Room rates show steady growth

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Hotels - a stable investment for 20 years

For investors in hotel real estate, the value and the costs are crucial. The obvious question arises: what happened to the value of hotel properties over the past 20 years? Invast hotels, a specialist in real estate investments, has investigated this.

The value of hotel real estate is partly based on the operating possibilities. To determine which trends in real estate values have occurred, one has to look at the developments in the hotel market within the same period. What was the actual room occupancy rate of Dutch hotels in the early ’90s?

Hotelmarket the Nederlands 1990-2010

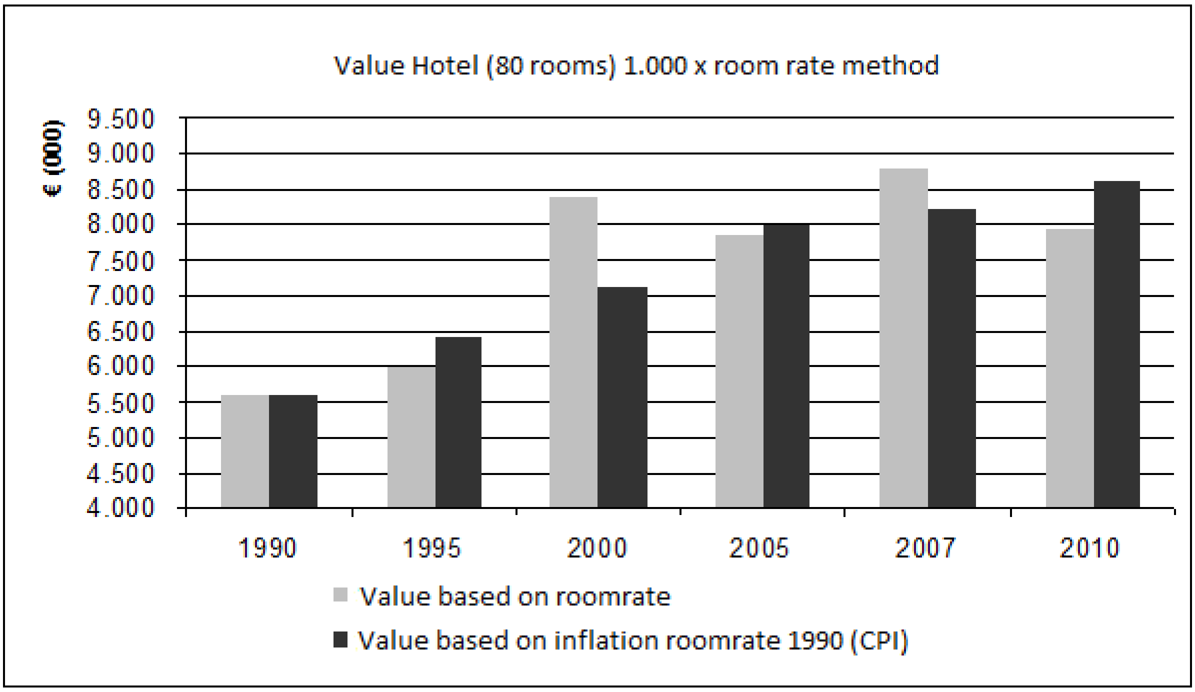
	1990	1995	2000	2002	2005	2007	2010
Roomrate	€ 70	€ 75	€ 105	€ 114	€ 98	€ 110	€ 99
Compared to 1990	-	*+5%*	*+50%*	+63%	*+40%*	*+57%*	*+41%*
Occupancy	69%	65%	76%	71%	69%	73%	64%
Compared to 1990	-	*-6%*	*+10%*	+3%	*0%*	*+6%*	*-7%*

The table depicts these figures. It clearly shows that the average occupancy of Dutch hotels is obviously sensitive to economic cycles, but the occupancy rate has remained relatively stable over the past two decades.

It is also clear that the room rates of hotels were fairly balanced over the past 20 years. Although an increase of 57 percent in 2007 when compared to 1990 seems like a lot, it appears to be equivalent to an annual indexation of nearly 2.6 percent. The average room rate in 2010 appears to correspond with an annual growth of less than 1.75 percent. By comparison, if the average room rate would have risen equal to the inflation, it would have been € 107.50 in 2010. That would be € 8.50 more than in reality. About half a breakfast!

