

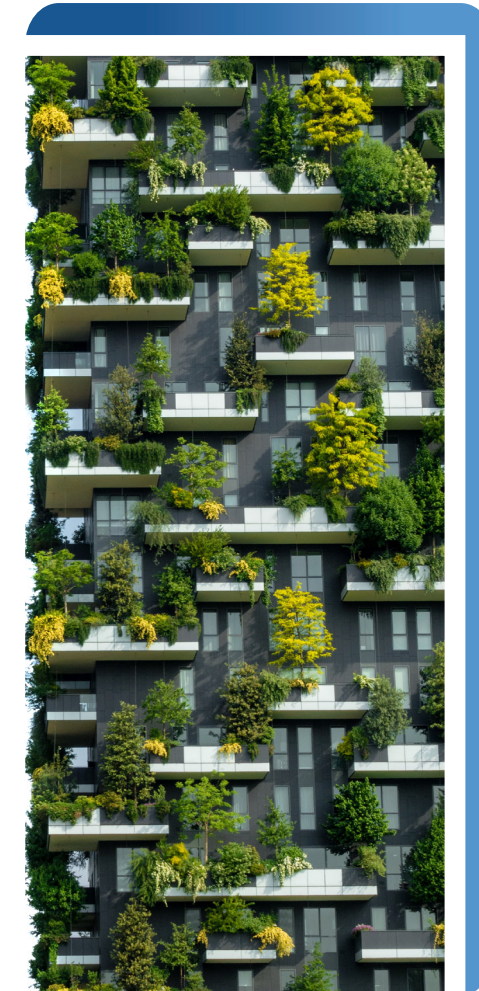
NET ZERO METHODOLOGY FOR HOTELS

2ND EDITION • JUNE 2023

APPENDIX B

HOTEL BUSINESS MODEL IN CONTEXT OF OWNER VS OPERATOR


GREENVIEW



APPENDIX B: HOTEL BUSINESS MODEL IN CONTEXT OF OWNER VS OPERATOR

To determine the approach for decarbonizing a hotel, it is important to note that the **brand of the hotel does not necessarily indicate the hotel's owner or operator.**

The well-known global hotel companies do not own many of their hotels. Several of these chains, such as Marriott International, Hilton, IHG, and Wyndham Hotels & Resorts, own very few. These companies enter into agreements with other entities that own the building (or will own it once it is developed). Then for the day-to-day operation of the hotel, the owner may sign an agreement with the hotel chain to operate the hotel, or the owner may choose to designate a different entity to operate it, in which case the hotel chain enters into a franchise agreement with the other entity operating it. Some of these roles may change over time as a hotel is sold to another owner, ends its management agreement and switches to a different operator, or exits its affiliation or franchisee status.

The differentiated roles by multiple entities for a single hotel create particular challenges in assigning responsibility and allocating emissions. Given the owner/operator distinction, **double counting** commonly occurs for a hotel when both owner and operator report their emissions for the same property. The common practice in hotels is for the operator to use the **operational control** approach of the GHG Protocol, while the owner uses the **financial control** approach.

This is one of many examples where approaches for hotels diverge from general commercial real estate, primarily because of the Hotel Management Agreement (HMA) or lease model where the hotel owner does not operate any of the building or considers some areas under its operation when contracted to a facility management company and "non-tenanted". Publicly traded Lodging Real Estate Investment Trusts (REITs) in some countries, including the US, are also regulated differently and are prohibited from operating a significant threshold of their portfolio in order to maintain tax status as a REIT.

In addition to the double counting issues, this complexity generates various scenarios. For an independent hotel, the same entity may own and operate the hotel. In rare cases, a major hotel chain may own, operate, and brand the hotel. In more cases, the hotel chain will operate the hotel but not own it. In even more cases, the operator will franchise the hotel to a different operator, and the building is owned by an entirely different entity. In the majority of cases for the global hotel chains, they franchise the hotel to a different operator, and that operator is a Small or Medium Enterprise (SME) which also owns the hotel. Figure 3 sets out some scenarios to provide further clarification on hotel ownership structures.

HOTEL OWNERSHIP STRUCTURES

Hotel Owner: the entity which owns the property, responsible for the building and all elements related to it. In some instances the owner will also operate the hotel, but in most examples the day to day operations are contracted out to an operator.

Hotel Operator: the entity which operates the property, responsible for day to day operations. Sometimes this is one of the well-known brands, but in many cases it is a third-party operator who manages the hotel under a franchise agreement with one of the brands.

Franchisor / Franchisee : this is when a hotel is managed under the 'flag' of a particular brand but is managed by a third-party operator. The Franchisor is the brand, the franchisee is the operator who buys the right to use the brand name.

