

# INvestment CANADA

SECOND QUARTER 2006

## WHERE ARE WE IN THE CONTINUUM?

WRITTEN BY DAVID LARONE, DIRECTOR, PKF CONSULTING INC.

We have been listening with great interest lately to various “other” soothsayers and industry players who are offering their thoughts on the status of the Canadian hotel industry. As Yogi Bera (not bear) was quoted as saying, “You can observe a lot by watching!” We think we have observed a lot but I am not sure what we have learned.

A favourite tomb currently, is that the Canadian hotel industry is on the cusp of a “cyclical recovery.” Frankly I am not sure what that means or how I would identify one if it came along. However, if it is a “good thing” I am all for it.

On the other hand, there are those who would have you believe that life, as we know it in the hotel industry is all but over and you may as well throw in the towel. On the presumption, that this is clearly a “bad thing”, I am definitely not in favour!

How does one judge where our industry is? Having established the “how”, would this lend clarity as to where we are going? I have always found it useful to return to a review of the facts as a good starting point to get a sense of reality.

In 1992, the average bottom line in the Canadian hotel industry (EBITDA) based upon PKF Trends in the Hotel Industry Data Base was \$1,800 per available room for all hotels. In 2000, the bottom line was \$11,100, the best year we have ever had in the hotel industry in Canada. After 9/11, SARS and a 30% increase in the value of the Canadian dollar, the bottom line in 2005 was \$9,400 which is where the industry was in 1998 and we have projected \$9,800 for 2006. Between 1998 and 2000, we had solid economic growth in Canada and modest supply growth and strong ADR growth. Therefore, the run-up in earnings may have been somewhat illusory. We have projected that the industry’s average bottom line will be back to 2000 levels of performance at \$11,100 by 2008.

In 2000, the average hotel transaction in Canada after eliminating specialized transactions was plus or minus \$100,000 per available room and the “yield” based upon trailing twelve-month earnings was 11.7%. In 2005, the average hotel transaction in Canada after eliminating specialized transactions was plus or minus \$100,000 per available room and the “yield” based upon trailing twelve-month earnings was 9.7%. Earnings have declined by 15.3%, while values have remained basically the same, resulting in lower “yields”. The problem with the foregoing analysis is that the average sales price is a function of what is being sold.

Another way of analyzing the relationship of earnings and sales prices is to correlate the earnings data with the “yields” from the transactions. The 2000 earnings of \$11,100 per available room at an 11.7% capitalization rate yields a per room value of approximately \$95,000. The 2005 earnings of \$9,400 per available room at a 9.7% capitalization rate yields a per room value of approximately \$97,000. While profits and returns have declined values have held.



### In This Issue . . .

- WHERE ARE WE IN THE CONTINUUM?
- MID YEAR CANADIAN HOTEL TRANSACTION SUMMARY

One Queen Street East  
Suite 2200  
Toronto, ON M5C 2Z2  
Tel: (416) 777-2200  
Fax: (416) 777-9232  
www.colliershotels.com



## CANADA

SECOND QUARTER 2006



*“Supply has been growing at a modest 2.1% per annum over the past 10 years, more or less in line with demand growth.”*

The Canadian economy has been growing at plus or minus 3% per annum since 1996. The Canadian economy is forecast/projected to grow at an annual rate of plus or minus 3% over the next two years.

The industry occupancy rate in 2000 was 65%, while its projected to be 65% in 2006. ADR in 2000 was \$111 and in 2005 it was \$118.61 representing an annual increase of approximately 1.3%.

Supply has grown by 2.1% per annum since 1996, while demand has grown by 2% since 1996.

If we are poised for a “cyclical recovery”, the outlook could be very promising for the industry. However, an initial question would be, “A recovery from what?” Projected 2006 earnings will be within 13% of the best year that the industry in Canada has ever had. The modest increases in average rate that we foresee will get us back to those 2000 levels of earnings by 2008.

A second question would be, “How would this “recovery” manifest itself?”

To experience a dramatic improvement from where we are currently would require one or some of a variety of circumstances to occur. One possibility would be a dramatic run-up in occupied room nights from current levels. This might be accomplished if we had experienced a substantial decline in occupied room nights due to a dramatic downturn in the economy or as a result of some nasty geopolitical event. We have experienced this in 2001 and 2003 and have recovered the lost occupied room nights as at the end of 2004.

