CANADIAN MONTHLY LODGING OUTLOOK – JANUARY 2013

THE CURRENT STATUS OF HOTEL DEVELOPMENT ACTIVITY AND CONSTRUCTION COSTS IN CANADA

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The Current Status of Hotel Development Activity and Construction Costs in Canada

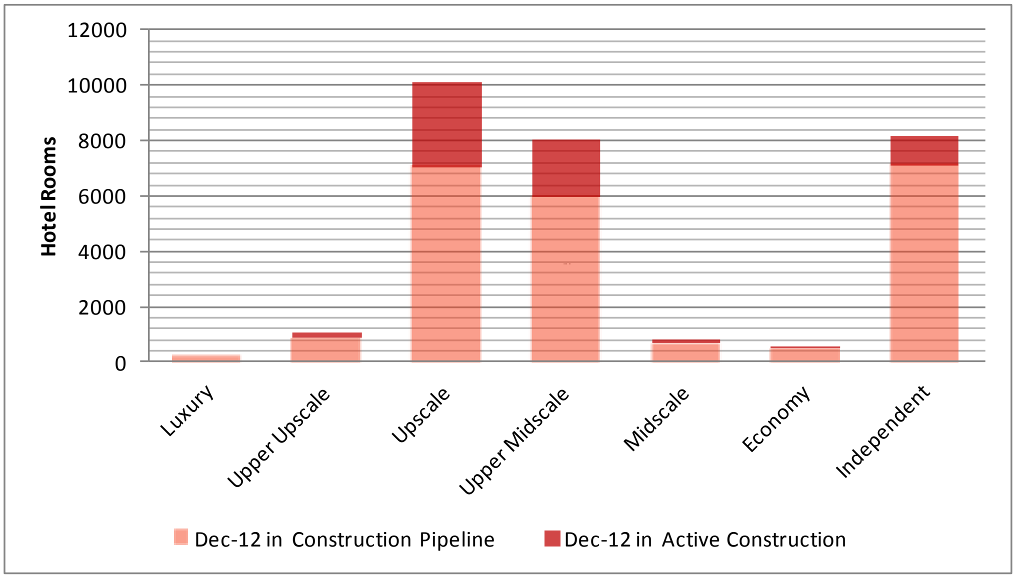
For the Canadian lodging industry, supply growth, at 0.5% was at the lowest level on record in 2012, but developers were nevertheless highly active in pre-planning, which is resulting in pent up supply increases going into 2013. Developers have been active yet prudent in dealing with increasing costs and competition. This article examines the status of Canadian hotel development activity in 2012 going into 2013 from various angles, including regional distribution, current trends in the types of property under development, the current environment for construction costs and financing, and developer attitudes.

New hotels in the development pipeline

New hotel construction increases when hotel operating fundamentals are strong at the same time that reasonably priced financing for new construction is readily available. Both of these factors were in place for many areas of the country in 2012. Many markets across Western Canada rallied in 2011 and further strengthened in 2012, and interest rates have dropped to and been sustained at record lows. In Canada, debt is currently available for feasible projects at loan-to-value ratios in the range of 50% to 75% of the construction cost. Developers are now racing to be the first to start moving dirt in markets in order to forestall the entrance of more competitors. Markets in Western Canada were ripe for the picking in 2012, and for many projects construction is well underway coming into 2013.

Strong RevPAR performance in certain markets and low lending costs are driving both development and hotel values. However, because of development cost constraints and the significant capital required for full-service properties, the new projects are predominantly limited-service, focussed-service, and extended-stay hotels. Figure 1-1 shows the hotel rooms in the construction pipeline and under active construction in Canada in December 2012 sorted by chain scale, as provided by Smith Travel Research.

