Why Casino Hotels Work

by James M. Klas

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Hotels are one of the most valuable ancillary additions to a casino, but also one of the most expensive. It can be hard to swallow the cost of adding or expanding a hotel. It can also be hard to swallow the idea of discounting a hotel room that cost so much to build in hopes of getting more revenue on the gaming floor. Even though hotels have become more common (and larger) at Indian casinos and have been critical to the success of Las Vegas mega resorts for decades, it is useful to look at what each side, the hotel and the casino, gains from the symbiotic relationship.

Hotels affiliated with casinos operate in a different manner from typical, non-casino properties. The hotels are primarily ancillary facilities – they exist to serve casino patrons and boost casino demand. Although, along with other ancillary facilities, they may be designed to be attractions in themselves, they are specifically intended to attract people to spend time and money in the casino.

As a result, casino hotels do not necessarily compete for the lodging demand present in the market area for other reasons. While in many cases such demand may be valuable, at times it is, in fact, counterproductive, supplanting potentially more lucrative casino patrons. This situation is not limited to casino hotels. Hotels catering to corporate business face the same problem in housing conventions, while for convention hotels the converse is true.

Because casino hotels are designed to attract gaming patrons, their primary competitors are other casino hotels, and their success is inextricably tied to the success of the gaming operation. Rooms may be offered at discounted rates, or, for the most lucrative patrons, "comped" entirely. Consequently, the available demand base can be expanded to improve competitive occupancy levels until the point that the incremental gaming revenue generated by the hotel patrons is no longer sufficient to justify greater discounts.

What Does the Hotel Get?

The standard measure of hotel revenue performance is REVPAR (Revenue Per Available Room). While the acronym is not specific, the "revenue" to which it refers is room revenue – more on that later. Mathematically, REVPAR is simply a multiplication of the average occupancy level times the average room rate per night:

Occupancy (%) x Average Room Rate ($) = REVPAR

As you can see, changes in either the occupancy level or the average rate can affect the REVPAR. For example, a hotel that charges $100 per night and has a 50 percent occupancy level has a REVPAR of $50. However, a hotel that charges $50 per night and gets 100 percent occupancy because of the cheaper rate also has a REVPAR of $50. The trick is to find the right rate to charge within that range to get the right balance of occupancy level to maximize the REVPAR.

The relationship is never inversely linear. For instance, if the same hotel charged $75 per night it might get an occupancy level of 75 percent, which would actually yield a higher REVPAR than either of the previous to alternatives, $56.25. But it might only get an occupancy level of 65 percent, yielding a lower REVPAR of $48.75, or perhaps it might even get a higher occupancy and REVPAR. It all depends on the elasticity of demand in the market and the rates and quality levels at competitors.

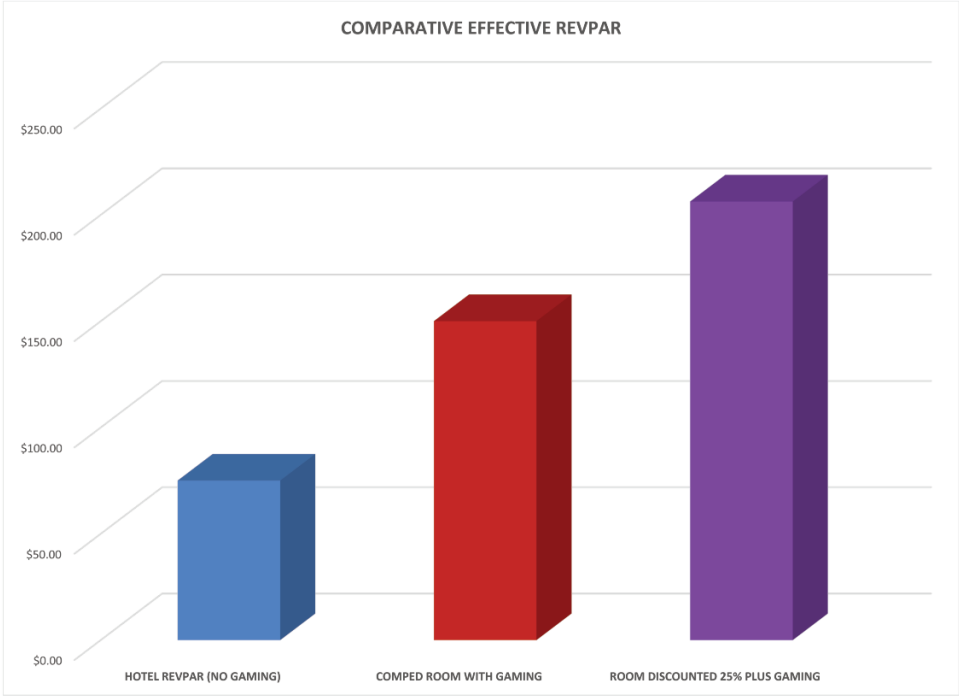
REVPAR only focuses on room revenue. That is because a typical hotel generates the majority of its revenue and the vast majority of its profits from the sale of the rooms. Revenue from other areas – restaurants, banquet halls, gift shops and the like – accounts for a smaller percentage, even when all added together, and typically yields a much lower profit margin. In this way, a hotel is like a casino, and the rooms are the slot machines – most of the revenue and even more of the profits come from them.

