

Canadian Lodging Outlook

December 2008



SMITH TRAVEL RESEARCH

What Can Hoteliers Do To Avoid Having The Value Of Their Assets Go South?

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Hotel values are based on two main sets of parameters: cash flows and lending variables. The current economic downturn is negatively affecting hotel cash-flow streams. This coupled with the scarcity of debt is causing hotel values to erode. Currently, the impact on market values is anywhere from 10% to 40%.

The extent of the impact greatly depends on the management's commitment to protecting average rate integrity, particularly in markets with declining occupancies. In Canada today, markets that are dependent on the leisure, manufacturing, and resource sectors are being impacted most severely in terms of decreased room-night demand. The demand for luxury hotels is also shrinking, as commercial travellers are downgrading to mid-tier brands.

To protect average rate integrity, hoteliers must avoid the "heads in beds" strategy, which entails sacrificing rate to shore up occupancy. The competitive price wars that result from this strategy degrade a property's average rate integrity, creating a weaker cash-flow position.

As credit remains constricted, shrinking cash flows mean lower debt coverage ratios (NOI/Debt Service). This translates into greater risk to the lender, which results in lower loan-to-value ratios (LTVs), higher interest rates, shorter terms, and shorter amortization periods. This further impacts the erosion in value.

In today's market, most lenders require a minimum debt coverage ratio of 1.5 to meet their underwriting criteria.

The following example shows how average rate integrity affects market value. Hotel A and Hotel B both have 200 guestrooms, and they both have an occupancy level of 67%.

be subjected to more stringent lending parameters. The resulting market value of \$85,000 per key is 21% less than that of Hotel A.

In other words, a prudent hotelier must safeguard average rate integrity at all costs! Properties that preserve their rate integrity, thereby protecting their cash

Hotel A		Hotel B	
200 Rooms		200 Rooms	
Occupancy:	67 %	Occupancy:	67 %
Average Rate:	\$125	Average Rate:	\$115
RevPAR:	\$83.75	RevPAR:	\$77.05
Interest Rate:	7.0 %	Interest Rate:	7.5 %
LTV:	70 %	LTV:	60 %
Amortization Period:	25 years	Amortization Period:	20 years
Equity Yield:	18 %	Equity Yield:	19 %
Discount Rate:	11 %	Discount Rate:	13 %
Terminal Cap Rate:	10 %	Terminal Cap Rate:	11 %
Value Per Key:	\$107,000	Value Per Key:	\$85,000

Hotel A has maintained its rate integrity at \$125, leading to a RevPAR of \$83.75. This property would have a debt coverage ratio of 1.6 and therefore would be valued using less stringent lending parameters, resulting in a market value of \$107,000 per key.

Hotel B has not maintained its rate integrity and has let its average rate decrease to \$115, leading to a RevPAR of \$77.05. This property would have a debt coverage ratio of 1.4 and therefore would

flows, will find less conservative lending parameters. With a lower perception of risk, acquiring financing or refinancing becomes more favourable. Hotels have higher cap rates than many other forms of real estate. If a property meets the lender's debt coverage ratio "stress test" through its cash flows, more traditional financing should be available. Banks have money to lend, but they are extremely averse to risk.

