commercial Mortgage Alert*, 16 October 2015.

10. "Hotel Investment Outlook 2015," *Jones Lang LaSalle*, January 2015.
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4

Creative development trends and the influences behind them

When your next hotel project breaks ground, will it break from tradition?

Urbanization has shaped the past and present skylines of global cities. Today, as people return to the urban core in major metropolitan areas, re-urbanization is not only influencing urban development trends, but also the development of non-urban projects across the globe.

Around the world, the percentage of people living in urban areas expanded from 30% in 1950 to 54% in 2014. By 2050, the United Nations foresees 66% of the world's population living in urban centers driven primarily by growth in developing countries, the preferences of a younger generation to live in the urban core and a heightened focus on making cities cleaner, safer and more walkable places to live.[1]

Today, hotel developers continue to react to the urbanization movement, facing new challenges with increasingly limited development space. Unprecedented demand for both residential and commercial real estate uses has raised already high barriers to entry in urban environments. As a result, hotel developers are employing creative and sophisticated techniques to maximize return in both established and emerging development markets.

Faced with heightened competition for space, hotel developers have implemented adaptive reuse to optimize projects. Hotel developers have converted atypical sites, such as historic post offices and judicial buildings, into adaptable lifestyle concepts with lower conversion costs compared to ground-up development. Examples include hostels, pod hotels and other concepts with flexible branding, such as soft brands that allow for the departure from strict franchise norms. In downtown London, for instance, the unused interior of a historic building was converted into 583 windowless, budget hotel rooms to accommodate strong demand.

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1. "World Urbanization Prospects: The 2014 Revision," United Nations, Department of Economic and Social Affairs, Population Division, 2015.
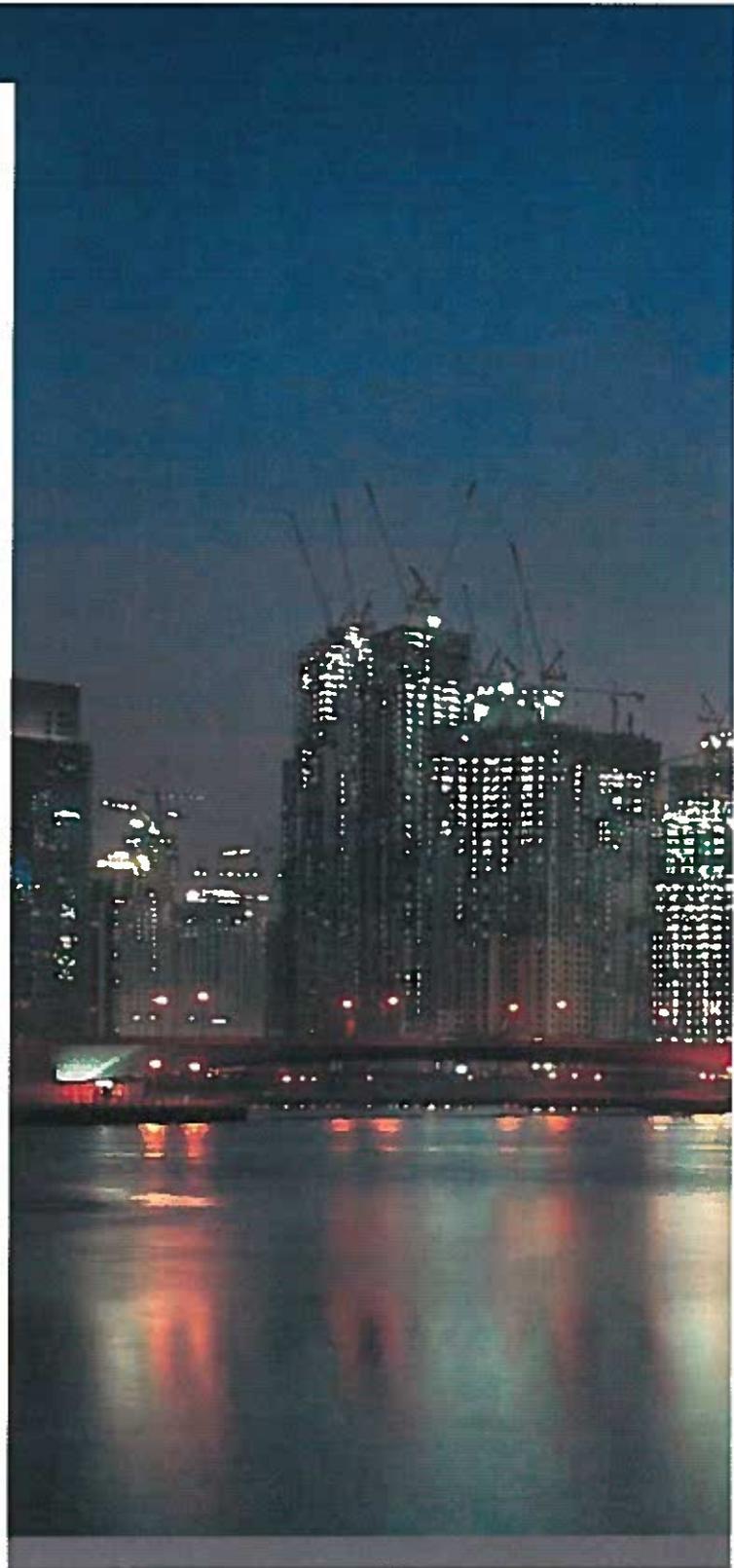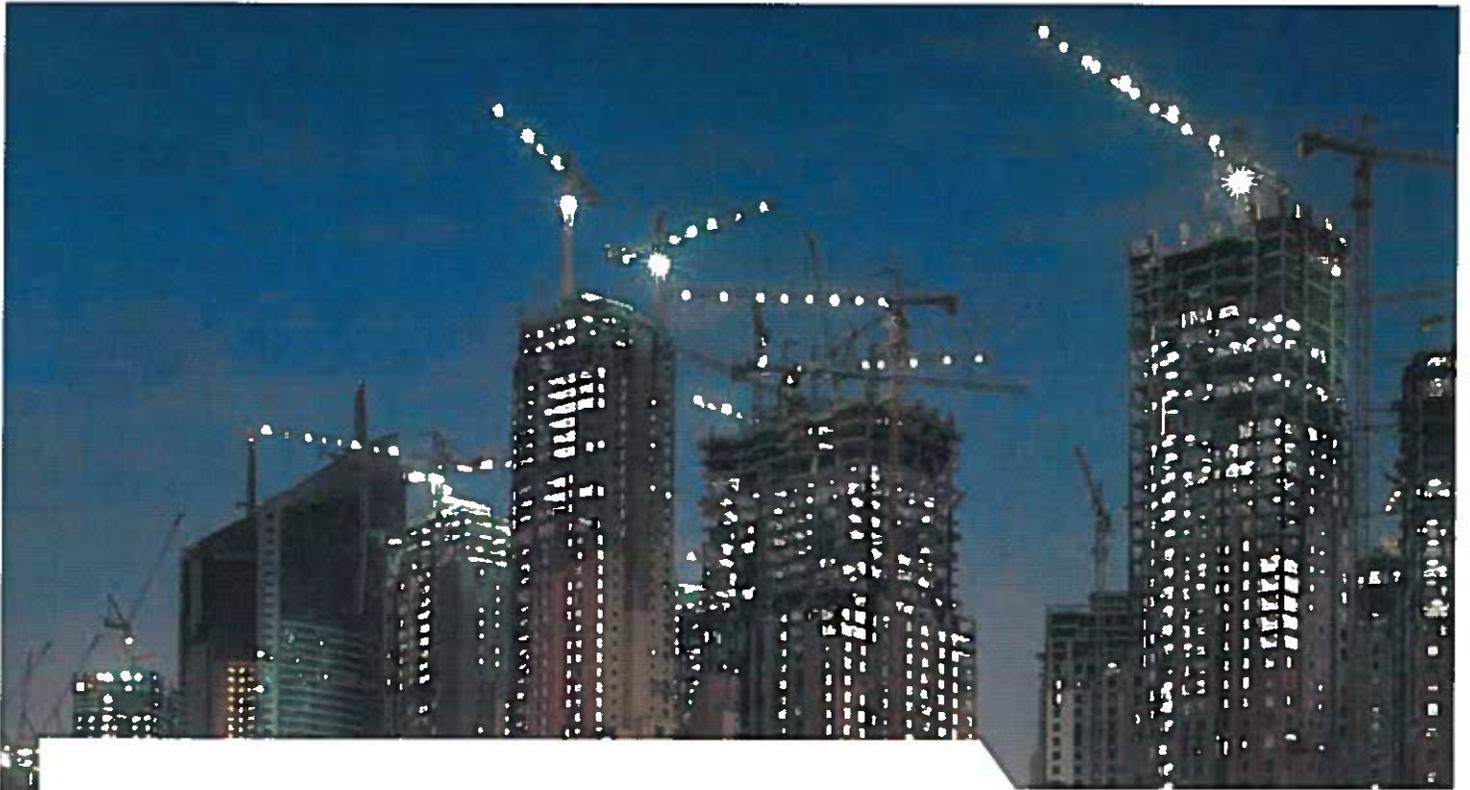
Adaptive reuse has been observed not only within existing hotel markets, but also within rising submarkets, adjacent to established demand areas. Redevelopments in peripheral markets often feature innovative food and beverage options to capture the attention of both local residents and guests.

