



SMITH TRAVEL RESEARCH

Brand Conversion: What You Need to Know

By Jason Wight - HVS Canada

The boom years of 2005 through the first half of 2008 are over. Now, instead of developing new hotels or undertaking expansions, hotel operators and owners are trying to maintain the profitability of their existing assets. Hotel owners are seeking solutions to ensure that their hotels weather this economic crisis and come out of it stronger than before. Brand conversion is one option that is picking up steam and will prove to be commonplace in Canada.

The recession is presenting a number of challenges to the hotel industry across the country. With the decline in demand, hotels are facing falling occupancies, declining RevPAR, and the risk of operators cutting their room rates. Depending on the degree of RevPAR decline and the room for cost cutting, owners may find it difficult to service their debt obligations. As margins shrink, it may be even more important that a property capture its fair market share from among its competitors.

Owners seek a franchise for one reason: to improve the performance of the hotel in order to increase the value of the asset. Typically, hotel owners look to place a flag on an existing independent hotel. For a variety of reasons, an owner may also choose to convert a branded hotel from one flag to another. The franchisors themselves want to bring additional assets into their system and increase their visibility in various markets. The benefits

that result from conversion to a brand can be substantial, but these advantages must be weighed against the challenges and costs involved in undertaking the conversion.

Advantages

By converting from an independent to a branded hotel, the hotel's overall exposure, operating costs, and building condition are likely to benefit.

From a front-of-the-house perspective, the hotel will have access to the brand's central reservation system, marketing campaigns, and loyalty programs. All of these serve to increase the property's exposure and desirability, which contribute to improving occupancy.

Being affiliated with a large brand provides opportunities to reduce a hotel's operating costs. Since hotel franchisors have a large number of locations and require that each property have similar linens and amenities, they are able to utilize economies of scale through central purchasing to acquire these items at a reduced cost. Although cost savings can be achieved through a conversion, it is important to determine whether the overall benefits outweigh the total cost of the conversion.

To be affiliated with a brand, a property will have to go through some level of renovation, referred to as a property

improvement plan ("PIP"). The PIP will upgrade and modify the property to meet the standards for the brand so that the property will be consistent with the other hotels within the system. These improvements often give the hotel a competitive advantage within its market and allow the hotel to command a higher room rate.

A new brand affiliation can improve a property's occupancy and average rate and thus RevPAR. Since the market value is based on a hotel's ability to generate a positive cash flow, the lower expenses and increased bottom line will ultimately increase the value of the asset.

Challenges

Although there is a significant upside to converting an independent hotel to a branded hotel, there are potential challenges that may arise from the process.

The physical construction of the asset can limit the number of available brands. Each franchisor has certain property specifications required for its hotels. These specifications potentially involve room size, meeting space, restaurant facilities, or the lobby area. Depending on the brand, these requirements may be fairly flexible or very strict. Because of these building requirements, some brands are more "conversion friendly" than others. Some conversion friendly brands include Doubletree by Hilton, Hotel Indigo from



