

Lodging Outlook



HVS



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Who will be the Winners in this Downturn?

By: Carrie Russell - HVS Canada

In this economic crisis, losers abound. Against this dramatic backdrop, the winners appear to be even more exceptional. Let's take a look at who within the lodging industry might actually benefit from this downturn in the cycle.

Kudos to the Canadian Banking System

The conservatism of the Canadian banking system has tempered the effects of the downturn on the Canadian lodging industry as a whole. Criticized in peak times for being overly conservative, Canadian banks are now looking like all-stars on the global stage. Canadian lenders were generally underwriting most deals at loan-to-value ratios well below those of their US counterparts (65% as compared to 80% loan-to-value ratios) with shorter amortization periods (20 vs. 30 years). Although this was frustrating for the overheated development community at the time, it has several key benefits that will dampen the negative consequences of this recession on hoteliers.

The conservative lending environment has held new hotel room supply in check. In the last 16 years, the largest increase in supply noted in Canada was 2.3% in 2000. This recession is clearly having an impact on demand, but for the most part oversupply will not amplify the effect of the recession on Canadian hoteliers.

Because of this conservative lending environment, Canadian hotel owners still have equity in their properties even as hotel values are declining. This is not the case for many hotel owners in the US, who were over-leveraged with first mortgage financing at 80% loan-to-value ratios and mezzanine financing to top that up. A 15% to 20% decline in value results in that equity piece virtually disappearing for US owners.

Developers with Capital

Another winner in today's market will be developers with the capital in place to build through the low point in the cycle and open a year or two from now, when demand should be rebounding. These developers will be benefitting from lower construction costs, which anecdotal evidence points to be 15% to 20% below where they were a year ago, and they will be opening into a market that has virtually no new supply with which to compete. Every developer aspires to be so lucky, but the capital will be a challenge to find in the current debt market unless it is already in place.

Cash is King

Those who have cash are going to reap the benefits of this downturn and find some great deals. We expect that 2009 and 2010 will provide some of the best buying

opportunities since the early 90s. Don't bother looking for fire sales in Canada though, as they aren't likely to happen – blame those conservative banks! Hotel values have declined and buyers will be able to benefit from that, but, as was already mentioned, most Canadian owners still have equity in their hotels, and so they will be much more likely to ride this downturn out than sell at the low point. Further to that, lenders aren't indicating that there are many problem loans on their books, so forced sales will be unlikely. The US is where all the action will be on that front.

Opportunity for Brand Conversions

In the heady days of years past, the brand guys were all about new build, the pipeline was filled with new product, and brands could be very selective about projects and absolutely rigid about brand standards. But times have changed. With the lack of capital available for new hotels, we are going to see the brands much more open to the idea of conversions and much more flexible on brand standards than they have been in the past. Companies that have strong conversions brands and hoteliers with properties ripe for conversion should both be able to benefit.