In developing destinations, such as Brazil, China and Mexico, demand is similarly moving from outer rural areas to metropolitan environments. However, unlike the established urban cores of the United States and Europe, which often restrict development based on zoning and building height, hotel developers generally face less regulation in developing destinations.

Some municipalities have enticed developers, providing financial incentives for both new development and redevelopment projects. In Colombia, for example, 30-year tax exemptions for new and remodeled hotel projects in city centers are being offered through December 2017. In addition, Dubai has waived a standard 10% municipality fee charged on construction permits for three- and four-star hotel developments through December 2017.

Urbanization trends have also influenced global resort markets. In urban resort markets, such as Miami Beach, Florida, older properties are being renovated and converted into new concepts. A recent redevelopment transformed a shuttered art deco hotel on Collins Avenue – a world-famous, upscale street only one block from the beach, featuring hotels, nightclubs and shopping – into a branded resort featuring a world-renowned chef and an underground bowling alley/nightclub, attracting tourists and locals alike.

In non-urban resort markets with a greater supply of development land, the influence of re-urbanization is also evident. In the Caribbean, new development has been focused on hotel and branded residential projects that have a centralized, community feel. In such developments, amenities and services have been focused on core service offerings that attract and gather guests and focus on local, authentic experiences, such as a central beach club, nature-inspired landscapes, health and wellness offerings and local cuisine.

Globally, the complexity of balancing supply and demand with return hurdles call for heightened due diligence for investors pursuing development opportunities. As both everyday living and travel preferences urbanize, hospitality development strategies must continue to adapt creatively to accommodate these demand trends.

5

Merger integration considerations

Are you prepared for a long life together?

The success of a deal largely depends on capitalizing on the value of the target as it is integrated into the acquiring business. A poorly planned integration can hinder a company's ability to realize the synergies and value creation opportunities that justified the transaction and the price paid. The significance of a well-planned integration cannot be overstated.

Industry participants in the hospitality sector are used to the challenges of buying and selling real estate, such as securing franchise agreements, engaging third-party management, financing and leases. However, when it comes to mergers and acquisitions, the unique nature of a given business entity can also pose additional challenges. The combination of two companies with different corporate strategies and infrastructures requires the integration of not just data and systems, but also a merger of cultures and purpose. Research by EY indicates that 85% of failed acquisitions are attributable to the mismanagement of cultural issues.

Challenges

In the course of complex entity-level acquisitions, operational inefficiencies and lack of synergy pose risks that could potentially lead to increased operating costs, business disruptions or loss of key employees and customers. Identifying these problems and executing a mitigation plan against them is vital to appropriately valuing a deal.

Consider these situations:

► Many mergers, which have different operating models, systems and cost structures have to rationalize duplicative non-real estate functions (HR, finance, legal, etc.). Failure to merge systems and harmonize processes effectively can result in higher costs and the presentation of an inconsistent face to the market, which can confuse customers and reduce revenue.

► Increased operating costs, such as labor, rents, collective bargaining agreements and stranded costs when selling companies, can diminish the value of the transaction. Companies need to plan for the additional costs of integration, which can average approximately 14% of total deal value.[1]

► Lack of communication and uncertainty can cause the loss of key employees and customers from both the acquirer and the target. Nearly 47% of key employees will leave within a year of a merger, and 75% within three years.[2] A comprehensive communications and outreach program to internal and external stakeholders before, during and following the transaction can mitigate the loss of talent and customers.