Figure 1-1 National Hotel Room Supply Pipeline by Chain Scale

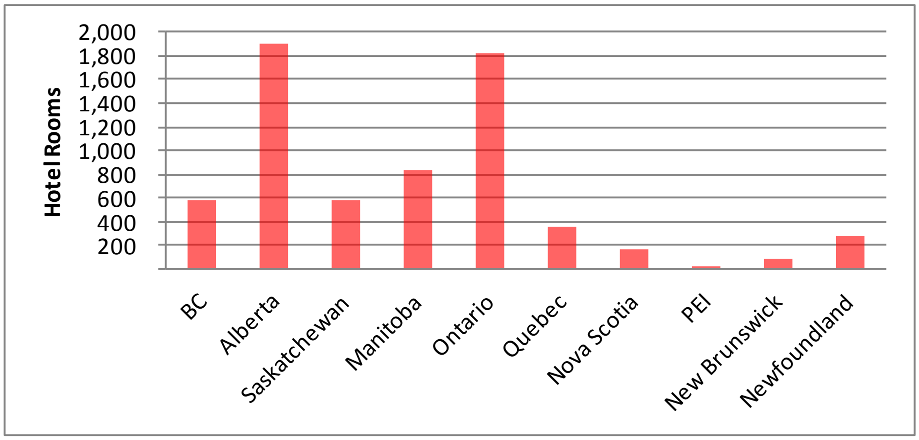


Source: Smith Travel Research

The majority of development is in the upscale and upper midscale categories. The luxury segment is seeing little growth following the recent influx of luxury hotels in Vancouver and Toronto. It is important to note that many of the projects in the supply pipeline are speculative and have the potential to be deferred or cancelled in the coming years.

In terms of regional distribution, active construction is occurring predominantly in Western Canada, which accounts for 59% of active construction in the country. Central Canada remains active, however, to a similar extent as previous years. The active construction pipeline in each province and territory in Canada is shown in Figure 1-2.

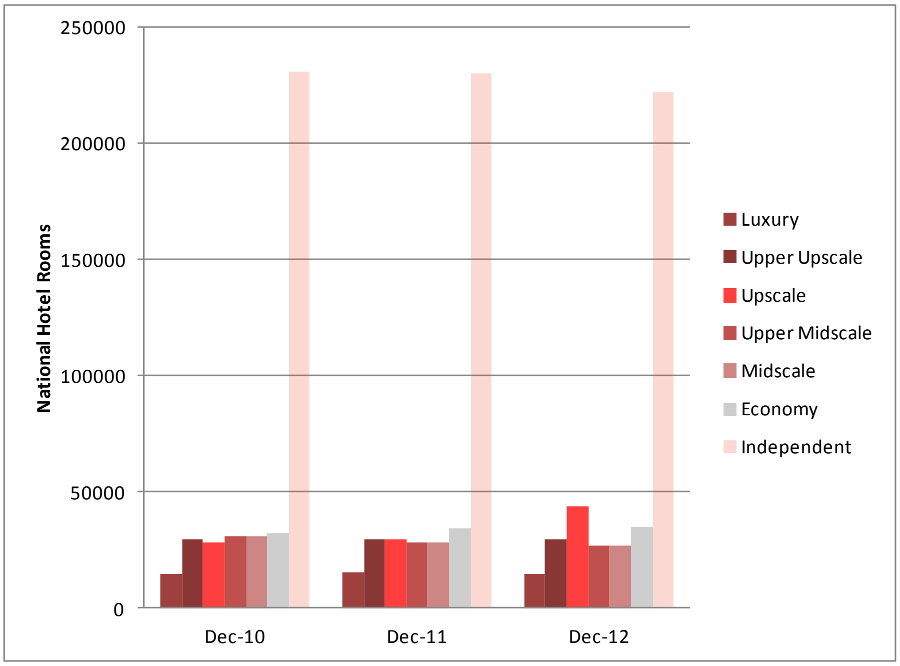
Figure 1-2 Active Construction of Hotel Rooms in Canada as of December 2012 – Distribution by Province



Source: Smith Travel Research

Figure 1-3 Existing National Room Supply by Chain Scale

We also examined how the existing supply in Canada has shifted in recent years in response to changes in guest preferences and increased competition. Figure 1-3 shows the shifts in chain scale within the national hotel room inventory over the past three years. It is important to note many of the supply inventory changes are the result of properties being converted from one category to another.



Source: Smith Travel Research

The drop in demand that occurred in 2009 pushed developers and existing operators wanting to increase their competitive advantage towards brands. Consequently, the number of independent hotel rooms declined from December 2010 to December 2012 by approximately 9,300 while the number of upscale hotel rooms increased by approximately 15,300.