December 2008	Number of Rooms	Occupancy Rate (%)		Average Room Rates (in \$CAD)		RevPAR (in \$CAD)		Room Supply % chg	Room Demand % chg
		2008	2007	2008	2007	2008	2007		
Nova Scotia Area	1,199	34.3%	31.5%	\$91.69	\$82.88	\$31.45	\$26.11	1.8%	10.5%
Halifax, NS	4,118	40.3%	41.5%	\$113.16	\$111.73	\$45.60	\$46.37	3.7%	0.8%
Montreal Downtown	10,137	41.3%	44.9%	\$129.10	\$129.55	\$53.32	\$58.17	2.3%	-5.8%
Montreal Area	2,247	41.8%	44.9%	\$104.42	\$100.60	\$43.65	\$45.17	0.8%	-6.3%
Quebec City, QC	3,948	44.8%	44.2%	\$125.68	\$120.15	\$56.30	\$53.11	0.0%	1.5%
Quebec Area	4,572	45.3%	45.0%	\$153.30	\$153.50	\$69.44	\$69.08	-0.2%	0.5%
Toronto Downtown	13,902	50.2%	50.9%	\$143.98	\$149.66	\$72.28	\$76.18	0.0%	-1.5%
Toronto North/East	6,912	42.2%	46.9%	\$116.29	\$112.74	\$49.07	\$52.88	2.1%	-8.3%
Toronto Airport/West	8,076	52.0%	54.1%	\$110.56	\$108.12	\$57.49	\$58.49	3.6%	-0.3%
Ottawa, ON	6,902	53.4%	50.3%	\$134.47	\$129.18	\$71.81	\$64.98	2.6%	8.9%
Ontario East	4,534	38.0%	39.7%	\$99.02	\$96.05	\$37.63	\$38.13	0.5%	-3.7%
Windsor/ Ontario SW	2,771	43.1%	44.4%	\$111.12	\$108.42	\$47.89	\$48.14	11.5%	8.3%
London/ Kitchener	2,958	40.5%	44.7%	\$91.17	\$97.42	\$36.92	\$43.55	0.0%	-9.5%
Ontario North/ Thunder Bay	2,171	48.7%	52.4%	\$91.68	\$85.71	\$44.65	\$44.91	-0.3%	-7.3%
Ontario NC/ Sudbury	4,685	37.6%	39.0%	\$103.74	\$98.00	\$39.01	\$38.22	2.8%	-0.8%
Niagara Falls, ON	9,271	37.1%	35.8%	\$129.60	\$130.43	\$48.08	\$46.69	-1.6%	1.8%
Ontario Central	3,759	46.9%	45.5%	\$112.08	\$111.09	\$52.57	\$50.55	1.5%	4.8%
Mississauga, ON	4,597	44.9%	48.4%	\$106.73	\$106.24	\$47.92	\$51.42	-0.9%	-8.1%
Winnipeg, MB	3,410	54.2%	56.3%	\$104.35	\$98.60	\$56.56	\$55.51	0.0%	-3.9%
Regina/Saskatoon, SK	2,352	52.8%	53.3%	\$112.16	\$99.47	\$59.22	\$53.02	3.8%	2.8%
Calgary, AB	8,492	53.5%	53.3%	\$138.84	\$132.58	\$74.28	\$70.67	-0.1%	0.4%
Edmonton, AB	8,552	56.6%	59.7%	\$124.09	\$117.18	\$70.23	\$69.96	4.2%	-1.2%
Alberta North Area	3,145	44.5%	52.6%	\$157.96	\$145.75	\$70.29	\$76.66	4.4%	-11.6%
Alberta South Area	8,300	45.3%	48.5%	\$145.79	\$145.49	\$66.04	\$70.56	3.2%	-3.5%
Vancouver Downtown	8,211	47.2%	54.2%	\$133.11	\$134.93	\$62.83	\$73.13	1.1%	-11.9%
Vancouver/ Burnaby Area	1,676	47.7%	52.5%	\$104.26	\$98.70	\$49.73	\$51.82	-0.4%	-9.5%
Richmond-Surrey/ East Area	3,665	58.4%	60.4%	\$116.69	\$111.06	\$68.15	\$67.08	2.4%	-1.1%
British Columbia Area	5,249	47.4%	53.1%	\$247.84	\$260.59	\$117.48	\$138.37	0.8%	-10.0%
Kamloops/ Kelowna Area	4,578	32.4%	36.6%	\$99.87	\$91.95	\$32.36	\$33.65	0.7%	-10.9%
Vancouver Island	4,478	43.6%	44.2%	\$99.22	\$101.06	\$43.26	\$44.67	1.2%	-0.2%
Provinces									
Alberta	30,654	49.3%	52.0%	\$131.10	\$124.42	\$64.63	\$64.70	2.9%	-2.5%
British Columbia	30,027	42.4%	46.5%	\$122.98	\$121.05	\$52.14	\$56.29	1.1%	-7.7%
Manitoba	4,333	51.9%	54.8%	\$88.10	\$80.16	\$45.72	\$43.93	0.0%	-5.3%
New Brunswick	4,522	32.2%	32.6%	\$99.50	\$89.23	\$32.04	\$29.09	3.4%	2.2%
Newfoundland	1,833	46.8%	43.2%	\$102.86	\$94.38	\$48.14	\$40.77	0.5%	8.9%
Nova Scotia	5,317	38.6%	36.8%	\$108.25	\$107.79	\$41.78	\$39.67	2.6%	7.6%
Northwest Territories	124	INS	INS	INS	INS	INS	INS	INS	INS
Ontario	77,428	42.8%	44.6%	\$112.52	\$109.65	\$48.16	\$48.90	1.3%	-2.8%
Prince Edward Island	949	27.5%	25.6%	\$64.05	\$59.43	\$17.61	\$15.21	-0.6%	7.1%
Quebec	26,126	41.0%	44.3%	\$115.83	\$113.70	\$47.49	\$50.37	1.5%	-6.2%
Saskatchewan	6,457	51.0%	53.7%	\$102.40	\$88.03	\$52.22	\$47.27	1.0%	-4.2%
Yukon Territory	281	INS	INS	INS	INS	INS	INS	INS	INS
Canada	188,051	42.7%	45.2%	\$116.52	\$112.00	\$49.75	\$50.62	1.5%	-4.0%

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Halifax, NS	4,118	66.6%	69.2%	\$130.30	\$127.34	\$86.78	\$88.12	3.1%	-0.7%
Montreal Downtown	10,137	62.9%	66.0%	\$149.79	\$148.71	\$94.22	\$98.15	2.6%	-2.2%
Montreal Area	2,247	55.4%	58.9%	\$105.46	\$102.24	\$58.42	\$60.22	3.7%	-2.5%
Quebec City, QC	3,948	69.4%	63.2%	\$159.48	\$138.13	\$110.68	\$87.30	0.7%	10.5%
Quebec Area	4,572	55.9%	56.1%	\$137.01	\$133.94	\$76.59	\$75.14	-0.2%	-0.7%
Toronto Downtown	13,902	71.5%	70.9%	\$169.53	\$170.30	\$121.21	\$120.74	0.8%	1.7%
Toronto North/East	6,912	61.8%	64.1%	\$119.27	\$117.30	\$73.71	\$75.19	2.8%	-0.9%
Toronto Airport/West	8,076	65.6%	68.4%	\$116.81	\$113.71	\$76.63	\$77.78	2.6%	-1.5%
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Ontario North/ Thunder Bay	2,171	67.0%	66.6%	\$93.79	\$90.10	\$62.84	\$60.01	-0.4%	0.2%
Ontario NC/ Sudbury	4,685	57.5%	57.6%	\$108.32	\$105.32	\$62.28	\$60.66	1.0%	0.9%
Niagara Falls, ON	9,271	56.3%	55.8%	\$137.29	\$141.24	\$77.29	\$78.81	-0.3%	0.7%
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Quebec	26,126	59.2%	61.3%	\$127.57	\$123.08	\$75.52	\$75.45	1.4%	-2.0%
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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).

*If you have any questions regarding this publication please send a message to bmacdonald@hvs.com
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