An alternative might be a dramatic increase in occupied room nights due to Canada becoming the next great global destination. There is no doubt that this country is a great destination and that we need to do a better job of merchandising. As an industry, we are well aware of this circumstance and significant efforts are underway to arrest our declining share of global tourism. Broad consensus is that we have a tough battle ahead. Thus, it is unlikely that an unforeseen increase in occupied room nights will light the way on a substantial upturn in the industry.

Another alternative might be that supply growth would decline substantially or cease altogether. Supply has been growing at a modest 2.1% per annum over the past 10 years, more or less in line with demand growth. The amount of money looking for a home in this industry and our modest approach to lending should ensure that we would continue to have balanced supply growth.

Another option would be for a substantial increase in ADR beyond the 1.3% that the industry has averaged per annum over the past five years and substantially beyond inflation. We could only hope that this would be the case. No one is holding his or her breath that this will transpire in the short term. In fact, the only time in the past 25 years that we have seen ADR growth materially above inflation was in the 1995 to 2000 period, a time when the industry was catching up from a “no growth” period for ADR in the first half of the 1990’s. Overall, during the 1990 to 2000 period, average rates increased by 2.8% per annum versus the core rate of inflation of 2.0%. While some of us may remember ADR growth in the range of 7.0% in the 1980’s, we must also remember that the core rate of inflation was approximately 6.0% for the decade.



“...levels of profitability are in line with earnings levels that we saw in 1998...”

The industry in Canada has been derailed by two significant events in the past five years that have pulled the earnings levels down in each instance, such that the industry has been trading water since 2001. From another perspective, despite some very significant bad news in 2001 and again in 2003, levels of profitability are in line with earnings levels that we saw in 1998, which were record levels of earnings at the time. The fact is that overall industry earnings have declined from levels that were at an all-time high to levels that are within record levels of profitability. We foresee those earnings again in the medium term.

To suggest we are poised for a significant upturn beyond current levels of earnings does not seem reasonable given historic experience.

A “cyclical recovery?” If this is meant to suggest exponential growth in industry profits, at the 30% per annum that we saw between 1995 and 1998 or even the 10% that we saw between 1998 and 2000, we don’t think so!

The dramatic growth in earnings was attained between 1995 and 2000 and for the most part has been retained thus far in this decade. Going forward, hopefully, we will see continued steady growth in line with a growing economy.

To continue with supply and demand growth relatively in balance, ADR’s improving modestly and bottom lines growing at plus or minus 5.0% is not a bad thing.

*Written by David Larone, PKF Consulting Inc.*

## MID YEAR TRANSACTION ACTIVITY

*Written by Colliers International Hotels*

The Canadian hotel investment market has remained active in the first six months of 2006, albeit at a slower pace than 2005. Year-to-date June 2006 results of \$368 million (49 trades) is considerably lower than the \$1.17 billion of volume (65 trades) realized at this point in 2005, however this is largely due to the timing of eight strategic acquisitions in 2005. In contrast, there is only one strategic acquisition to-date in 2006, the Delta Victoria Ocean Pointe Resort & Spa, which sold for \$34 million (142,300 per room) to CHIP REIT in April.

About 5,130 rooms have traded this year, at an average price per room of \$69,900. The majority of trades (80%) sold for under \$10 million. Cap rates ranged from 2.4% to 16.4% but 21 trades (68% of those that reported cap rates) fell between 9% and 12%.

There were distinct regional differences in transaction activity between YTD June 2005 and 2006. Five hotel sales occurred on the east coast this year, an area reporting only six trades in the previous five years combined. About 80% of trades occurred in secondary or tertiary markets, some of which have never recorded sales, such as Edson (Alberta) and Georgina (Ontario).

We anticipate the pace of activity for 2006 to intensify as there are several high quality assets currently in the market or under contract. In 2005, 69% of activity occurred in the first half of the year, whereas this year we anticipate the majority of trades will close in the second half of the year. A Mid-Year Transaction Summary is provided on the following page.