Competition for development sites increased in 2012, and we expect the appetite for sites to continue into 2013. Successful secondary and tertiary market operators have shown interest in some growing urban markets, and urban developers have seen the upside in low cost developments in some secondary markets. Colliers' third annual Investor Sentiment Survey released in the fourth quarter of 2012 indicates that interest in developing hotels remains strong, which is similar to the results of the previous survey undertaken in the fourth quarter of 2011.

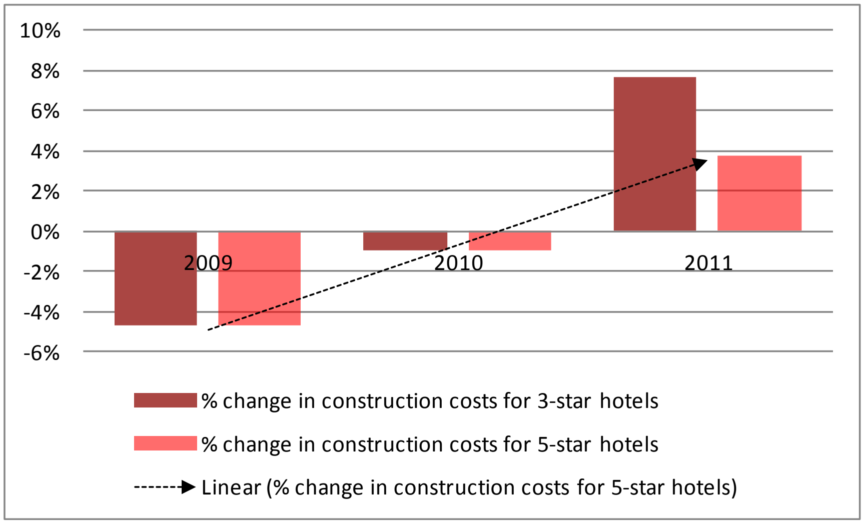
Hotel construction costs continue to rise

With an increase in construction and development activity comes a scarcity of resources. Canada has been struggling with trade labour shortages, which has led to an increase in the cost of skilled labour. Provinces have begun to compete with one another for skilled tradesworkers, many of whom are being scooped up and placed into the energy-based markets of Northern Alberta, Southern Saskatchewan, and, to a lesser degree, Northern BC. As a result of the undersupply of skilled labour, some construction projects have had to offer wages/packages that are competitive with those offered in oil markets. This caused labour costs to rise in 2011 and remain at this level through 2012.

In addition to increased labour costs, the cost of both land and materials has been on the rise. Land costs began to rise in 2011, when local investors had to compete with foreign investors and hoteliers negotiated for top sites. Urban and suburban markets with strong RevPAR performance in 2011 saw significant increases in land costs for hotel development, which continued into 2012. The cost of materials—particularly steel and concrete—also increased slightly in 2011, according to an industry survey conducted by Turner & Townsend. Statistics Canada identified a similar trend in 2012, with some metropolitan areas seeing a 3.5% increase in material costs from third quarter of 2011 to the third quarter of 2012.

As a result of increases in the cost of labour, land, and materials, the cost of building a hotel in Canada increased dramatically in 2011, as shown in the construction cost survey that Turner & Townsend undertook in 2012 (Figure 1-4).

Figure 1-4 Change in Canadian Hotel Building Costs



Source: Turner & Townsend 2012

The cost of building a hotel in Canada had declined significantly in 2009, when the recession was in full force. As development came to a halt, prices dropped to entice developers and stimulate the demand for materials and labour. The development cost declined further but much more modestly in 2010. With the recovery of the market established in 2011, there was a new hunger for hotel development, which caused building costs to rise. Part of this increase reflects the normalization of prices in the absence of recessionary pressures. Our market interviews indicate that modest cost increases were seen in 2012 and that labour costs remained high yet relatively stable.