1. *The right combination: managing integration for deal success*, EY and MergerMarket, 2014.
2. Timothy J. Galpin and Mark Herndon, *The Complete Guide to Mergers and Acquisitions: Process Tools to Support M&A Integration at Every Level*, Third edition, Jossey-Bass, 2014.

Key leadership considerations for a successful transition

A successful integration needs to be meticulously planned and execution initiated well in advance of the transaction's closing. Ideally, this will take the form of a dedicated project management office (PMO), where employees and resources are dedicated to the transition, rather than having employees manage the integration alongside their day jobs. Company leadership and the established PMO should:

► Establish an integration management framework early in the process and identify and empower integration leadership

► Establish operating and financial key performance indicators (KPIs), synergy targets and milestones early in the process

► Allocate responsibility for achieving KPIs and targets, monitor continually and evaluate success at predetermined points

► Plan for day one early; many tasks can be started well before closing the transaction to facilitate a smooth transition

at close; these can include establishing legal entities, obtaining consents from interested parties (lenders, lessors, brands, etc.), preparing for financial reporting and controlling cash

Of equal importance to operational planning is the sharing of the organization's strategic vision. To help ensure integration success, leadership must clearly communicate the strategic vision of the newly formed entity – its purpose – to key stakeholders, including customers, employees and partners. Defining organizational purpose creates transparency throughout the integration process, engages stakeholders and informs future decision-making.

The success or failure of a transaction depends on the level of integration preparation and readiness, engagement with key stakeholders and dedicated resources. Companies that recognize the importance of a structured integration are more likely to achieve superior transaction outcomes.

Checklist for a successful integration

|	
Dedicated PMO, appointed and empowered early in the transaction process	✓
Internal and external communication plan	✓
Detailed day one readiness plan set up early to facilitate a smooth transition	✓
KPIs developed well in advance to monitor and evaluate the success of the post-transaction integration process	✓

6

Critical success factors for tourism markets

Is your destination prepared to meet the needs of tomorrow's traveler?

With the global tourism industry in its sixth consecutive year of growth,[1] destinations throughout the world have moved to align their products and experiences with rapidly evolving and complex industry trends. In 2015, destination marketing organizations (DMOs), entities that promote places for tourism, employed a number of strategies to deliver consistent experiences across tourism products, using the power of social media analysis and leveraging the resources of the sharing economy. Given the success, many DMOs have had with these strategies, public and private tourism stakeholders – including economic development agencies, governing bodies and hotel owners and operators – are taking notice and increasingly empowering DMOs to enhance a destination's value proposition.

DMO's focusing on delivering consistent experiences across tourism products have taken into consideration the preferences of different demographic groups. According to the 2015 MMGY Global Portrait of American Travelers®, 47% of millennial travelers reported that their travel destinations represent "who they are," compared with only 34% of Gen Xers and 34% of baby boomers.[2] Customers are increasingly demanding that travel enrich their lives, and be driven by exposure to unique experiences and integration with local atmospheres, as opposed to travel driven by a singular product (e.g., individual hotel or attraction) within a destination.
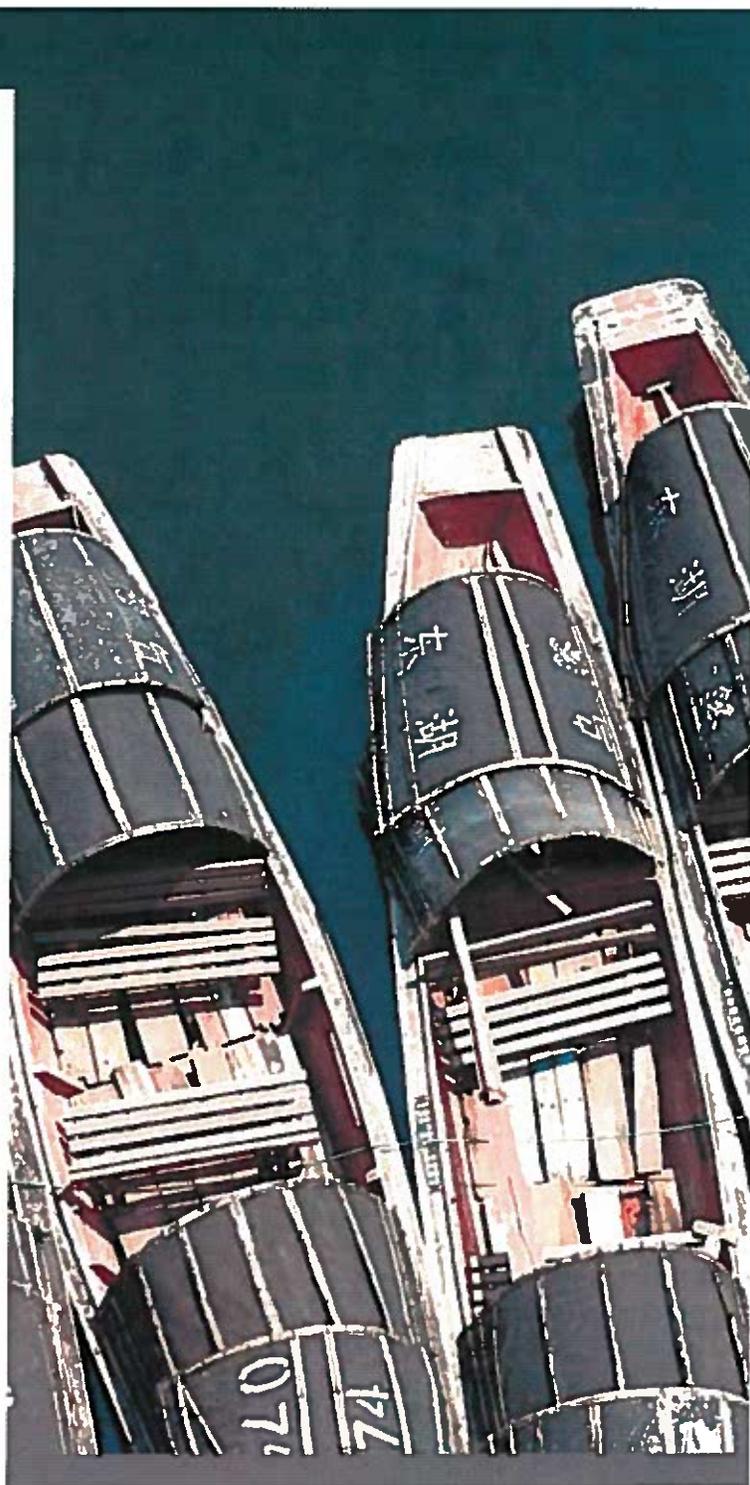
1. "Over 1.1 billion tourists travelled abroad in 2014," *UN World Tourism Organization*, http://media.unwto.org/press-release/2015-01-27/over-11-billion-tourists-travelled-abroad-2014, accessed 10 December 2015.
2. "MMGY Global Portrait of American Travelers®," *MMGY Global*, http://mmgyglobal.com/services/research/portrait-of-american-travelers/MMGY, 2015.

