

# Canadian August 2006 Lodging Outlook



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## Don't Overpay For Hotel Sites

Reprint - By: Steve Rushmore, February 2002 - HVS International - New York

**D**eveloping a new hotel is an exercise in balance. The cost of the land, building and furnishings must balance out with the ultimate value of the completed project. If one or more of the cost components is excessive, the entire hotel development might become unfeasible.

In a number of Asian cities, as well as Paris, London and New York, where land costs have been extremely high, it has often been difficult to justify new hotel development because the cost/feasibility balance is out of kilter.

What is meant by feasibility? To achieve economic feasibility, the hotel's value upon completion must be greater than the cost of developing the project. For example, if a 200-room hotel cost US\$20-million to build, it would need a market value upon completion of more than US\$20-million in order to be feasible. No developer would want to have to sell a hotel upon completion at a price less than the money expended to build it, plus a developer's profit.

The acquisition of the site is generally the first step in developing a hotel. Overpaying for land is one of the easiest ways to adversely affect the project's overall feasibility. For example, when the land component in Hong Kong represented more than 50% of the hotel project's cost, it should have been evident this type of improvement would not be viable.

There are ways to check to see how much a particular hotel project can afford to pay for land. The process starts with a calculation of the rooms revenue at the point in time when

the hotel achieves a stabilized occupancy. Using the 200-room hotel example described above, it was estimated that this property would have reached a stabilized occupancy of 72% with an average room rate of US\$85 by its third year of operation. This calculates to a total rooms revenue of:

$$200 \text{ rooms} \times 365 \text{ days/year} \times 72\% \times \text{US\$85} \\ = \text{US\$4,468,000 rooms revenue}$$

The next step is to make a locational adjustment based on the desirability of the site's location. The following percentages provide a range of locational adjustments that will then be multiplied by the projected rooms revenue:

- Highway Location 3% to 4%
- Suburban Location 4% to 8%
- Center City Location 5% to 9%
- Trophy City Location 6% to 10%

Let's assume that the subject property is situated in a good center city location and the appropriate locational adjustment is 7%. The adjusted rooms revenue would be:

$$\text{US\$4,468,000} \times 7\% = \text{US\$313,000 adjusted} \\ \text{rooms revenue}$$

The land value is estimated next by dividing the adjusted rooms revenue by a percentage rate of return that generally approximates the interest rate for local hotel mortgages. In this example, the local hotel mortgage interest rates are 8%. The land value is calculated as follows:

$$\text{US\$313,000} / 0.08 = \text{US\$3,900,000 land value}$$

If the developer is able to acquire the land at a price either equal to or below this value, then the land component is in balance. The developer should proceed with caution if the cost of land is significantly above US\$3,900,000.

A rough rule of thumb for full-service hotels: Land should not comprise more than 15% to 20% of the project cost. For some limited-service and extended-stay hotels, land can represent as much as 20% to 25% of the total cost. In this example, the land component is approximately 19% of the US\$20-million cost, which is on the high side of the acceptable range.

As you can see, a hotel's rooms revenue is the deciding factor in this approach for balancing the land cost component. If a developer is faced with an out-of-balance land cost, the two logical options are to increase the number of rooms (if zoning and market conditions permit) or enhance the quality of the facilities and service so the property is able to achieve a higher average room rate (again if market conditions permit). These adjustments are evident in the Asian markets with their high land costs. There is an over abundance of 5-star hotels and practically no 2- or 3-star properties.

While location, location, location is considered one of the primary traits for a successful hotel, the economics of the land acquisition cost is an important factor that must be balanced before proceeding with a new hotel development. ♦