Conclusion

As the recession loosened its grip on the country, Canada experienced an increase in development activity in 2011 and 2012. Energy-based markets have shown impressive RevPAR growth, which has led hoteliers to fight for the best sites available in these markets. Lending rates remained low through 2012 and continue to be so going into 2013, and the industry sentiment is that there will be no major increases in the next 12 months. Lending remains readily available for feasible projects. These factors indicate that development and construction activity will continue into 2013 at a sustained level. With many sites now tied up or under construction however, hoteliers will have to keep an eye out for alternative or growing markets, where upside or barriers to entry for others can be found. We will continue to see property conversions, particularly in the full-service category from independent to upscale and upper-midscale, as the cost to build these projects from new is prohibitive.

About the Author

Andrew Higgs is a hotel Consulting and Valuation Associate with the HVS Vancouver office in Canada. Andrew received his Bachelor of Commerce at Ryerson University's Hospitality and Tourism Management program and has spent several years in various managerial roles in Toronto's restaurant industry.

Canadian Lodging Outlook January 2013

STR and HVS are pleased to provide you with the month's issue of the Canadian Lodging Outlook. Each report includes occupancy (Occ), average daily rate (ADR), and revenue per available room (RevPAR) for three major markets and the Provinces.

If you would like a detailed hotel performance data for all of Canada, STR offers their Canadian Hotel Review. The Canadian Hotel Review is available by annual subscription which includes both monthly and weekly issues. Each monthly issue of the Canadian Hotel Review also includes an analysis provided by HVS. For further information, please contact: info@str.com or +1 (615) 824-8664 ext. 3504.

January 2013	Occupancy Rate (%)		Average Room Rates ($CAD)		REVPAR ($CAD)		Room Supply	Room Demand	Number of Rooms	
	2013	2012	2013	2012	2013	2012	% chg	% chg	Sample	Census
Montreal	45.4%	47.6%	$124.94	$123.31	$56.74	$58.69	0.5%	-4.1%	16,890	27,873
Toronto	56.7%	55.5%	$130.83	$127.05	$74.16	$70.55	0.5%	2.6%	31,501	36,709
Vancouver	48.6%	49.2%	$123.54	$120.93	$60.04	$59.54	0.6%	-0.7%	19,479	26,415
Provinces										
Alberta	54.2%	51.4%	$135.12	$128.75	$73.28	$66.12	0.4%	6.0%	38,909	68,249
British Columbia	45.2%	46.4%	$130.82	$127.90	$59.12	$59.39	0.8%	-1.9%	37,590	82,758
Manitoba	51.7%	51.6%	$114.40	$113.17	$59.14	$58.34	3.1%	3.4%	5,717	13,863
New Brunswick	38.8%	40.9%	$105.13	$106.97	$40.83	$43.77	-3.2%	-8.2%	5,197	10,396
Newfoundland	55.5%	51.0%	$127.13	$123.16	$70.59	$62.80	1.6%	10.6%	1,877	5,634
Nova Scotia	42.0%	42.5%	$108.87	$106.38	$45.76	$45.17	1.2%	0.2%	6,393	10,699
Northwest Territories	INS	INS	INS	INS	INS	INS	INS	INS	204	1,373
Ontario	48.8%	48.6%	$118.23	$117.29	$57.66	$56.98	0.9%	1.3%	85,449	133,539
Prince Edward Island	33.5%	36.3%	$88.87	$86.76	$29.79	$31.46	0.0%	-7.6%	889	3,727
Quebec	45.0%	47.1%	$125.56	$124.40	$56.53	$58.64	0.1%	-4.4%	27,733	75,041
Saskatchewan	58.7%	58.7%	$128.07	$123.28	$75.15	$72.40	4.1%	4.0%	8,185	17,103
Yukon Territory	INS	INS	INS	INS	INS	INS	INS	INS	378	1,608
Canada	**48.7%**	**48.6%**	**$124.31**	**$121.72**	**$60.51**	**$59.13**	**0.8%**	**1.0%**	**218,521**	**424,404**

*INS = Insufficient Data

HVS

About STR

STR provides information and analysis to all major Canadian and U.S. hotel chains. Individual hotels, management companies, appraisers, consultants, investors, lenders and other lodging industry analysts also rely on STR data for the accuracy they require. With the most comprehensive database of hotel performance information ever compiled. STR has developed a variety of products and services to meet the needs of industry leaders.

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