How hoteliers can handle a minimum-wage jump December 15 2015
Hoteliers have several solutions to consider in the face of minimum-wage hikes.

(Photo illustration: Annamarie Hudson)

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CLEVELAND—Over the past dozen years, 23 cities in the United States increased minimum wage above the federally mandated level. Another nine cities have similar legislation pending, and more are expected to follow suit. Meanwhile, government officials, economists and Americans everywhere debate the merits of more than doubling the federally mandated minimum wage from $7.25 to $15.

Because labor cost represents the majority of a hotel's expenses, this issue has significant implications for hotel executives, owners and operators. Hotel & Leisure Advisors' research indicates that a 100% minimum-wage increase could raise a typical full-service hotel's payroll expense by 50%. Assuming this wage increase, hotel operators will be tasked with maintaining guest satisfaction and brand standards while reducing expenses and/or increasing revenue to maintain profit levels.

Impact on a full-service hotel

In our analysis, we used a hypothetical 248-room, full-service hotel with food-and-beverage outlets and meeting space. The employees are non-union.

Hypothetical Hotel Performance & Revenue Assumptions			
Average of all U.S. Full-Service Hotels			
ADR	$166.05	**Avail. Room Nights**	90,520
Occupancy	74.8%	**Occupied Rooms**	67,709
Total Rooms	248		

Revenue Dept.	Total	RevPOR	RevPAR
Rooms	$11,243,073	$166.05	$124.21
Food & Beverage	$3,848,577	$56.84	$42.52
Other/Misc.	$685,892	$10.13	$7.58
Total Revenue	$15,777,542	$233.02	$174.30

Note: RevPOR = Revenue per occupied room. RevPAR = Revenue per available room

Source: *PKF TRENDS In the Hotel Industry USA Edition 2015*

The following table presents the hypothetical hotel's payroll before and after the minimum-wage increase. Theoretically, the minimum wage could increase 100%; however, not all employees will receive a 100% raise. We proportionately increased the wages based on existing pay scale differences at various positions throughout the hotel. We assumed all salaried employees would earn at least $50,500 considering the Department of Labor's issuance of proposed rules that would raise the monetary threshold of all salaried workers exempt from overtime pay from $23,660 to $50,440.

Effect of Hypothetical Minimum Wage Increase on Total Payroll
Typical U.S. Full-Service Hotel

Department	Baseline Hourly Avg. Wage	Baseline Payroll (2)	Hourly Avg. Wage after Min. Wage Increase	Payroll after Min. Wage Increase (2)	% Payroll Increase
ROOMS					
Subtotal/Average without Salaried	$9.26	$1,139,000	$16.58	$2,039,200	79%
Salaried Employees' Payroll (1)(3)		$190,000		$209,000	10%
TOTAL ROOMS PAYROLL		**$1,233,000**		**$2,080,200**	**69%**
MAINTENANCE					
Subtotal/Average without Salaried	$10.00	$160,018	$17.14	$274,241	71%
Salaried Employees' Payroll (1)(3)		$70,000		$77,000	10%
TOTAL MAINTENANCE PAYROLL		**$230,018**		**$351,228**	**53%**
FOOD AND BEVERAGE					
Subtotal/Average without Salaried	$6.94	$930,001	$11.20	$1,500,402	61%
Salaried Employees' Payroll (1)(3)		$245,000		$269,500	10%
TOTAL F&B PAYROLL		**$1,175,001**		**$1,769,902**	**51%**
SALES, MARKETING, AND A&G					
Subtotal/Average without Salaried	$12.11	$230,000	$17.76	$337,400	47%
Salaried Employees' Payroll (1)(3)		$545,000		$599,500	10%
TOTAL SALES, MARKETING, AND A&G		**$775,000**		**$936,900**	**21%**
TOTAL SALARIES, WAGES, & BONUSES		**$3,413,019**		**$5,138,230**	**51%**

* FTE = Full Time Equivalent
(1) Payroll increase assumes 20% for tipped employee hourly wage and 10% for salaried employee wage
(2) Assumes 2,000 hours worked per year
(3) Excludes benefits & payroll taxes

Sources: Hotel & Leisure Advisors and *PKF TRENDS in the Hotel Industry USA Edition 2015*

Overall, our analysis indicated a 51% payroll increase (excluding benefits

Overall, our analysis indicated a 51% payroll increase (excluding benefits and payroll taxes) for the hypothetical subject hotel, which equaled a $25.48 expense increase per occupied room. The impact will be felt across most departments.

The Rooms department incurred the greatest percentage change in labor expenses because these employees' average hourly wage is closest to the current minimum wage.

Food & Beverage department payroll was less affected because a high percentage of the F&B employees are tipped and will not see their hourly wage increase to the federal minimum (although we did include a 20% wage increase for all tipped employees). Restaurant, roomservice and banquet servers will benefit from price increases in the hotel's F&B outlets because tips will increase accordingly.

The Adminstrative & General and Sales & Marketing departments will feel the least impact since the majority of those employees earn a salary. We anticipate salaried positions will be given pay increases to fairly compensate for the broad and significant pay increases (in terms of percent change) for front-line employees.

