

FF&E: The Magic Formula for Hotel Operators-a Nightmare for Investors?

Klaus Fidschuster explains the economics of hotel furnishing.

FF&E stands for “Furniture, Fixtures & Equipment”, which roughly covers the entire furnishing of a hotel. Generally, this represents the moveable objects that are placed within the property and could possibly be removed by the tenant.

Based on hotel category, FF&E constitutes approx. 12-16 % of total investment. FF&E is a value driver that should not be underestimated, considering that the interior of a hotel reveals within which category it is positioned. Even more important, however, is the comfort factor, which is decisive for whether a guest accepts an establishment, comes again and even recommends it to others. It is thus surprising that FF&E represents a “black box” in negotiations with operators and project realization for the project developer. Differing perceptions regarding which positions are included in the FF&E budget lead to uncertainties. In order to avoid these, experience has shown that the following approach is useful:

Estimation of costs

Budgets are generally determined based on the requirements set forth by the operator. For a first assessment of the estimated cost dimensions, figures provided by international operators provide valuable approximations. Experience has shown that the following budgets are required for the following categories:

- 4,000-6,000 Euros per room for 2-star hotels
- 9,000-12,000 Euros per room for 3-star hotels
- 15,000-20,000 Euros for 4-star hotels
- Approx. 30,000 Euros per room for 5-star hotels
- At least 35,000 Euros per room for hotels within the high-end segment, i.e. 5-stars plus

There is no upward limit.

The interior furnishings (furniture, fixtures and fittings, decorative elements) constitute approx. half of these budgets.

What is included?

A complete FF&E-budget should include the following aspects:

- Guest room furnishings, including all moveable and non-moveable furniture, decorative lighting and decorative elements such as, for example, curtains
- All design-elements within the guest areas (elevators, restrooms, hallways)
- Complete furnishing of restaurants, bars and conference facilities
- Furnishing of the administrative- and staff areas, as well as equipping of all storage facilities, large kitchen appliances
- Small equipment (glass, silver, porcelain) as well as technical devices for conference facilities and guest entertainment
- Relevant computer equipment (excluding network) and telecoms user-equipment

Based on the definition set forth by the operator, this could also include vehicles and carpeting

Classification of Costs

A classification of costs helps establish whether, for example, furniture is categorized as “Building Structure” (DIN cost type 300 + 400) or as FF&E (DIN cost type 600). This classification is especially important in the case where the operator himself is in charge of the installation of FF&E or carries the budgetary responsibility thereof. In this case, follow-up negotiations are kept at a minimum for all parties involved. In addition, the clear classification facilitates the owner’s negotiations with the general contractor, since categories are fixed. Further, this helps avoid double counts in the budget. Lastly, this activity is helpful in calculating the fees for the interior designer.

Conceptual design – the nuts and bolts!

Experienced consultants will not usually be involved in a project until after the first designs have been discarded. It is a misbelief to assume that a good location speaks for itself. Especially international hotel operators expect even the first exposé to be plausible with regard to location, conceptual design, logistics, room size and F&B. Professional consulting is characterized by its ability to advise on planning issues, independent of potential operators. Several aspects of the hotel type in question are taken into consideration simultaneously. The advantages: it is possible to negotiate with potential operators at the same time. Further, the owner saves time and money, since the design already entails fundamental elements and is thus consistent from the point of view of the operator. This also guarantees that the planned hotel matches the calculations performed in the preceding feasibility analysis.

For financial institutions, the alternative use of the property plays an important role with regard to design. A change of operator should not result in any major investments. A project developer will thus only take into consideration specific operator requests, if these would also be considered appropriate by other operators and would not lead to any dismantling or removal in the case that a new operator takes over.

Interior Design – the crux of the biscuit

The interior design of a property constitutes a great challenge, that should only be tackled by experts. Unfortunately, it is often the case that both developers and operators underestimate the role of the interior designer. Even at an early stage, the interior designer can positively contribute to creating the atmosphere and comfort for a property. For example: If public space is not sufficiently dimensioned, an experienced interior designer can take this into consideration at an early stage of the planning process and can optimally utilize and design the available space. If an interior designer is consulted at too late a stage, the then already committed architectural design can not be changed, so that an optimal allocation of space as the necessary basis for ambiance and atmosphere is no longer possible.

It is also crucial that the interior designer and hospitality consultant have influence on the building specifications. Since essential idiosyncratic elements are entailed within the construction rather than the FF&E budget – including, for example, wall- and floor coverings, ceiling design as well as lighting fixtures – the possibility exists that these will not fit into the overall conceptual design. Thus, interior designers are not merely decorators who arrange furniture within the premises. Much rather, their role is to use approx. half the FF&E-budget – usually approx. 6-8 percent of the total investment – to plan and design what the customer then perceives and for which he is willing to pay the calculated room rate.