To ensure tourism strategies are aligned with the expectations of different groups of customers, DMOs develop and implement strategies that:

- Define and emphasize a destination's competitive attributes and purpose
- Communicate the destination's purpose to customers in key feeder markets
- Ensure customer experiences align with the destination's purpose across various tourism products

By following this approach, destinations far ranging and diverse as Vietnam, Turks and Caicos, and Las Vegas have successfully elevated their overall customer experience and increased visitation and spend.

Social media platforms have become intrinsic elements of travel and they are an increasingly prominent source of travel information, product recommendations, critiques and sales. They also allow individual customers to share their experiences – both good and bad – with friends, followers and the broader online community.

DMOs in destinations such as Denmark, Mexico and Puerto Rico have increasingly partnered with social media marketing firms to ensure their brands and customer experiences reach their target demographic online. DMOs have also turned to social media data analytics platforms to help them assess their customers' behaviors and preferences. The DMO ultimately communicates this information to stakeholders, such as hotel owners and developers, which enables them to respond quickly to evolving trends and to manage their brand.

Some destinations are now elevating guest experiences through improved integration of technology and promotion of products within the sharing economy. Globally, shared lodging and transportation have in many ways disrupted traditional operating models. As a result, many DMOs are partnering with technology providers to improve the access, experience and affordability of their products and services. Examples include Mexico City,

San Francisco and Philadelphia, which have actively promoted usage of sharing economy companies to increase transportation capacity in areas with limited public transit and to increase lodging supply during peak visitation periods. Empowered DMOs should take central roles in evaluating their destination's unique challenges and be at the forefront of identifying and embracing the growing number of solutions available.

As changing consumer behaviors, innovations in technology and shared economy concepts continue to shape the global tourism landscape, destinations successful at attracting sustained visitation growth will largely be those with empowered DMOs. Granting DMOs the tools, resources and budgets needed to capitalize on key tourism trends and collaborate with public and private stakeholders will be critical to a destination's ability to grow and maintain competitiveness.

# Technology and the innovation agenda

Does your technology platform sustain your business or accelerate it?

Technology continues to play an ever-increasing role in the hospitality sector. It is making a difference from the front of the house, to the back of the house. In fact, hospitality and leisure sector leaders cited technology as one of their businesses' top organic growth strategies in EY's November 2015 *Global Capital Confidence Barometer* survey, and for a good reason: opportunities for growth may exist across many aspects of the product life cycle. In the year ahead, hospitality players should expect further technological advancements to loyalty programs and revenue management strategies (RMS) — and greater adoption of the Internet of Things (IoT).

Loyalty programs

Rigid, points-driven loyalty programs have dominated the travel and hospitality industry for many years, and they have worked well. Today, however, gaining a competitive advantage with those programs appears nearly impossible, as they sit largely outside the type of responsive, personalized customer experience that guests increasingly demand. Ideally, every customer is a loyalty opportunity, with no sign-up or status required.

Accordingly, opportunities for differentiation and growth may exist by breaking the boundaries of traditional "buy-10-and-get-1-free" programs. By using technology such as advanced analytics, RMS and segmentation around customer attributes, organizations have the ability to constantly surprise and delight customers by delivering unexpected rewards to them (e.g., upgrades, refreshments, entertainment and unique experiences). And since organizations can control the issuance of these rewards, they have the ability to minimize their true cost of redemption and maximize their loyalty lift.
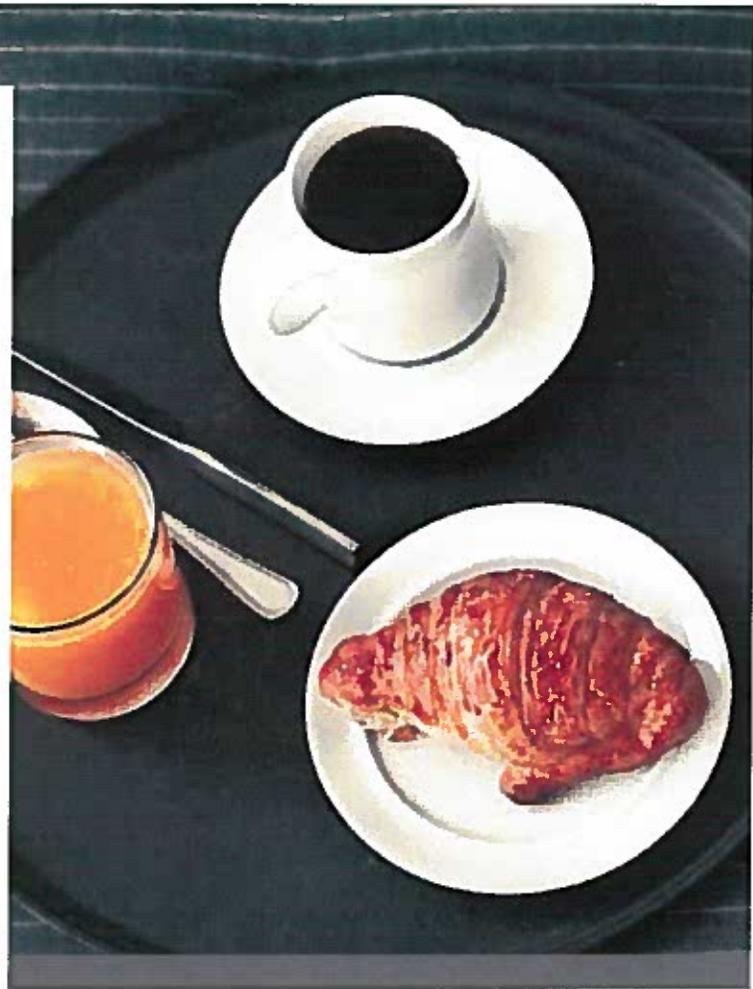
This new paradigm borrows heavily from virtual game concepts, where developers have found that unexpected rewards built into the fabric of the game experience dramatically increase engagement, usage and revenue conversion. This type of "surprise-based" loyalty creates a competitive advantage that is enabled by mobile apps and social media platforms, which in turn act as a large driver for key customer engagement opportunities.