**CANADIAN LODGING OUTLOOK**  
**HVS INTERNATIONAL - CANADA**

August 2006	Number of Rooms	Occupancy Rate (%)		Average Room Rates (\$)		RevPAR (\$)		Room Supply % chg	Room Demand % chg
		2006	2005	2006	2005	2006	2005		
Nova Scotia Area	1,084	81.2%	79.8%	\$109.64	\$99.47	\$89.03	\$79.38	2.0%	3.8%
Halifax, NS	3,297	84.0%	83.2%	\$131.07	\$129.22	\$110.10	\$107.51	2.4%	3.4%
Montreal Downtown	9,171	81.1%	81.0%	\$151.65	\$155.82	\$122.99	\$126.21	2.7%	2.9%
Montreal Area	4,949	74.0%	76.7%	\$104.65	\$101.80	\$77.44	\$78.08	0.4%	-3.2%
Quebec City, QC	3,749	83.8%	85.3%	\$153.78	\$157.06	\$128.87	\$133.97	0.0%	-1.8%
Quebec Area	5,445	71.5%	69.5%	\$129.49	\$124.89	\$92.59	\$86.80	1.0%	3.9%
Toronto Downtown	13,422	79.0%	77.3%	\$183.79	\$155.16	\$145.19	\$119.94	0.5%	2.7%
Toronto North/East	6,157	79.7%	76.2%	\$121.58	\$112.61	\$96.90	\$85.81	3.2%	7.8%
Toronto Airport/West	7,960	73.2%	71.0%	\$110.67	\$110.85	\$81.01	\$78.70	5.9%	9.2%
Ottawa, ON	6,359	70.6%	66.1%	\$125.22	\$122.11	\$88.41	\$80.71	0.0%	6.8%
Ontario East	4,030	76.6%	74.0%	\$115.44	\$110.72	\$88.43	\$81.93	0.3%	3.9%
Windsor/ Ontario SW	2,957	56.2%	60.2%	\$98.45	\$98.22	\$55.33	\$59.13	1.1%	-5.6%
London/ Kitchener	5,792	67.5%	64.6%	\$105.15	\$101.01	\$70.98	\$65.25	2.0%	6.6%
Ontario North/ Thunder Bay	1,473	78.2%	81.2%	\$90.23	\$83.58	\$70.56	\$67.87	0.0%	-3.8%
Ontario NC/ Sudbury	3,896	78.0%	77.1%	\$123.89	\$117.60	\$96.63	\$90.67	1.8%	3.0%
Niagara Falls, ON	8,884	86.8%	84.8%	\$179.72	\$174.26	\$156.00	\$147.77	4.0%	6.4%
Ontario Central	2,982	73.8%	71.4%	\$114.50	\$101.40	\$84.50	\$72.40	4.3%	7.7%
Mississauga, ON	5,512	69.9%	62.1%	\$106.62	\$102.35	\$74.53	\$63.56	2.4%	15.3%
Winnipeg, MB	3,845	70.8%	67.3%	\$95.69	\$88.00	\$67.75	\$59.22	0.0%	5.1%
Regina/Saskatoon, SK	4,248	65.6%	69.0%	\$97.71	\$95.30	\$64.10	\$65.76	-1.1%	-6.0%
Calgary, AB	8,435	81.6%	81.4%	\$126.54	\$115.60	\$103.26	\$94.10	0.4%	0.6%
Edmonton, AB	7,015	78.2%	70.4%	\$111.97	\$103.85	\$87.56	\$73.11	1.8%	13.1%
Alberta North Area	2,172	84.9%	83.6%	\$188.04	\$160.91	\$159.65	\$134.52	1.9%	3.4%
Alberta South Area	6,385	78.1%	76.8%	\$171.47	\$173.22	\$133.92	\$133.03	3.0%	4.8%
Vancouver Downtown	7,830	86.5%	88.8%	\$190.16	\$182.82	\$164.49	\$162.34	0.0%	-2.6%
Vancouver/ Burnaby Area	2,284	90.4%	84.1%	\$128.18	\$120.81	\$115.87	\$101.60	0.0%	7.4%
Richmond-Surrey/ East Area	5,629	84.2%	82.4%	\$117.51	\$103.50	\$98.94	\$85.28	-3.5%	-1.4%
British Columbia Area	6,036	68.2%	68.3%	\$135.21	\$130.85	\$92.21	\$89.37	1.8%	1.7%
Kamloops/ Kelowna Area	4,531	81.6%	77.5%	\$126.16	\$121.67	\$102.95	\$94.29	0.6%	5.8%
Vancouver Island	3,496	82.4%	81.5%	\$166.42	\$161.39	\$137.13	\$131.53	0.8%	1.9%
<b>Provinces</b>									
Alberta	24,007	80.0%	77.3%	\$139.97	\$132.24	\$111.98	\$102.22	2.0%	5.5%
British Columbia	29,155	81.5%	80.8%	\$149.81	\$142.82	\$122.10	\$115.40	0.5%	1.4%
Manitoba	4,754	70.8%	66.6%	\$94.51	\$85.80	\$66.91	\$57.14	0.0%	6.4%
New Brunswick	3,502	79.6%	78.1%	\$118.91	\$114.80	\$94.65	\$89.66	0.6%	2.5%
Newfoundland	1,751	84.8%	72.2%	\$132.74	\$118.93	\$112.56	\$85.87	1.1%	18.8%
Nova Scotia	4,381	83.3%	82.4%	\$125.79	\$122.12	\$104.78	\$100.63	2.1%	3.3%
Northwest Territories	66	INS	INS	INS	INS	INS	INS	INS	INS
Ontario	69,424	75.6%	73.0%	\$137.65	\$127.40	\$104.06	\$93.00	2.0%	5.6%
Prince Edward Island	939	84.2%	84.3%	\$138.12	\$129.35	\$116.30	\$109.04	0.0%	-0.1%
Quebec	23,314	77.8%	78.3%	\$137.78	\$139.25	\$107.19	\$109.03	1.1%	0.4%
Saskatchewan	5,717	67.8%	68.6%	\$94.86	\$89.49	\$64.32	\$61.39	-0.3%	-1.4%
Yukon Territory	585	77.0%	75.3%	\$106.43	\$103.65	\$81.95	\$78.05	0.0%	2.2%
Canada	167,595	75.4%	72.7%	\$120.92	\$113.64	\$91.17	\$82.62	1.3%	5.1%

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Canada	167,595	60.4%	59.8%	\$110.25	\$104.77	\$66.59	\$62.65	1.5%	2.5%

## CANADIAN LODGING OUTLOOK HVS INTERNATIONAL - CANADA

### DEFINITIONS

Occupancy:	Rooms sold divided by rooms available.
Room Revenue:	Total room revenue generated from the sale or rental of rooms.
Average Daily Rate (ADR):	Room revenue divided by rooms sold.
Room Revenue Per Available Room (RevPAR):	Room revenue divided by rooms available (occupancy times average room rate will closely approximate RevPAR).

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