# COLLIERS INTERNATIONAL HOTELS

## CANADA

SECOND QUARTER 2006

### MID YEAR TRANSACTION SUMMARY\*

#### Canada

**Toronto:** 416-777-2200

Bill Stone  
Alam Pirani  
Deborah Borotsik  
Robin McLuskie

**Vancouver:** 604-681-4111

Tom Andrews

#### United States

**San Francisco:** 415-788-3102

Bob Eaton  
Mark McDermott  
Henry Bose  
Darryl Law  
Jean Lesure

**Irvine:** 949-724-5593

Bob Kaplan  
Rod Apodaca

**Seattle:** 206-223-0866

Chris Burdett  
Andy Layton

#### Mexico

**Cancun:** 52-998-898-1487

Juan Jose Gallardo

#### Europe

**London:** 44-20-734-4666

John Sheppard  
Paul Bartrop  
Colin Hall  
Robert Stapleton

**Moscow:** 7-501-258-5151

Robert Stoddard

**Prague:** 4-20-221-451-518

Richard Horton

#### Asia/Pacific

**Sydney:** 612-9257-0222

Robert McIntosh  
George Nicholas  
Michael Thomson

**New Zealand:** 64-9-356-8826

Jack Charters

**Hong Kong:** 852-2828-9888

Antonio Wu  
David Faulkner

**Singapore:** 62-223-2323

Rachel Wee

**Tokyo:** 81-3-5563-2111

Alec Menikoff

	NAME	LOCATION	ROOMS	DATE	PRICE	PRICE PER ROOM	CAP RATE (%)
	Best Western Rocky Mountain House Inn & Suites	Rocky Mountain House, AB	81	Jun	\$8,550,000	\$105,600	11.0
	Battery Hotel and Suites <sup>1</sup>	St. John's, NF	125	Jun	n/a	n/a	n/a
	Causeway Bay Linkletter	Summerside, NS	109	Jun	\$2,450,000	\$22,500	12.0
	Comfort Inn	Scarborough, ON	81	Jun	\$3,860,000	\$47,700	n/a
	Days Inn- Sydney	Sydney, NS	167	Jun	\$4,500,000	\$26,900	n/a
	Econo Lodge	Ridgetown, ON	40	Jun	\$1,325,000	\$33,100	n/a
	Foxwood Inn and Suites - Drayton Valley	Drayton Valley, AB	68	Jun	\$6,580,000	\$96,800	12.6
	Glenier Inn <sup>2</sup>	Mississauga, ON	39	Jun	\$12,000,000	n/a	n/a
	Holiday Inn Express Hotel & Suites	Sherwood Park, AB	90	Jun	\$11,800,000	\$131,100	9.9
	Holiday Inn Hotel & Suites Winnipeg Downtown	Winnipeg, MB	140	Jun	\$4,300,000	\$30,700	2.4
	Hotel Gander <sup>3</sup>	Gander, NF	152	Jun	\$4,800,000	\$31,600	10.0
	North Shore Inn (formerly Ramada Inn North Vancouver)	North Vancouver, BC	82	Jun	\$6,200,000	\$75,600	n/a
	Place Louis Riel All-Suite Hotel	Winnipeg, MB	294	Jun	\$16,500,000	\$56,100	10.4
	The Leduc Inn	Leduc, AB	120	Jun	\$8,600,000	\$71,700	11.3
	Toronto Gateway Inn	Scarborough, ON	78	Jun	\$3,200,000	\$41,000	n/a
	Days Inn Kelowna	Kelowna, BC	91	May	\$5,650,000	\$62,100	7.5
	Delta Sherbrooke Hotel and Conference Centre <sup>4</sup>	Sherbrooke, QC	178	May	\$12,750,000	\$71,600	9.0
	Delta Trois-Rivières Hotel and Conference Centre <sup>4</sup>	Trois-Rivières, QC	159	May	\$13,600,000	\$85,500	9.0
	Knights Inn	Kitchener, ON	45	May	\$2,166,000	\$48,100	n/a
	Pine Ridge Motel	Courtice, ON	19	May	\$1,075,000	\$56,600	n/a
	Super 8 Motel - Whitecourt	Whitecourt, AB	61	May	\$5,400,000	\$88,500	12.0
	Delta Victoria Ocean Pointe Resort and Spa**	Victoria, BC	239	Apr	\$34,000,000	\$142,300	6.0
	Hilton Garden Inn Toronto/Burlington <sup>5</sup>	Burlington, ON	120	Apr	\$15,864,000	\$132,200	n/a
	Homewood Suites Toronto/Burlington <sup>5</sup>	Burlington, ON	88	Apr	\$11,633,600	\$132,200	n/a
	Kingsway Motel	Oshawa, ON	25	Apr	\$1,100,000	\$44,000	n/a
	Lakeview Inn & Suites (formerly Super 8 Motel)	Edson, AB	45	Apr	\$4,400,000	\$97,800	11.9
	Lionhead Lakefront Resort & Yacht Club	Georgina, ON	87	Apr	\$2,800,000	\$32,200	n/a
	Radisson President Hotel & Suites Vancouver Airport <sup>6</sup>	Richmond, BC	184	Apr	\$22,300,000	\$121,200	7.0
	Renaissance Vancouver Hotel Harbourside <sup>7</sup>	Vancouver, BC	437	Apr	\$27,295,000	\$62,500	5.0
	Talisman Mountain Resort	Collingwood, ON	94	Apr	\$8,272,000	\$88,000	9.1
	Best Western Dorchester Hotel <sup>8</sup>	Nanaimo, BC	65	Mar	\$3,700,000	\$56,900	10.0
	Comfort Inn Leamington	Leamington, ON	62	Mar	\$3,160,000	\$51,000	9.5
	Days Inn - Leamington	Leamington, ON	94	Mar	\$3,954,000	\$42,100	3.2
	Guildford Inn & Suites <sup>9</sup>	Surrey, BC	86	Mar	\$7,400,000	\$86,000	n/a
	Super 8 - Slave Lake	Slave Lake, AB	58	Mar	\$5,500,000	\$94,800	10.7
	Super 8 Motel - Toronto North	Vaughan, ON	85	Mar	\$7,800,000	\$91,800	11.2
	The Ritz Cafe & Motor Inn	Whitecourt, AB	62	Mar	\$4,500,000	\$72,600	16.4
	Travelodge Regina East	Regina, SK	181	Mar	\$2,800,000	\$15,500	10.0
	Water's Edge Inn	Niagara Falls, ON	67	Mar	\$2,050,000	\$30,600	10.7
	Casablanca Winery Inn (formerly Kittling Ridge Winery Inn)	Grimsby, ON	79	Feb	\$8,675,000	\$109,800	n/a
	Coastal Inn Fort Howe Hotel	Saint John, NB	135	Feb	\$4,500,000	\$33,300	n/a
	Inn on 7th	Edmonton, AB	172	Feb	\$6,400,000	\$37,200	n/a
	Sunset Inn	Niagara Falls, ON	32	Feb	\$1,500,000	\$46,900	n/a
	Best Western Fort Inn	Fort Saskatchewan, AB	70	Jan	\$7,500,000	\$107,100	7.9
	Best Western Okotoks Lodge	Okotoks, AB	64	Jan	\$6,200,000	\$96,900	9.7
	Causeway Bay Calgary (formerly Budget Lodge)	Calgary, AB	72	Jan	\$2,800,000	\$38,900	12.0
	Hampton Inn Toronto/Mississauga	Mississauga, ON	69	Jan	\$6,400,000	\$92,800	11.5
	Service Plus Inns & Suites	Red Deer, AB	90	Jan	\$9,050,000	\$100,600	13.5
	Super 8 Motel - Athabasca	Athabasca, AB	48	Jan	\$3,250,000	\$67,700	11.0