There are many different configurations of the relationship between owners, operators and franchisees. Below are some examples:

Cathedral House Hotel, Glasgow: independent family owned and operated hotel

Radisson RED, Finnieston Quay, Glasgow: owned by Forrest Hotels, managed by Radisson

Holiday Inn Express, Greenock, Glasgow: owned and operated by Starboard Hotels, under franchise agreement with IHG (Holiday Inn Express brand)

Mercure Glasgow City: owned by Alternative Income REIT plc, managed by Jupiter Hotels under a franchise agreement with Accor (Mercure brand)

Hotel Indigo, Glasgow: jointly owned by Heeton Holdings (60%), KSH (20%) and Lian Beng (20%), managed by Interstate Hotels & Resorts under a franchise agreement with IHG (Indigo brand).

The implication of this complexity is that not only will there be double counting and different roles and responsibilities when it comes to decarbonization, it will often be the case that two or more entities will have to share the responsibility for addressing Scope 1 and 2 emissions, and increasingly Scope 3 as the momentum towards net zero increases and expectations grow for companies to address Scope 3. In addition to the basic owner/operator/franchisee role, other scenarios exist that create further complexity. These are set out below.

APPENDIX B

HOTEL BUSINESS MODEL IN CONTEXT OF OWNER VS OPERATOR

ADDITIONAL SCENARIOS OF HOTEL OWNERSHIP

- A hotel whose **operator owns a share of the hotel asset**, which may be a controlling or non-controlling interest
- A hotel that is part of an **affiliation program** that acts differently from a franchise model
- A hotel which is **managed together with a branded residence model**, where the hotel operator is managing the building as a facility but the portion of branded residence is occupied by tenants and the units are not part of its operational control or management of utility efficiency and conservation measures. If under a Triple Net Lease (NNN) structure, the tenant pays all expenses normally attributed to the owner or operator such as building insurance, real estate tax, and maintenance.
- A resort structured in a **vacation ownership model** where an individual owns a unit or a fraction of a unit
- A hotel structured in a **condo-hotel model** where individual units are sold and then may or may not be part of the hotel's operational "pool" available to guests
- A hotel that is **part of a larger building where the hotel occupies several floors** of the building, but is not the building's overall operator or facility manager
- A hotel's **restaurant or other amenities are operated by an entirely different entity**, and may be sub-contracted by the operator or leased by the owner of the building, and have some shared services and utility distribution but different levels of operational control
- A hotel has an **agreement with nearby apartment rental units of a sharing economy model**, where the hotel operates some of the aspects such as linens and cleaning and provides the sales and distribution support.

LINKING HOTEL EMISSIONS WITH AN ENTITY

While the scenarios can be numerous, the key implications for net zero pertain to where the ultimate decisions are made to undertake or invest in actions to reduce GHG emissions. The main points to consider are:

- **There will be inherent "double counting" of emissions** as an owner will be responsible for the emissions using an approach of **financial control**, while the operator will be responsible for the emissions using the approach of **operational control**.¹
- **If the hotel is owned or operated by an entity with a portfolio of hotels**, then while the nuances of specific properties may include unique situations and scenarios, overall they will be relatively insignificant to the total emissions of the entity that are most relevant for stakeholders. The larger the portfolio, the less significant.
- **Capital expenditure (CAPEX) investments** in energy efficient equipment, onsite renewable energy, and other building design that will reduce carbon are generally funded by, and are the decision of, the owner of the building, not the operator. This may be in an escrow account with specific stipulations of a reserve for replacement from which investments should be made in upkeep and improvement of the asset, but are still within the owner's control.
- **Operational expenditure (OPEX) of the hotel** is the responsibility of the hotel operator, usually within annual budgeting processes needing owner approval.
- **Procurement of energy is typically handled by the operator**, but may require owner approval for decisions in energy procurement contracting or as part of annual budgeting of OPEX. This includes the purchase of renewable energy.
- **When a hotel is franchised, it becomes part of the hotel chain's Scope 3**, but the hotel chain is not a decision-maker in either the CAPEX investment decisions of the building and equipment, nor the OPEX components of the hotel's expenses.
- **As a general premise, real estate appreciates in value over time.** Ownership of hotels is cyclical in several ways, which often disincentivizes investment in energy efficiency and decarbonization if not addressed in early stages of development or acquisition, or the terms of equity investors or debt lenders.
- **The ownership of hotels is diverse and fragmented globally and even within any given country.** Many of the owners of branded hotels are SMEs. Some may just be parking money in real estate. This creates difficulty in gaining economies of scale, engaging on the concept of net zero, and achieving reduction decarbonization targets.
- **Pursuing net zero for the hotel industry requires systemic and transformational change** in the strategy, planning, decisions, accounting, and operation of hotels. This change will take time and should be recognized as such, but it should not be an excuse for any entity within the value chain to back down from decarbonization.