WHAT YOU SHOULD CONSIDER BEFORE LENDING TO HOSPITALITY INDUSTRIES
This white paper discusses credit risk considerations for the three most-researched hospitality industries on RMA’S eStatement Studies.

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HOTELS (EXCEPT CASINO HOTELS) AND MOTELS

CREDIT CONSIDERATIONS

ADVANTAGES

Improved demand-side drivers along with a spike in leisure and business travel bring welcome news to the hotel and motel industry. Improved consumer confidence in the economy has increased travel and tourism, helping grow this sector. With limited supply and stronger demand, room rates are increasing, driving up revenue. This demand enhances opportunities for this sector to grow both domestically and internationally.

RISKS

But there are some risks that pose challenges to the hotel and motel industry. Higher costs and expenses related to renovation erode profits. So too does the ubiquitous daily room rate change, which means income in this sector is highly volatile, greatly affecting cash flow and adding pressure to operating margins. Also, as demand increases, it is likely that there will be a new supply of rooms added to inventory. This will affect occupancy rates, particularly in high-travel areas or tourist destinations.

For those exploring growth opportunities overseas, lingering uncertainty such as macroeconomic issues in Europe and political turmoil in South America are concerns. In addition, labor costs including union versus non-union employees and healthcare costs influence profitability in this sector.

FUNDING NEEDS

- Purchasing a property.
- Remodeling.
- New construction.
- Debt consolidation.
- Working capital for ongoing financing needs.
CREDIT RISK ISSUES TO CONSIDER

- How consumer confidence influences profitability in this sector.
- The critical staffing and employment factors that indicate a good business model.
- How the adoption of new technologies can show that a hotel or motel is poised for continued growth in its market.
- What to look for that could indicate the threat of rate compression in the local sector.
- Which type of hotels and motels are poised for the strongest expansion.

FULL-SERVICE RESTAURANTS

CREDIT CONSIDERATIONS

ADVANTAGES

Sales at full-service restaurants have increased recently and economic forecasts show that growth will continue thanks to a strengthening economy. Dining out is one of America’s most popular recreational activities, and that is only likely to increase. In surveys, almost half of all consumers say they’d like to eat out more often. Data indicate that as the economy strengthens, consumer demand for the convenience of eating out will grow in the restaurant industry.

There is also renewed interest in upscale dining by younger consumers and business travelers. For Millennials, restaurants are important social hubs as well as places to eat. There’s also been an increase in international travel to the United States which is expected to continue. Full-service restaurants, particularly in tourist areas, should expect to see increased business generated by those travelers.
Risks

Although sales are increasing, they are modest compared to pre-recession levels. Some industry analysts say consumers are still in a “recession mindset.” They are cautious and continue to look for ways to reduce their spending, which includes eating out. Businesses are also reducing expenses by cutting down on business lunches.

The industry also faces a challenge from rising wholesale food costs and there have been record-shattering prices for food in the commodities markets. Restaurants are also starting to see intensifying competition for employees. As the economy continues to improve, the industry will likely see a higher employee turnover rate. This could drive up labor costs for restaurants.

Consumers are also focusing more on healthy eating, food quality, and local sources for food. They are also more conscious about weight and obesity issues. The Healthy Eating Index—the USDA’s measurement of the quality of Americans’ food choices—is expected to grow in coming years. These trends pose potential threats to full-service restaurants that have not adequately adapted their menus to the farm-to-table movement or the Healthy Eating Index.

Funding Needs

- Equipment.
- New construction or renovation of existing building.
- Rent.
- Promotion.
- Employee wages.
- Licensing.
- Working capital.

Credit Risk Issues to Consider

- How the trends in “casualization” of restaurants and the Healthy Eating Index can impact full-service restaurants.
- How changes in consumer confidence levels influence a household’s expenditures on eating out.
- How government policies and health department regulations affect full-service restaurant operating costs.
- How employment trends impact restaurant expenses.
3 FAST FOOD RESTAURANT OPERATORS

CREDIT CONSIDERATIONS

ADVANTAGES

Compared to other operators in the hospitality sector, the fast food restaurant industry has fared well over the last several years due to the convenience they offer consumers. As the economy recovers and consumer spending increases, revenue for these restaurants is expected to grow. In addition, the quickening pace of society means there will continue to be an almost round-the-clock demand for fast food.

RISKS

However, strong competition within the fast food sector forces operators to keep prices very low to attract consumers, minimizing profits. And, as consumer eating habits continue to evolve, fast food restaurants must alter their menus to meet demand. This often involves working with more expensive suppliers for higher-quality ingredients. To offset these potential threats to revenue, fast food restaurant operators must turn to internal cost controls and explore the benefits of franchising.

FUNDING NEEDS

- Establishing a new location or expanding a current location.
- Food inventory and working capital.
- Marketing capital.
- Replacing or rehabilitating outdated kitchen equipment, fixtures, and furniture.
- Atmosphere/ décor improvements to attract clients.
- Renovating/ training to comply with health department regulations.

CREDIT RISK ISSUES TO CONSIDER

- How consumer preferences and habits affect demand.
- How menu expansion can affect long-term profitability.
- How competition within the sector affects profit.
- The most important criteria to draw convenience-minded clientele.
- How increased consumer spending will positively affect certain types of fast food restaurants.
- Which internal controls can reduce waste and improve profit.
- The benefits of franchising.
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Phone: 800-677-7621
Fax: 215-446-4101
Website: www.rmahq.org

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