A boring investment

Back to the value of hotel real estate. To estimate the value based on the operating data, several methods can be used. In this case, we choose the ultimately simple 1.000 x room rate method. This is because especially in the early ´90s this method was used by many hoteliers. To calculate the value, a hotel of 80 rooms is used as a reference. This is depicted in chart 1. Obviously, we see the same pattern as with the development of average room rates in the Netherlands in the past 20 years. Based on these key figures it is fair to say that hotels are a relatively stable long-term investment. This category of investment seems less spectacular than many people think. Though boring, it is a good and stable investment.



Market perception

In the past twenty years, hoteliers and investors had a very different market perception. They evaluated the development of room rates and transaction rates much more favourably. Therefore, their perception of the value of hotels and hotel real estate would have led to higher values. Now where does this difference between perception and actual market value come from when it comes to investment in hotels and hotel real estate?

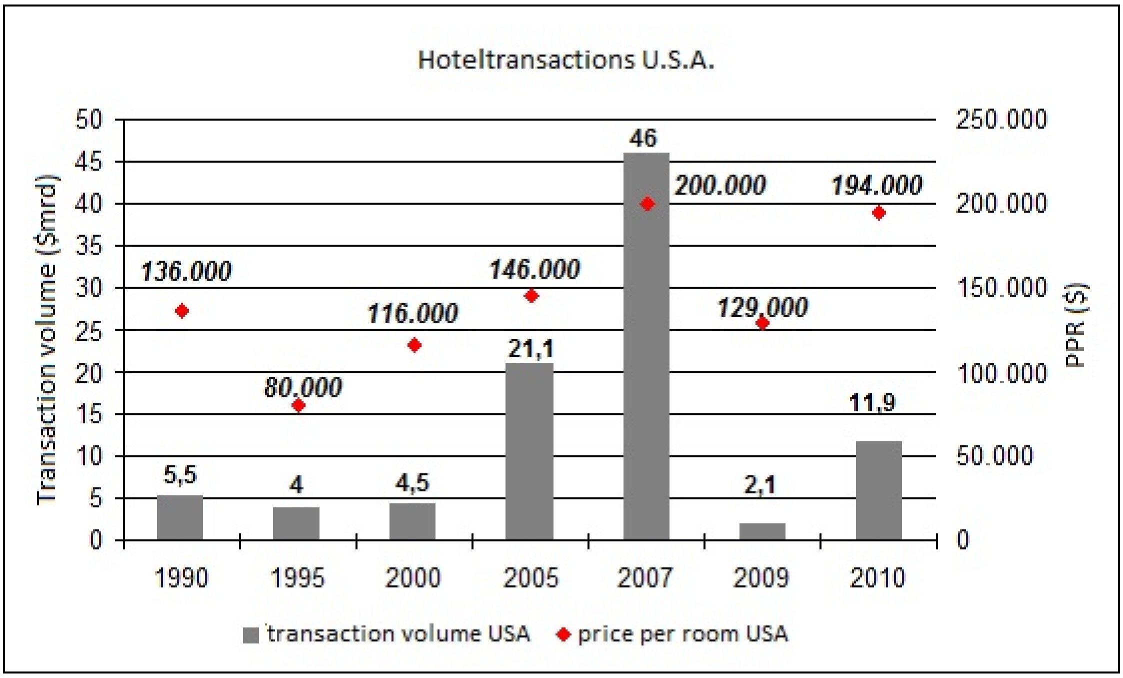
'At strategic locations the development of the value differs significantly from the national average'

The operation figures of a hotel are highly dependent on the location, the operator, the history, and the overall finish of the hotel. Due to these factors some hotels increase much more in value than others. Furthermore, in 2011 hotel real estate is often seen as a 'trophy asset'. This includes appealing hotels such as Hotel l'Europe in Amsterdam and Hotel des Indes in The Hague. Also, the development of certain strategic locations differs from the national average. For example, hotels in the Amsterdam Schiphol region increase much more in value than hotels in many other regions.
In addition, the valuation method of the early '90s does not take into account the interest rates and its effect on the price. Finally, the valuation method is independent of the available supply of capital by financiers.