March 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	1,313	48.1%	51.1%	\$93.96	\$89.74	\$45.19	\$45.86	1.8%	-4.3%
Halifax, NS	4,023	60.3%	61.2%	\$113.86	\$114.35	\$68.66	\$69.98	3.2%	1.7%
Montreal Downtown	9,998	50.4%	47.5%	\$127.67	\$130.31	\$64.35	\$61.90	1.4%	7.7%
Montreal Area	2,361	46.5%	49.6%	\$104.79	\$104.23	\$48.73	\$51.70	0.8%	-5.6%
Quebec City, QC	4,023	50.1%	58.4%	\$114.76	\$115.89	\$57.49	\$67.68	0.0%	-14.1%
Quebec Area	4,530	52.7%	54.9%	\$139.29	\$149.83	\$73.41	\$82.26	-0.1%	-3.9%
Toronto Downtown	14,465	64.2%	63.0%	\$150.17	\$162.64	\$96.41	\$102.46	1.1%	3.0%
Toronto North/East	6,718	49.2%	52.7%	\$114.44	\$118.57	\$56.30	\$62.49	1.4%	-5.4%
Toronto Airport/West	8,076	56.5%	65.8%	\$114.71	\$117.80	\$64.81	\$77.51	3.6%	-11.1%
Ottawa, ON	6,743	62.8%	62.3%	\$132.08	\$129.52	\$82.95	\$80.69	2.6%	3.4%
Ontario East	4,620	45.5%	48.1%	\$103.34	\$100.28	\$47.02	\$48.23	0.5%	-4.9%
Windsor/ Ontario SW	2,771	50.2%	53.7%	\$108.47	\$106.01	\$54.45	\$56.93	11.5%	4.3%
London/ Kitchener	2,747	50.1%	51.6%	\$101.11	\$104.91	\$50.66	\$54.13	0.0%	-3.1%
Ontario North/ Thunder Bay	2,230	62.5%	59.1%	\$94.32	\$92.55	\$58.95	\$54.70	0.0%	5.7%
Ontario NC/ Sudbury	4,760	46.0%	50.7%	\$100.81	\$100.40	\$46.37	\$50.90	2.9%	-6.5%
Niagara Falls, ON	8,619	39.5%	41.9%	\$121.71	\$125.48	\$48.08	\$52.58	-1.6%	-7.2%
Ontario Central	3,924	45.4%	53.9%	\$110.37	\$111.24	\$50.11	\$59.96	3.4%	-13.1%
Mississauga, ON	4,597	52.5%	54.3%	\$108.84	\$110.40	\$57.14	\$59.95	-2.7%	-5.8%
Winnipeg, MB	3,410	66.3%	72.5%	\$109.59	\$111.37	\$72.66	\$80.74	0.0%	-8.6%
Regina/Saskatoon, SK	2,454	65.7%	68.8%	\$119.29	\$107.81	\$78.37	\$74.17	3.2%	-1.5%
Calgary, AB	8,649	65.4%	66.5%	\$144.47	\$143.05	\$94.48	\$95.13	-1.0%	-2.6%
Edmonton, AB	8,955	68.7%	78.0%	\$127.04	\$126.86	\$87.28	\$98.95	3.5%	-8.8%
Alberta North Area	3,245	47.7%	63.1%	\$141.99	\$142.24	\$67.73	\$89.75	3.9%	-21.4%
Alberta South Area	8,544	49.8%	57.7%	\$133.27	\$129.53	\$66.37	\$74.74	2.1%	-11.9%
Vancouver Downtown	8,031	62.6%	68.3%	\$143.60	\$146.21	\$89.89	\$99.86	2.1%	-6.4%
Vancouver/ Burnaby Area	1,997	60.5%	67.3%	\$110.19	\$107.56	\$66.66	\$72.39	-0.4%	-10.5%
Richmond-Surrey/ East Area	3,993	64.3%	68.1%	\$118.61	\$117.60	\$76.27	\$80.09	0.0%	-5.5%
British Columbia Area	5,468	59.5%	67.8%	\$177.83	\$214.20	\$105.81	\$145.23	0.6%	-11.8%
Kamloops/ Kelowna Area	4,909	44.2%	51.1%	\$101.46	\$97.56	\$44.85	\$49.85	1.1%	-12.6%
Vancouver Island	4,278	60.6%	62.5%	\$103.04	\$102.53	\$62.44	\$64.08	1.9%	-1.1%
Provinces									
Alberta	31,762	58.8%	66.6%	\$127.68	\$125.35	\$75.08	\$83.48	2.1%	-10.0%
British Columbia	30,659	54.0%	59.7%	\$118.25	\$122.95	\$63.86	\$73.40	1.2%	-8.5%
Manitoba	4,349	59.9%	68.0%	\$95.70	\$88.20	\$57.32	\$59.98	0.1%	-11.7%
New Brunswick	4,581	46.9%	44.4%	\$105.77	\$99.65	\$49.61	\$44.24	3.3%	9.0%
Newfoundland	1,833	63.7%	56.4%	\$104.21	\$100.82	\$66.38	\$56.86	0.5%	13.5%
Nova Scotia	5,336	54.9%	55.0%	\$108.61	\$107.57	\$59.63	\$59.16	2.3%	2.2%
Northwest Territories	204	INS	INS	INS	INS	INS	INS	INS	INS
Ontario	77,192	49.8%	53.0%	\$115.24	\$115.79	\$57.39	\$61.37	1.3%	-4.8%
Prince Edward Island	949	35.8%	34.6%	\$74.76	\$69.64	\$26.76	\$24.10	-0.6%	2.8%
Quebec	26,386	47.8%	49.4%	\$113.61	\$114.85	\$54.31	\$56.74	1.1%	-2.1%
Saskatchewan	6,536	61.4%	63.1%	\$108.68	\$95.33	\$66.73	\$60.15	1.3%	-1.3%
Yukon Territory	281	INS	INS	INS	INS	INS	INS	INS	INS
Canada	190,068	51.7%	55.6%	\$115.33	\$115.06	\$59.63	\$63.97	1.3%	-5.7%

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Halifax, NS	4,023	52.7%	54.7%	\$112.85	\$113.44	\$59.47	\$62.05	3.2%	-0.6%
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The Strong will Survive: Mid-Market Hotels

Mid-market hotels that are well located, well maintained, and strongly branded are in a good position to ride out this cycle. As expense accounts are cut and discretionary income wanes, there is and will continue to be a trading down from the upscale segment into mid-market properties. In

many cases, brands in the mid-market segment (which include Hilton's Hampton Inn and Hilton Garden Inn, Marriott's Courtyard and Residence Inn, and InterContinental's Holiday Inn Express) are actually gaining market share. The downturn is affecting these properties, but the market leaders are being hurt far less than their competitors.

This Too Shall Pass...

Times are bleak right now, and it is clear that there is more pain to come in the form of declines in occupancy, rates, net incomes, and values. Nevertheless, all cycles have their winners, and this downturn is no exception. ▲

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
Web Site: <http://www.hvs.com>*

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Vancouver Office
Suite 400 - 145 West 17th Street
North Vancouver, BC
Canada BC V7M 3G4
(604) 988-9743
(604) 988-4625 fax

Toronto Office
6 Victoria Street
Toronto, ON
Canada M5E 1L4
(416) 686-2260
(416) 686-2264 fax

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OFFICE:
735 E. Main St.,
Hendersonville, TN 37075
(615) 824-8664



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OFFICE:
Anthony Pollard,
1206-130 Albert Street,
Ottawa, Ontario K1P 5G4
(613) 237-7149