Often the operators select the interior designer. In this case, the clear definition of what is to be included in the FF&E budget (rather than construction) helps to brief and guide the interior designer.

Renovations and their perfidies

The outlined approaches to the planning of FF&E for a new development apply to some extent also to the renovation of existing properties. Likewise, the conceptual design is often neglected, despite its relevance with regard to the investment's success. The continuation of an established style with new means and professional advice helps allocate available resources selectively and efficiently. At this point, it should be underlined that FF&E entails not only the standard furnishings but also the communications and IT equipment, large kitchen appliances as well as smaller equipment.

Appropriate accumulation of reserves

Ongoing operations necessitate thinking about the accumulation of a reserve for replacement of FF&E. It is better to separate this money from day-to-day operations, so that it is not used for other purposes. Hotel chains commit owners to set aside an annual reserve for replacement for FF&E and to put this reserve into a separate account, which is historically based on management contracts. Generally, a reserve of approx. 3.5 percent of annual revenues within a representative year of operations is set aside. For luxury- and design hotels, where furnishings are very elaborate or contemporary, this could amount to 5 percent of revenues. As a result of technological advances, these percentages have increased. While 3 percent of revenues sufficed in the past, technological upgrades necessitate approx. one- to two percentage points of additional reserves. In the start-up phase of a hotel, i.e. the first 3 to 4 years, reserves will, respectively, be lower. Generally, in the first year, one percent represents the norm. This is increased by 1 percent per annum until the fourth year of operation.

The concept of committing owners to the accumulation of a reserve for replacement by means of a management contract has been used by hotel investors to commit lessees of a property along the same lines. Thus, the operator must commit to accumulate a reserve on a separate account- i.e. a blocked account, to which both the owner and operator have joint access, at least for larger renovations. This ensures the quality of the furnishings. And the owner avoids unwelcome surprises in the case of an operator change.

There are, nevertheless, cases in which (international) banks - when financing a property - retain the reserve for replacement on an account. In the case of financial distress, as soon as the bank receives control over the distressed property, it is in a position to use the retained funds to rejuvenate the property to then sell or change operators.

Author's Profile

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Checklist FF&E Reserve: Major stumbling blocks**1) Unnecessary renovation activities, i.e. upgrade of FF&E:**

The fact that an FF&E reserve is accumulated every year leads many general managers / property managers into falsely believing that this should be invested in the given year. Thus, especially in the first operating years, unnecessary replacements or improvements are made and financed through the FF&E reserve. As a consequence, the required capital to finance renovation activities that are actually necessary and cost intensive is then not available.

2) FF&E reserve too small in the first operating years:

Within the first operating years, the FF&E reserve is often too small, which makes sense within the context of liquidity. However, in the following years, this reserve should be increased so that it will suffice when renovation activities become necessary in later years.

3) Costs for extensive renovation activities are underestimated:

An FF&E reserve only rarely covers the necessary means to cover extensive renovation activities for older properties. Calculating the expected costs of required activities at an early stage helps budget costs on a timely basis.

4) Underestimating technological change:

Within the context of ongoing technological developments, for the electrical appliances in the guest rooms, such as television-flatscreens, internet connections (i.e. WLAN), etc. a reserve additional to the FF&E reserve should be set aside. One to two percent of revenues – depending on the hotel's positioning and its standard of IT-equipment – are definitely adequate.

A well thought-out and detailed 10-year budget for maintenance and replacements can help avoid these stumbling blocks.

Exemplary FF&E Renewal Schedule

Department		0-5 years	5-7 years	7-10 years	10-15 years	15-20 years
Rooms	Wall Coverings	X				
	Carpets		X			
	Curtains		X			
	Mattresses	X				
	Furniture				X	
	Lighting				X	
	Television Sets			X		
Bathroom	Tiles					X
	Lighting					X
	Controls				X	
	Sanitary Equipment				X	
	Shower Partitions			X		
Wellness	Floor/Wall/Ceiling	X				
	Sauna / Steam Bath			X		
	Pool					X
	Technical			X		
Public Space and	Fitness Equipment		X			
	Wall Coverings	X				
	Carpet		X			
	Moveable furniture		X			
	Fixtures			X		
Back-of-House Areas	Lighting		X			
	Large Kitchen					X
	Floor / Wall					X
Technical Installations	Elevators (interior)				X	
Administrative / Other	Phone Equipment				X	
	IT		X			

Source: HOTOUR GmbH; November 2007