Hotel transactions

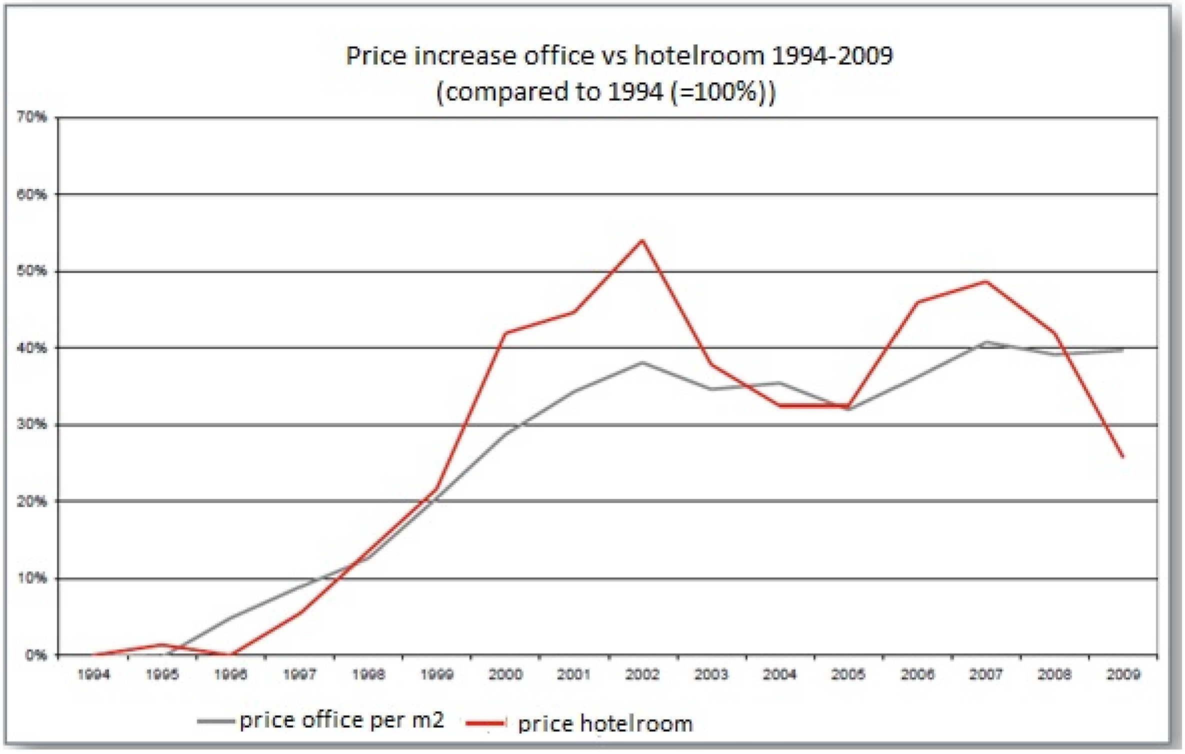
Available operating data are not the sole basis for determining the value of hotel real estate. We could also look at the actual transaction prices of hotels. Unfortunately, the available data was incomplete as this has only been recorded consistently in recent years. Moreover, the Dutch market is quite small, leading to averages being strongly influenced by one or two transactions. Therefore, we take the U.S. transaction market as an example. A comparison of figures shows that the development of hotel transactions and transaction rates per room in the United States are very clearly related to those of the European hotel market. The result is depicted in chart 2. When comparing the average transaction rates per room over the past 20 years, it shows that in 2010 the average transaction rate was 43 percent above the rate in 1990. This implies an average increase of 1.8 percent annually. When using the annual inflation as a reference, the average transaction rate per room would have to be over $ 209,000.

Hoteltransactions VS



Saleability

Previous calculations show that the increase in the price paid per room does not differ much from the annual inflation rate, calculated as from 1990. However, it is clear from this chart that over the years the transaction volume varies considerably. The sale of a hotel is much more challenging in economically difficult times. In recent years, the Dutch market has clearly shown this. One reason is that investors are less willing to take risks. Banks also play an important role, because they demand more stringent financing conditions. Finally, there is a gap between the perception of the buyer and the seller regarding the value.



Office market
A comparison with the office market paints a clearer picture of the attractiveness of hotel real estate. The increase in hotel room rates barely deviates from the increase in average rent per square meter of office space. Moreover, the average rent of offices is strongly influenced by the completion of new offices. Furthermore, office buildings are often left empty, sometimes for prolonged periods. In the Netherlands, the vacancy level of hotels is much lower than that of offices.

Conclusions
Is investing in hotels or hotel real estate interesting or not? On the one hand it is not, because the yield development seems to be equal to the annual inflation rate. However, this finding once again shows the stability of hotel real estate as a long term investment. Additionally, an investor who only invests in hotel real estate - and does not operate it - requires a certain return. This return can vary widely with hotels, due to variations in rents or management contracts. The operating results may be an added value for the property owners when compared to, for example, office real estate. Finally, it appears that investors in hotel real estate who have a long-term investment in mind, have little to fear. Regardless of economic crises and other events that may affect the value, once again it is clear that hotel real estate represents a stable and long-term investment. So, if you are an hotelier and you own your property for as long as this magazine exists, chances are that you can retire with your mind at rest!