

Study

Valuation of Hotel Properties

HypZert 'Hospitality and Restaurant Industry'
Professional Group

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Words of Welcome

**by the Chairman of the Committee for Tourism
for the German Bundestag, Klaus Brähmig MdB**

Germans are world champions when it comes to travelling and the country's popularity with foreign visitors as a travel destination continues to grow. Tourism has now become an important economic factor. Figures published by the Federal Ministry for the Economy at the beginning of the year are clear confirmation of this: tourism was responsible for approx. 2.9 million jobs in 2010, accounting for 7% of jobs in Germany. Employees in tourism generated an added value of almost €100 billion and thus more than the employees in either engineering or the car industry.

Branches which appear to have nothing to do with tourism also profit from tourism, be they the bakers supplying fresh bread rolls to the hotel or guesthouse, the shops at the airport or the newsagent at the railway station. Taking into account all activities associated with travelling, tourism contributes directly and indirectly to an economic performance of approx. €215 billion.

Politics supports the tourism industry to ensure that this welcome and successful development continues. The German Tourist Board (DZT), which promotes Germany as a travel destination abroad, is financed by the Federal Government. The growing numbers of foreign tourists are the fruits of DZT's labours.

In Germany, the federal government also supports projects which contribute to the improvement in the economic performance of the tourism industry, which is mainly dominated by medium-sized businesses. After all, it is the entrepreneurs and employees in the local tourism economy who are fundamental to the financial success of the industry. The hospitality and restaurant industry in particular is dominated by a high proportion of small and medium-sized businesses, which are firmly rooted in their respective regions. The industry offers jobs, not only in the major cities, but also in rural areas, and it is these jobs which cannot be outsourced abroad.

The sustained upswing in German tourism and especially the trend towards city breaks are also having a positive effect on the hotel industry. According to figures published by the Federal Statistics Office, the number of overnight stays in the hotel industry rose by 5.5% to 240.8 million last year. The 2010 figure was 'only' 228.3 million. The Occupancy Rate rose on average from 63.3% to 65.1%. The Gross

Room Rate was €98.50. This means that room rates in Germany lie €8.00 or 8.7% below the European average. Although guests welcome the relatively inexpensive room prices in Germany, this is not always of benefit to the hotelier. After all, he needs profits to pay his staff and to be able to invest in his hotel.

The reduction in the value added tax rate from 1 January 2010 had rightly been a bone of contention for some time; however, it is recognised that the reduction has allowed many hotel owners the opportunity to invest once again in their properties, the continuous training of their staff and in recruitment. This fiscal measure has supported the competitive position of the German hotel industry in Europe and has therefore also contributed to the strong economic development in the hotel industry.

Nevertheless, this welcome development should not blind us to the fact that loan financing of hotel properties remains difficult. The largely insufficient capital resources available to hotel owners are forcing them to borrow capital, which usually means that their hotel becomes the collateral. The following study will describe in detail the professional approach adopted to create a platform for cooperative and fair collaboration of the hotel and finance industries.

This is a study by professionals for professionals. It provides an insight into the methodology of hotel valuations and undoubtedly contributes to the standardisation and application of common terminology. The study contributes to an understanding of both hotel chains and family-run businesses. The HypZert 'Hospitality and Restaurant Industry' Professional Group has committed its experience and knowledge of the various specialised property types to paper.

It would give me great pleasure if the reading and undertaking of a detailed evaluation of this study successfully promotes collaboration between all involved, i.e. the hospitality, property and finance industries.



Foreword

Since its foundation in 1996, **HypZert**, as one of the first certification bodies for real estate valuers, has certified over 1,200 valuers who are responsible for the determination of market and mortgage lending values in and for the finance industry.

A new aspect of HypZert's activities is the recording and sharing of the professional knowledge, including specialist subjects, of this large number of valuers for their mutual benefit. In order to achieve this, HypZert has been establishing the following professional groups since 2002 with the objective of collating the expertise of valuers and making their findings accessible to all in the form of compact studies:

- International
- Hospitality and Restaurant Industry
- Retail
- Energy & Environment
- Industry
- Agriculture
- Logistics
- Care Facilities

Today, HypZert's 'Hospitality and Restaurant Industry' Professional Group has the following members, who are also authors of the following study:

- Dipl.-Ing. Helmut Keber
- Dipl.-Ing. Ralf Lamprecht
- Dipl.-Kauffrau Christine Mayer
- Dipl.-Ing. Harald Müller
- Dipl.-Ing. Ulrich Peters
- Dipl.-Ing. Heike Stork

This Professional Group was established in Spring 2007. It published its first 'Bewertung von Beherbergungsimmobilien' [Valuation of Hotel Properties] study in October 2008. This study is an update of the 2008 paper.

The ‘Hospitality and Restaurant Industry’ Professional Group thanks Matthias Dobrick for making the findings of his university thesis ‘Methodische Untersuchung zur Verkehrswertermittlung von Hotelimmobilien’ [methodical investigation of the determination of market values of hotel properties], written in December 2011 as part of his studies into the Housing and Real Estate Industries at the University of Zittau/Görlitz, available to the Group.

Objective of the study

Four years have passed since the first ‘Valuation of Hotel Properties’ study by the ‘Hospitality and Restaurant Industry’ Professional Group was published. The dynamism of the international, and specifically the national property market, already discussed in 2008, has returned to pre-crisis levels following a significant setback caused by the 2008 financial crisis. The overheating of the markets in 2006 and 2007 and resulting over-optimistic future estimations escaped a sober analysis of the potential of the property market and achievable returns. Investment turnovers in the property sector continue to rise due to a lack of investment alternatives compared to the long-term average. The holding period for properties has shortened significantly and the expectations for returns are more precisely defined depending on the investor class and degree of risk awareness.

In this professionalised market, demand for qualified property valuations has increased substantially, not just in the case of German investors. The valuation is a key element in the decision-making process when initiating and executing property transactions and their financing.

Hotel properties have continued to establish themselves as an independent asset class in this investment market. One reason for this is certainly the poor performance of German office properties, which have registered below average returns over the past ten years. IPD’s DIX index shows office properties in Germany as the worst performing asset class over the past ten years, with an annualised total return averaging only 2.1%. As a result of the sustained investment pressure and a shrinking supply of (well performing) retail and residential properties, hotel properties are shifting strongly into the focus of investors. The sustained growth in travel globally, and thus the overnight stays, are reasons for the positive forecasts in the hotel investment sector. In Germany alone, the Federal Statistics Office reported an increase in overnight stay figures in **all** hotel businesses, from 338.7 million in 2004 to approx. 394.1 million in 2011, which equates to growth of approx. 16.3%. Furthermore, the nominal as well as growing proportion of professionally operated hotel chains means that a greater number of suitable investment vehicles are available to capital investors.

This study should:

- support the real estate valuer in the assessment and valuation of hotel properties;
- establish, compare, contrast and explain hotel industry terminology;
- provide benchmarks from current market activities;
- help to better identify opportunities and risks of properties for the purpose of the financing and loan decision processes; and
- offer recommendations for their application.

The study cannot be used to offer an insight into the valuation of this type of operational property, but is intended more as a consolidating expert knowledge and market experience in order to prepare property valuations which meet the high market requirements. The specific requirements of the (German) financial industry in terms of adequate risk assessment are, of course, paramount. The findings and information provided by this study are based on current market conditions. Quoted ranges of comparable parameters are based on average market levels and individual valuations must be adjusted to reflect the peculiarities of the individual case by the valuer.

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