February 2009	Number of Rooms	Occupancy Rate (%)		Average Room Rates (in \$CAD)		RevPAR (in \$CAD)		Room Supply	Room Demand
		2009	2008	2009	2008	2009	2008	% chg	% chg
Nova Scotia Area	1,199	41.6%	42.3%	\$86.45	\$86.32	\$35.96	\$36.51	1.8%	0.0%
Halifax, NS	4,023	56.6%	56.9%	\$114.24	\$112.81	\$64.66	\$64.19	3.2%	2.6%
Montreal Downtown	9,998	55.1%	52.5%	\$132.65	\$135.51	\$73.09	\$71.14	1.4%	6.4%
Montreal Area	2,247	47.7%	51.9%	\$105.49	\$106.25	\$50.32	\$55.14	0.8%	-7.5%
Quebec City, QC	4,023	61.4%	64.3%	\$127.92	\$135.99	\$78.54	\$87.44	0.0%	-4.6%
Quebec Area	4,524	58.3%	60.4%	\$146.16	\$149.03	\$85.21	\$90.01	-0.2%	-3.7%
Toronto Downtown	14,465	57.5%	61.1%	\$148.12	\$156.08	\$85.17	\$95.36	1.1%	-4.8%
Toronto North/East	6,912	48.6%	55.5%	\$116.92	\$121.52	\$56.82	\$67.44	1.4%	-11.1%
Toronto Airport/West	8,076	63.1%	67.9%	\$118.49	\$120.74	\$74.77	\$81.98	3.6%	-3.7%
Ottawa, ON	7,161	71.8%	73.8%	\$142.67	\$139.79	\$102.44	\$103.17	2.6%	-0.1%
Ontario East	4,591	44.5%	49.2%	\$101.90	\$100.50	\$45.35	\$49.45	0.5%	-9.2%
Windsor/ Ontario SW	2,771	46.0%	48.1%	\$113.46	\$105.19	\$52.19	\$50.60	11.5%	6.8%
London/ Kitchener	2,873	53.1%	59.3%	\$103.21	\$109.63	\$54.80	\$65.01	0.0%	-10.4%
Ontario North/ Thunder Bay	1,963	60.8%	61.5%	\$94.09	\$91.27	\$57.21	\$56.13	-0.3%	-1.6%
Ontario NC/ Sudbury	4,906	44.9%	53.1%	\$101.37	\$99.92	\$45.52	\$53.06	2.9%	-12.9%
Niagara Falls, ON	8,540	38.1%	38.0%	\$125.33	\$121.90	\$47.75	\$46.32	-1.6%	-1.2%
Ontario Central	3,821	48.5%	55.2%	\$115.77	\$116.10	\$56.15	\$64.09	3.4%	-9.3%
Mississauga, ON	4,597	51.7%	59.0%	\$108.78	\$112.89	\$56.24	\$66.61	-2.7%	-14.6%
Winnipeg, MB	3,410	62.8%	68.2%	\$109.74	\$105.54	\$68.92	\$71.98	0.0%	-8.0%
Regina/Saskatoon, SK	2,454	62.4%	71.9%	\$116.71	\$109.59	\$72.83	\$78.80	3.2%	-10.5%
Calgary, AB	8,658	63.9%	66.0%	\$145.60	\$147.42	\$93.04	\$97.30	-1.0%	-4.0%
Edmonton, AB	8,463	70.5%	76.0%	\$123.53	\$124.07	\$87.09	\$94.29	3.5%	-3.9%
Alberta North Area	3,322	51.6%	67.7%	\$145.49	\$137.84	\$75.07	\$93.32	4.7%	-20.1%
Alberta South Area	8,511	52.1%	55.6%	\$132.77	\$127.04	\$69.17	\$70.63	3.3%	-3.2%
Vancouver Downtown	8,146	66.3%	70.8%	\$139.32	\$143.51	\$92.37	\$101.61	2.1%	-4.4%
Vancouver/ Burnaby Area	1,871	59.6%	65.0%	\$107.42	\$105.93	\$64.02	\$68.85	-0.4%	-8.7%
Richmond-Surrey/ East Area	3,993	64.9%	71.4%	\$119.24	\$118.54	\$77.39	\$84.64	2.4%	-7.0%
British Columbia Area	5,550	61.9%	68.8%	\$202.98	\$223.28	\$125.64	\$153.62	1.0%	-9.1%
Kamloops/ Kelowna Area	4,758	41.0%	42.5%	\$102.43	\$94.92	\$42.00	\$40.34	1.3%	-2.3%
Vancouver Island	4,501	57.6%	56.9%	\$99.45	\$96.44	\$57.28	\$54.87	1.7%	3.0%
Provinces									
Alberta	31,128	59.9%	65.3%	\$127.89	\$124.28	\$76.61	\$81.15	2.6%	-5.9%
British Columbia	30,831	53.7%	57.8%	\$120.77	\$121.51	\$64.85	\$70.23	1.5%	-5.8%
Manitoba	4,349	56.6%	61.9%	\$94.82	\$87.66	\$53.67	\$54.26	0.1%	-8.5%
New Brunswick	4,642	44.3%	45.1%	\$100.67	\$97.88	\$44.60	\$44.14	3.3%	1.3%
Newfoundland	1,833	70.8%	55.1%	\$88.19	\$100.09	\$62.44	\$55.15	0.5%	29.1%
Nova Scotia	5,222	49.1%	48.4%	\$107.32	\$106.69	\$52.69	\$51.64	2.3%	4.0%
Northwest Territories	325	64.0%	70.8%	\$167.00	\$143.08	\$106.88	\$101.30	0.0%	-9.6%
Ontario	77,564	49.6%	53.6%	\$115.96	\$116.21	\$57.52	\$62.29	1.2%	-6.3%
Prince Edward Island	949	44.0%	44.6%	\$79.81	\$69.62	\$35.12	\$31.05	-0.6%	-1.9%
Quebec	26,236	51.7%	53.6%	\$118.30	\$119.81	\$61.16	\$64.22	1.3%	-2.4%
Saskatchewan	6,627	63.7%	63.9%	\$102.14	\$93.94	\$65.06	\$60.03	1.3%	1.1%
Yukon Territory	281	INS	INS	INS	INS	INS	INS	INS	INS
Canada	189,987	52.7%	56.0%	\$116.66	\$115.50	\$61.48	\$64.68	1.5%	-4.4%

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Quebec City, QC	4,023	50.6%	52.7%	\$122.83	\$126.39	\$62.15	\$66.61	0.0%	-4.0%
Quebec Area	4,524	53.1%	53.9%	\$141.78	\$144.55	\$75.29	\$77.91	-0.2%	-1.6%
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IHG, Courtyard by Marriott, Radisson by Carlson, and Best Western.

The PIP is another challenge facing owners seeking to convert their property. In the current economy, the thought of spending millions of dollars to bring an asset up to specific brand standards may be hard to stomach. Finding the money to pay for the conversion can prove to be difficult, as many hotel owners do not have the required amount of cash on hand and there is still a limited availability of financing. The magnitude of the PIP will vary depending

on the specific brand, the condition of the asset, and the type of hotel.

The desired brand may not be available if a hotel with that brand is already present in the market. This could significantly limit the brand options for a property, especially if all the surrounding hotels are the same type of product.

Conclusion

Branding an independent hotel can help the property solidify its competitive

position within its market and increase its operating performance in ADR, occupancy, and RevPAR. Before proceeding with a conversion, an owner must know the hotel's market, the desired brand and the brand performance, the costs to convert, and the savings and benefits of the brand. With this knowledge, an owner will be equipped to make a wise decision as to whether a conversion is suitable for his or her property. ▲

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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The Hotel Association of Canada is a federation of provincial and territorial associations, hotel chains and suppliers with a mandate to represent members nationally and internationally and to provide cost-effective services that stimulate and encourage a free market accommodation industry.

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