Source: Colliers International Hotels

Notes:

<sup>1</sup> Price unavailable at time of writing.

<sup>2</sup> Price per room unavailable as site has been rezoned for a substantial residential redevelopment. New owners plan to convert property to a retirement home.

<sup>3</sup> Cap rate is estimated.

<sup>4</sup> In addition to the hotel components, the Owner also purchased an office building at the Sherbrooke site and a retirement home at the Trois-Rivières site, and the allocated values for these components have not been included in the purchase prices stated. The overall purchase price was \$47.5 million with a cap rate reported at 9%.

<sup>5</sup> Purchased for a total price of \$27.5 million and price per room is prorated.

<sup>6</sup> The sale price includes the purchase of three levels of parking in an adjacent parking garage. The hotel is part of the larger President Plaza development. A portion of the site (18,232 SF) is leased for a term of 99 years with an annual rent of \$89,000. The property also has five retail tenants representing \$340,000 in annual income.

<sup>7</sup> Purchase price was based on USD \$24 million (converted at 1.1373). In addition, there was a mandatory PIP requirement from Marriott International of US\$15 million.

<sup>8</sup> Purchase price includes seven small retail stores.

<sup>9</sup> Historical income was negative. The property went into receivership March 15, 2005 and the Hampton Inn flag was pulled April 15, 2005.

\* Excludes the sale of eight hotels owned by Westmont/Whitehall Partnership to Westmont/Kimco for \$100 million.

\*\* Strategic transactions typically involve at least two of the following conditions: 1) a pricing premium is paid; 2) the asset is located in a high barrier to entry market or within the geographic hub of an owner's principal business; or 3) the opportunity allows for an extension of the company's brand or portfolio.