Revenue management

Traditional RMS creates pricing strategies based on the forecasting of demand. While still in widespread use and often considered state of the art, forecast-based pricing misses opportunities to maximize long-term customer value as it focuses on short-term revenue gains.

By failing to differentiate pricing at the customer level, forecast-based pricing may miss opportunities to acquire new customers, build the loyalty program, maximize share in the customer's mind or factor in the full spending of customers during their stay when pricing inventory.
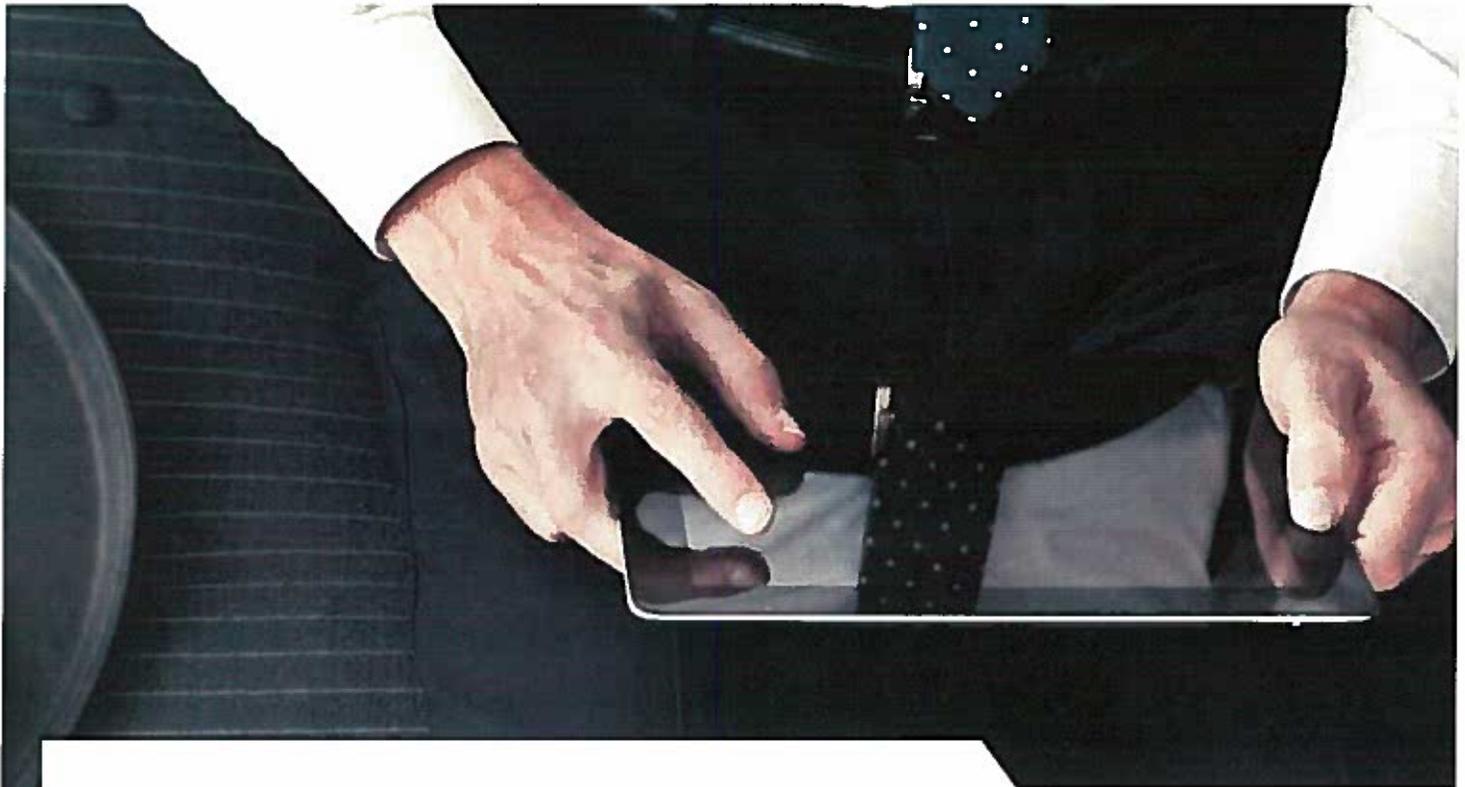
Against this background, hotel companies seeking to optimize revenue management in today's competitive environment should consider the following:

- Data integration across enterprise systems, breaking down data silos and opening up RMS to access and process more complex data feeds in a more flexible fashion

- Upgrades to the RMS software interface to create a more immersive analytical experience within a single window to the world

- Surprise-based loyalty tactics, delivering unexpected benefits to targeted customers

A good RMS may equate to a real-time trading system: a single platform that integrates customer data, forecasting, demand from third parties (e.g., online travel agencies), local event information, market news and advanced visualization and analytic studies within a single window to the world. A powerful RMS that allows analysts to seamlessly put this data to use creates opportunities for better pricing, stronger loyalty and operational improvements.

Internet of Things

Opportunity is on the horizon as hospitality companies adopt the IoT, a network of everyday physical objects or "things" that contain electronics, sensors and network connectivity, which allows them to collect and exchange data. These objects can communicate with each other, increase operational efficiency and enhance the guest experience at the same time. This will allow a number of time-consuming processes to be automated. For example, new smart refrigerators will reorder depleted stock, adjust the temperature as required and notify staff if any parts are not functioning properly. Similarly, a guest's hotel room preferences regarding lighting, temperature and favorite snacks will be recorded to provide a more personalized experience.

As the IoT footprint within the hospitality industry increases, management companies will be able to aggregate and take advantage of experience data. The proliferation of IoT devices is anticipated to create strategic relationships between technology platforms and hospitality companies, as experience data enables users to capitalize on new opportunities and manage new risks.