Maintaining profitability despite payroll increase

If minimum-wage increases are approved and payroll costs increase dramatically, savvy hoteliers will look for ways to mitigate the impact while maintaining guest experiences. At the property level, we identified several ways for hoteliers to increase or maintain profitability, whether or not a minimum-wage increase occurs:

- **Increase room rates.** This solution seems simple and could be achieved in markets where supply growth has been sluggish; however, in markets where supply increases outpace demand growth, rate increases will be challenging.
- **Reduce work hours.** Decrease work hours for hourly employees and hire more part-time employees to prevent overtime pay. Salaried managers could be required to handle more tasks and/or cover shifts normally covered by hourly employees.
- **Change employee benefits for new hires.** Hoteliers could charge a nominal fee for meals, lower matched retirement contributions, require employees to purchase their uniforms, charge for parking or reduce parking subsidies (mainly downtown properties), and reduce paid vacation time. It would be important to grandfather in existing employees to protect employee morale.

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- **Consider outsourcing.** Contract out more jobs to third-party vendors to capitalize on economies of scale. This has become a trend for laundry and valet positions; however, managers could hire a third-party company for additional departments if contracted prices are lower than the cost of operation by the subject hotel.
- **Cross-train employees.** This can lead to more scheduling flexibility, a reduction in the number of employees on payroll and increased productivity. For example, front-desk clerks could be trained to answer external telephone calls in lieu of operating a separate PBX department. This mitigating factor is frequently discussed but rarely properly executed or sustained in the hospitality industry.
- **Charge for complimentary services.** Assess a fee for services not widely used by the majority of guests. For example, hotels that provide complimentary airport shuttle service could charge guests who use the service a nominal fee. An additional example would be charging for extra coffee and tea packets that exceed minimum brand standards.
- **Consolidate positions in which responsibilities overlap.** For example, if multiple properties are managed by the same company and are close to one another, directors of departments such as front office, sales, accounting, housekeeping and maintenance could oversee all properties. This tactic must be carefully strategized to ensure that service is not disrupted and operational efficiencies aren’t compromised.
- **Renegotiate contracts with online travel agencies to increase top-line revenue.** This mitigating factor considers that cost savings cannot only come from cutting operating services that sacrifice guest services. Hoteliers could be more aggressive and take a risk by not relying heavily on OTAs. Another option is to charge guests who book through OTAs a fee to offset the commission expenses.
- **Reevaluate loyalty rewards programs.** Consider devaluing points and increasing the number of points required for complimentary nights. The airline industry has begun to revamp its loyalty programs, making it more rewarding for those who pay higher rates and travel more frequently.
- **Find ways to increase purchasing power with vendors.** The benefit of being affiliated with a franchise or larger management company is the ability to negotiate lower prices on supplies.
- **Invest in sustainable innovation.** This ensures technology increases meet guest satisfaction while decreasing operating costs. For example, mobile applications that allow guests to check in on

their smartphone and use it as their key eliminate wait time in the lobby and require fewer front-desk staff. Virtual concierges reduce the need for guests to engage with employees. Sustainable innovation should allow for some employees to be replaced with technology. It also should be leveraged to enhance the guest experience while finding ways to shift employee productivity to other areas of the hotel.

- **Lease outlets such as restaurants, lounges and gift shops.** This allows operators to generate a steady stream of lease income without the expense of operating the department.
- **Establish sponsorships with other businesses.** Do this to examine ways to help lower the cost of food, supplies, and uniforms. An example is a beverage company sponsoring itself by providing logoed flatware and glassware at no cost.

Ripple effect

Though hoteliers should be able to implement changes that allow them to mitigate the increased labor expenses, unintended consequences could arise.

On the positive side, possible effects include improved employee morale, because the majority of staff members would receive a substantial increase in earnings, and a higher minimum wage would force hotel operators and brands to invest in innovations that could lead to cost savings, possible workforce reductions, increased productivity and enhanced guest services.

However, a hike in the federal minimum wage would produce more neutral or negative effects than positive outcomes, especially when it comes to rates, turnover for salaried employees, development and other factors.

Rates will have to increase at some point. The extent this impact will have on the different hotel segments (commercial, group and leisure) is difficult to quantify but could lead to shortened business trips and vacations, and fewer or shorter conferences and meetings.

Next, the turnover ratio for salaried employees might increase if their benefits are reduced, their hours or job responsibilities are increased or if their wages are not increased proportionally to their hourly subordinates.

Development of dual-branded hotels could increase as investors seek ways to maximize expense savings through shared employees, back-of-house synergies, communal public area amenities and lower development house synergies, communal public area amenities and lower development costs.

Brands that maximize value by leveraging their purchasing power, brand recognition, proprietary systems and lower franchise fee expenses will be more attractive to investors, which could change how brands compete to expand their footprint and which brands may be consolidated.

From a valuation standpoint, if hotel operators are unable to efficiently and effectively manage variable expenses, net operating incomes will decrease, which could result in decreased real estate value. Should falling NOIs become a systemic problem within the industry, financing new developments could become more difficult. Hotel capitalization rates could increase as investors consider increased risks involved with operating such a labor-intensive asset with slim profit margins.

Industry outlook

Hoteliers must consider their guests when deciding which tactics to embrace as they look to streamline operations, increase revenue and reduce labor costs. For example, guests who frequent upper-upscale and luxury hotels and resorts have higher expectations for amenities and service levels—and are willing to pay for them. Hoteliers who cut back on service while commanding the same rates could face pushback.

Conversely, price-sensitive guests who gravitate to the economy or midscale segments do not expect full-service amenities, so dramatically raising rates while providing the same or stripped down offerings might not sit well.

We believe hotel operators will be creative in their long-term approach, even though the transition period might alarm owners and the industry. Although our hypothetical scenario illustrates a worst-case scenario (minimum wage more than doubling at once instead of gradually), it highlights the profound effects a significant minimum-wage increase could have at the property level and on the industry as a whole. We urge hoteliers to prepare for the impacts that pending wage increases could have on their properties and devise strategies aimed at maintaining profitability.

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