But when a hotel is part of a casino, owned and operated by the same entity, the hotel guests can reasonably be expected to generate additional revenue within the casino, revenue that is much more valuable proportionally, and generates a much higher profit margin than anything in a non-casino hotel beyond the rooms themselves. Indeed, for a casino hotel, its like selling one room for the price of two, or even more.

Casino hotels typically generate between $150 and $500 per occupied room per night in incremental gaming revenue for the casino, with most falling in the $200 to $400 range. Thus, if a casino hotel rents a room for $100 night and gets an

occupancy level of 75 percent, instead of a REVPAR of $75, it generates the equivalent of between $150 to $375 per night in REVPAR with the incremental gaming win taken into account. While the incremental gaming revenue goes on the casino's portion of the income statement rather than the hotel's, the complex as a whole benefits as if the hotel was charging three or four times its actual room rate.

That is why it makes sense to discount, or even "comp" entirely the room to a higher value gambler. Even if you deduct the $100 that would have been paid to rent the room, the complex is still anywhere from $100 to $300 ahead of where they would be if they simply sold the room at full fare to someone who did not gamble. The difference is shown graphically in the figure at right.



What Does the Casino Get?

Technically, this question has already been addressed. The casino gets the incremental gaming revenue from the hotel guest, not the hotel itself. However, there is another way to look at the benefit to the casino that brings the true value of the hotel addition into perspective.

While it is not a common term of art in the same way as REVPAR, you can look at the population base in the local market for a casino, and derive a comparable statistic – REVPAG or Revenue Per Available Gamer. The concept is similar in the sense that it tracks the average revenue generated per day, in this case by the local population rather than by the hotel room. It is different, however, in that it is a measure of market penetration on the demand side (per gamer) rather than facility utilization on the supply side (per room).

REVPAG for a given population can be calculated by multiplying the percentage of that population that gambles times the number of visits they make in a year, times the average amount the casino wins during each visit divided by 365 days. The two variables of percentage visiting and number of visits can be combined together into a single "participation rate" that is simply the product of the two. Thus, if 30 percent of the people visit the casino and they visit on average 10 times per year, the participation rate would be three. The mathematical equation for REVPAG is shown below:

$$\frac{\textit{Participation Rate x Average Win}}{\textit{365 days}} = \textit{REVPAG}$$

Across the U.S., the participation rate for local markets generally ranges from between 4.0 and 12.0 with most falling between 5.0 and 10.0. The average win per visit for local markets generally ranges between $35 and $90, with most falling in the $45 to $65 range. As an example, if the market within one-hour of a casino has a participation rate of 7.0 and an average win per visit of $50, then the REVPAG for that market would equal $0.96 (7.0 x 50/365). If that one-hour drive-time area has a total population of gaming age of 100,000, that would mean the casino captured $96,000 per day or approximately $35 million per year in gaming win from that population. Of course, this calculation is structured to assume that the casino is the only one capturing that local demand. If there is more than one casino within that one-hour drive, the casino would only capture a portion of the total.

The effective REVPAG of the hotel guests staying at the casino can also be calculated, but is dramatically higher. Recall that most casino hotels generate incremental gaming revenue of between $200 and $400 per occupied room night. The number of guests staying in an occupied hotel room on any given night generally averages between 1.75 and 2.25. If the casino hotel has an occupancy level of 75 percent with an average of two guests per room and average incremental gaming revenue of $300 per occupied roomnight, then the REVPAG for the hotel guests would equal $112.50 (.75 x 300/2). When you compare that figure to the $0.96 illustrated above for a hypothetical local population, the difference is

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exponential. If the hotel has 100 rooms, that $112.50 equates to $22,500 in incremental gaming revenue per night or $8.2 million per year. If the hotel has 500 rooms, that increases to $112,500 per night or over $41 million per year.

As the examples show, a 500-room hotel attached to the casino could generate more gaming win than having 100,000 people living within a one-hour drive. Indeed, building a hotel adjacent to your casino is the equivalent of having an entirely new city suddenly appear next to your casino in addition to the population in your local market. If there are already too many casinos dividing up that local pie, adding that hotel (that city) directly to your property can make a huge difference.

The particulars of exactly how many rooms will be occupied in your casino hotel and how much those guests will spend beyond what your casino would already be capturing can vary quite a bit from property to property and market to market, as the ranges referenced indicate. However, the general pattern and the order of magnitude of the benefits of adding hotel rooms to your casino where sufficient demand can reasonably be expected does not change. It is easy to see why appropriately scaled and positioned hotels are critical to exceedingly competitive markets like Las Vegas and so valuable to so many Indian casinos around the country. ♣

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