Embracing innovative advancements in loyalty programs, RMS and the IoT will not only enhance the guest experience, but also drive top- and bottom-line results for hotel owners and management companies. To capitalize on tomorrow's opportunities and position companies for further growth, managers must evaluate their technology agenda today.
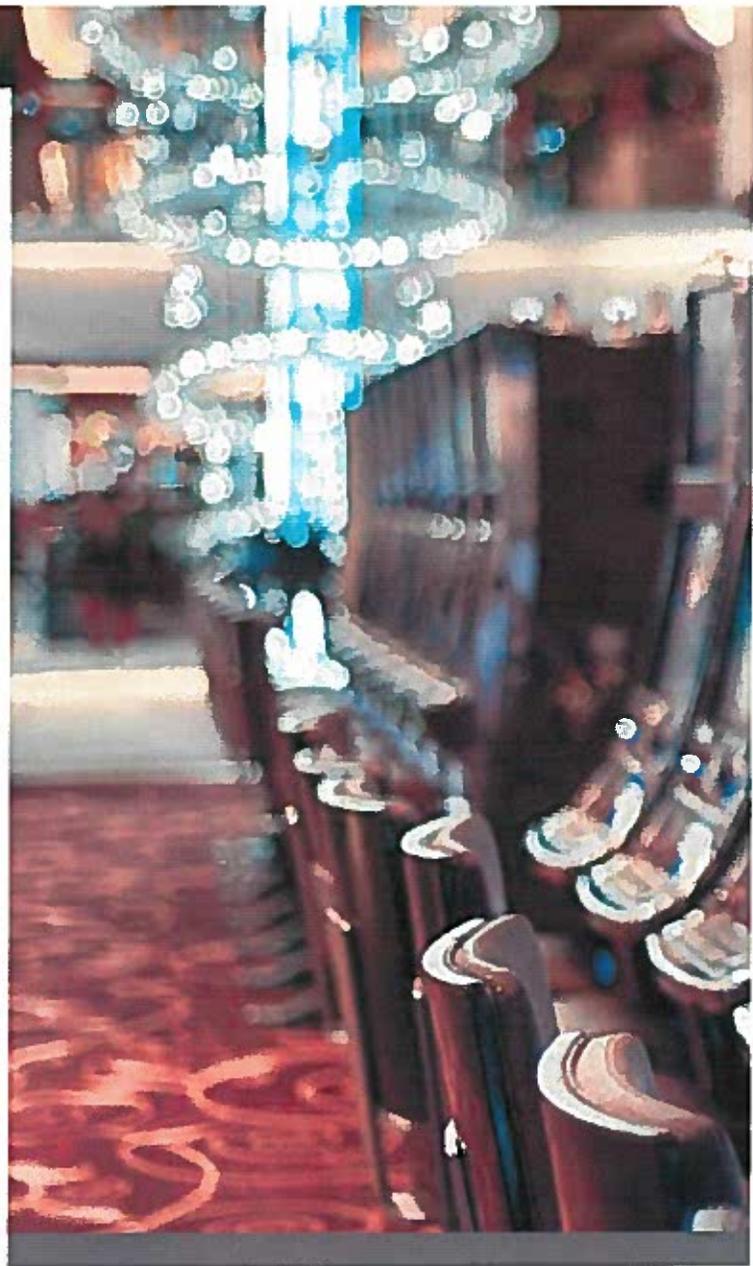
8

Global gaming update

Will you take a chance on the next generation of players?

The global gaming industry is at a turning point. Its traditional customers are growing older, and millennials — individuals born between 1982 and 2004 — have different gaming and entertainment preferences than its traditional customers. Across the world, casino operators are seeking to identify effective ways to evolve and cater to this new tech-savvy and sociable generation.

While young adults in the US, aged 21 to 35 years, the demographic that includes millennials, have higher rates of casino visitation than any other age group (39%),[1] they prefer to spend a significant portion of their time at non-gaming venues, including restaurants, nightclubs and dayclubs. As a result, US casinos have observed a decline in the percentage of total revenue generated by gaming activities and the percentage of visitors who gamble during their stay.[2] For example, the percentage of Las Vegas Strip revenue generated by gaming decreased from approximately 59% in 1984 to 37% in 2014, and the share of Las Vegas visitors who gambled during their stay decreased from 83% to 71% between 2009 and 2013.

Overall, a shift in revenue composition away from gaming activity can be partially attributed to the more limited appeal of slot machines to younger players. While table games continue to attract younger players, the traditional slot machine experience does not generally align with the preferences of these players. These young players are seeking an interactive, social gaming experience where they can use their skills to exert control over outcomes — traits that have contributed to the rapid rise of leisure activities such as video games, online poker and fantasy sports. In contrast, most casinos currently cater to the preferences of a small subset of slot machine players that produces the majority of slot revenues — approximately 40% of slot revenues are generated by 5% of players[3] — players that prefer the traditional slot machine experience.

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1. "State of the States: The AGA Survey of Casino Entertainment," *American Gaming Association*, www.americangaming.org/sites/default/files/research_files/aga_sos2013_rev042014.pdf, 2013.
2. According to the UNLV Center for Gaming Research and the annual visitor profile by the Las Vegas Convention and Visitors Authority (LVCVA) available at http://www.lvcva.com/

3. "Keeping Players in the Game, Breaking the Cycle," *WMS Gaming Inc.*, 2014.

Casino operators have recognized this issue and are attempting to address the challenge of getting millennials onto the casino floor without alienating the traditional core customer. Addressing the issue is critical to the long-term success of the gaming industry, as modern casinos earn approximately 70%-80% of their gaming revenue from slot machines.

The solution is anticipated to include a combination of factors, including casino design, and technological and legislative changes. Casinos are evaluating how to rearrange their floor layouts to enhance the social aspects of slot machine play, and slot manufacturers are investing in the development of games that are more social and interactive. For example, Caesars Entertainment Corporation is conducting confidential tests of a new "casino within a casino" environment in its Las Vegas Strip location. It is observing the reactions of millennials on its novel floor layouts and it is also experimenting with social game features such as displaying leaderboards that feature the high-point players.[4]

Further, the industry is pushing for legislation that will enable slot makers to develop skill-based games – defined as games where the outcome is derived from the player's ability rather than chance – with arcade or video game characteristics. These games are anticipated to broaden the casino's appeal to a wider audience, including the millennial generation. Nevada has been one of the pioneers in the space and is expected to offer skill-based slot machines that integrate arcade-style features by mid-2016. This is an important development for the industry, as newly adopted regulations in Nevada are anticipated to serve as a template for other states. These changes may provide the critical mass needed for suppliers to invest in the content development for skill-based and arcade-style games.

In Asia, casino operators have also witnessed the movement toward skill-based games, albeit to a lesser degree, given the increased focus on table games in destinations such as Macau and Singapore.

Casino operators have recognized the different preferences of millennials and are seeking to meet their needs to remain relevant over the long term. The future success of the gaming industry will depend on the ability of casino operators to evolve to meet the desires of this tech-savvy and sociable generation while maintaining their existing customer base.

4. "Caesars testing 'casino within a casino' to attract millennial gamblers," CalvinAyre.com, 30 September 2015.

9

# Supply and demand: the economics of the sharing economy

Can peer-to-peer benchmarking help you turn up the heat on your competition?

Expedia's $3.9 billion acquisition of HomeAway, a peer-to-peer lodging platform, in November 2015 is a clear indication that peer-to-peer platforms are not just another alternative lodging option. While many concepts are vying for market share, Airbnb, Inc. remains the focal point with more than 1.5 million listings in 34,000 cities in 190 countries and growing.[1]

Current owners and developers in the lodging industry need to ask themselves the following questions:

- How is peer-to-peer inventory affecting my hotel's performance and value?

- Is my hotel adequately protected against the growing supply of peer-to-peer inventory?

- How do I consider peer-to-peer inventory to better understand its potential impact on the feasibility for new lodging developments?

Peer-to-peer inventory continues to grow and is a noticeable share of the total lodging supply in gateway markets. In November 2015, London had approximately 11,000 Airbnb listings alongside its existing inventory of approximately 134,000 traditional hotel rooms, representing approximately 7.6% of London's total lodging market.[2] Despite the considerable supply of peer-to-peer inventory in major gateway markets globally, such units may not affect all hotels equally – it will depend on how each hotel is positioned.

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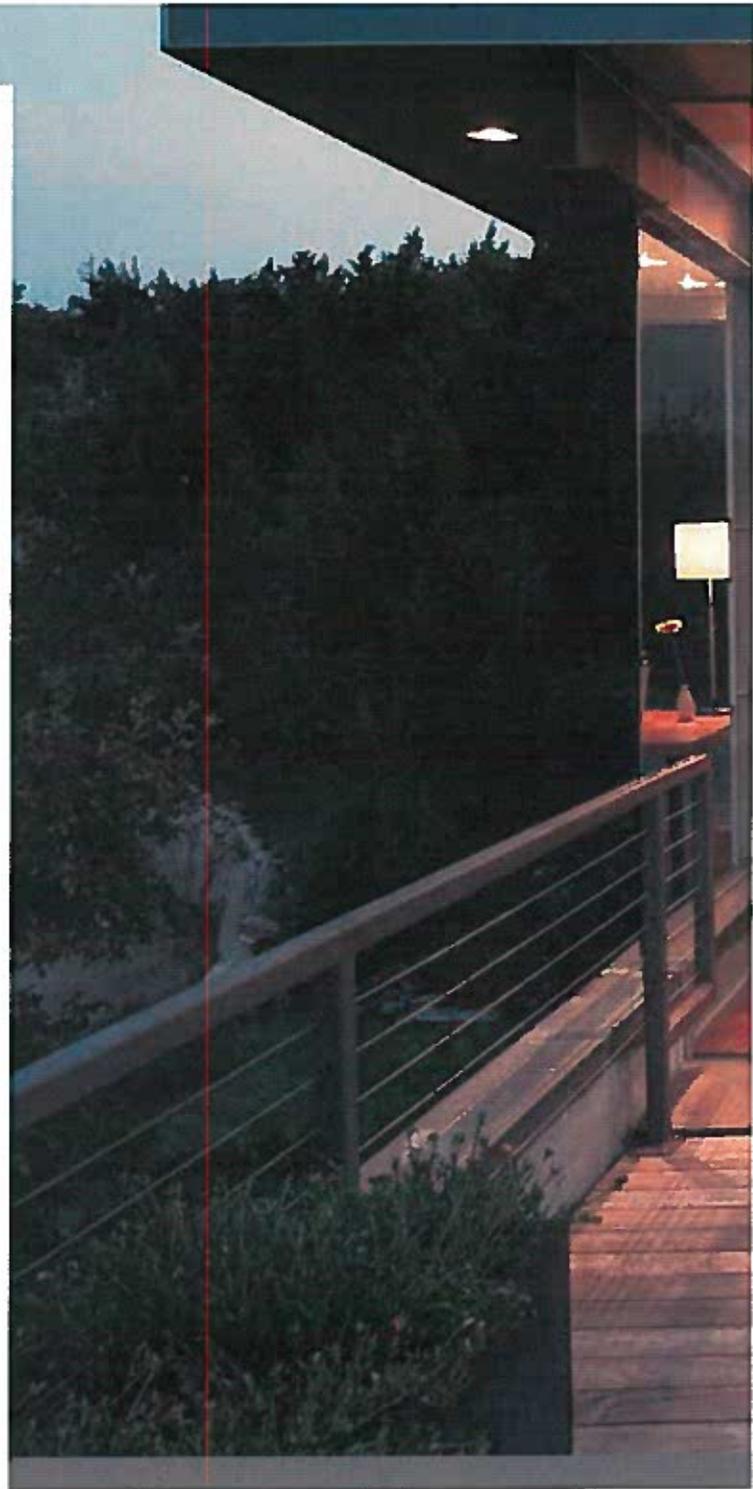
1. "Lodging: The ABCs of Airbnb," *Wells Fargo*, 20 August 2015.
2. "Airbnb and London's competitive landscape," *Hotel News Now*, 4 November 2015.

Peer-to-peer inventory is most competitive with traditional lodging products at lower price points. As the majority of the users of peer-to-peer concepts are leisure travelers, and price sensitivity is relatively greater with them than with business travelers, this results in a greater concentration of lower-priced units. Of the approximately 8,600 competitive Airbnb listings in New York City in May 2015, more than 80% were listed at a price point of less than US$300 per night.[3] Generally, higher-priced hotels, such as those in the upper upscale and luxury segment, appear to be better insulated against the impact of peer-to-peer concepts.

Developers need to consider the existing and proposed housing supply in a submarket to understand the potential impact of peer-to-peer offerings on the local lodging market. In submarkets with a high concentration of residential units but limited lodging supply, a greater share of peer-to-peer inventory is

more likely. For example, Airbnb units comprise approximately 38% of the total lodging supply in Brooklyn, a mostly residential borough of New York City.[4]

In addition to thinking about positioning and location, developers and owners should consider how peer-to-peer inventory affects hotel performance during times of rate compression. It is evident that the elasticity of peer-to-peer supply can result in a significant increase in listings during periods of high demand or major events, thereby impairing hotel operators' ability to fully capture rate premiums. For example, during the Pope's visit to New York City in September 2015, Airbnb sold 20,000 units.[5] Additionally, during the 2014 World Cup in Brazil, a reported 20.0% of the World Cup attendees stayed in Airbnb listings.[6] From September 2014 to August 2015, Airbnb's inventory in New York City ranged from a

low of approximately 308,000 listings in February 2015 to a high of approximately 510,000 listings in December 2014, an increase in supply of 65.6%.[7] This variability in inventory is a key factor in measuring the impact of the flexibility and power of these platforms.

Peer-to-peer concepts are here to stay. As they continue to grow, it is critical for owners and developers to evaluate the potential effect peer-to-peer inventory may have on the performance and value of current and future hotel projects.

3. "Digging to the core of Airbnb's Big Apple data," *Hotel News Now*, 4 August 2015.

4. Ibid.
5. "Hoteliers will lose the Airbnb war," *Hotel News Now*, 16 October 2015.
6. "FIFA World Cup 2014 Makes Airbnb 'Brazil's Largest Hospitality Company,' Spurs Favela Gentrification," *Latinpost.com website*, 10 July 2014.

7. "Airbnb and Impacts on the New York City Lodging Market and Economy," *HVS Consulting & Valuation*, 13 October 2015.

10

Revenue recognition: considerations for an evolving standard

Have you fine-tuned your financial reporting?

Hospitality companies are continuing to evaluate how their financial statements will be affected by the new revenue recognition standard[1] issued by the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) (collectively, the Boards). The new standard will supersede nearly all existing revenue recognition guidance in US GAAP and IFRS. As a result, hospitality companies will need to reassess their policies and practices for recognizing revenue arising from arrangements with owned, managed and franchised properties.

The Boards and the Joint Transition Resource Group for Revenue Recognition (TRG), a group formed by the Boards that includes preparers, auditors, regulators, users, members of the Boards and other stakeholders, continue to discuss implementation issues related to the new standard. These discussions have led to proposed amendments to certain aspects of the standard to make it easier to understand and apply. These aspects include evaluating contract collectibility, identifying performance obligations[2] and accounting for licenses of intellectual property.

In addition, representatives from several hotel operators and large public accounting firms are participating in the hospitality industry task force formed by the American Institute of Certified Public Accountants (AICPA) to discuss the standard's application to common industry transactions. This task force will also assist in the development of a new AICPA accounting guide that will discuss the application of the new standard to transactions within certain industries, including hospitality.

The following points briefly summarize the topics that are being discussed by the hospitality task force and will be addressed in the forthcoming AICPA accounting guide. All hospitality companies should consider these topics as part of their evaluation and implementation of the new standard. They include:

Management and franchise arrangements with hotel owners

- Identifying goods or services promised to a customer (e.g., arranging services for hotel guests; licensing of hotel intellectual property; employment of hotel personnel; access to reservation

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1. The FASB issued the new revenue standard in Accounting Standards Update 2014-09, *Revenue from Contracts with Customers*. The guidance will be codified in Accounting Standards Codification 606, *Contracts with Customers*. The IASB issued the new revenue standard in IFRS 15, *Contracts with Customers*.
2. A performance obligation is the promise to transfer to the customer (1) a good or service that is distinct from other promises in the contract or (2) a series of goods or services that are substantially the same and have the same pattern of transfer.

systems; marketing; and other back office support) that individually, or when bundled with other promises in the contract, represent performance obligations

► Determining the pattern of recognition of variable consideration received in a contract for the services described above, including application of the "constraint"[3]

Revenue arrangements with guests of owned and leased hotels

► Identifying goods or services promised to a customer (e.g., room stays, housekeeping, use of amenities and ancillary services) that individually, or when bundled with other promises in the contract, represent performance obligations

Accounting for loyalty programs

► Evaluating whether the loyalty program customer is the hotel owner or hotel guest

► Determining which elements of the loyalty program (e.g., receipt of payments by hotel owners to fund future redemptions and fees for program costs) represent performance obligations

Sales of real estate encumbered by a management or franchise agreement

► Understanding how the superseding by the new standard of existing real estate sales[4] guidance could change the timing of sale or profit recognition in certain circumstances

Although the Boards recently decided to postpone the effective date of the new standard by one year,[5] hospitality companies should still be actively engaging with their auditors and other advisors to evaluate their existing revenue arrangements and address interpretation and application issues. While some companies may be able to implement the standard with limited effort, others will find implementation to be a significant undertaking.

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3. The new standard allows for recognition of revenue related to estimates of variable consideration (e.g., fees earned based on a percentage of the underlying hotel's revenues, reimbursements based on costs incurred) when it is probable that a significant reversal of revenue will not occur in a future period. The standard uses the term "constraint" to describe the evaluation of whether it is probable that a significant reversal of revenue will occur.

4. ASC 360-20, *Real Estate Sales*.

5. For US GAAP reporters, the standard will be effective for public entities for annual reporting periods beginning after 15 December 2017 and interim periods therein. Nonpublic entities will be required to adopt the standard for annual reporting periods beginning after 15 December 2018. Public and nonpublic entities will be permitted to adopt the standard as early as the original public entity effective date (i.e., annual reporting periods beginning after 15 December 2016 and interim periods therein). Early adoption prior to that date will not be permitted. For further information, refer to ASU 2015-14, *Revenue from Contracts with Customers — Deferral of the Effective Date*.

For IFRS reporters, the standard will be effective for annual periods beginning on or after 1 January 2018. Early adoption prior to that date is permitted. For further information, refer to IFRS amendment to IFRS 15, *Effective Date of IFRS 15*.

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