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Lodging Outlook

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Hotel Life Expectancy

By: Stephen Rushmore,MAI, CHA, HVS International - New York.

You're driving down a street and you notice two hotels. Both appear neat, clean and orderly. One has exterior corridors, a flat roof that reveals the air-conditioning fan units, an out-of-date Tudor-style brick exterior, a plain, square swimming pool, and a small guestroom converted to a fitness room. The other has interior corridors, a front desk providing entrance security, a mansard roof that conceals the air-conditioning equipment, art deco exterior decor, a free-form swimming pool with water falls and slide, and a well-designed health club.

It shouldn't surprise you that the modern hotel captures more than its fair share of occupancy and operates at a higher Average Daily Rate than the older property. Revenue loss stemming from out-of-date appearance and inferior facilities is functional obsolescence. Hotel appraisers recognize that obsolescence reduces income potential and value.

The life cycle of most hotels is characterized by rapid growth in occupancy and net income during the first five to 10 years. Then a hotel stabilizes, and net income remains fairly level from eight to 15 years after opening.

After that, net income begins to decline as the property nears the end of its economic life and its income-generating capability decreases.

Studies show that a hotel's economic life averages about 40 years, but the standard deviation is, believe it or not, 20 years. That means the risk of hotel investing is related to not knowing whether the economic benefits will last up to 60 years or end in 20.

"Hoteliers may be able to do something about functional obsolescence. But external obsolescence - the social and economic context of a hotel - is beyond a hotelier's control."

Various factors affect the economic life of a lodging facility. Functional obsolescence can be key to hotel value decline.

In the above example, it's likely that the first hotel is 15 years old and in its decline, while the second is brand-new. It's also possible that both hotels are 15 years old, but the second just underwent a major renovation.

Functional obsolescence is curable. Most hotels have a continuous program of furniture replacement and decor updating to keep functional obsolescence in check during a facility's initial years. But the first hotel hasn't undergone the massive renovation generally required between the 15th and 20th years.

Thousands of older hotels are in the declining phase of their life cycles. Those with food locations and sound structures are prime candidates for the type of massive overhaul that will add years to their life. Other will eventually lose their national affiliation, deteriorate in appearance and go out of business.

External obsolescence is a loss in income and value resulting from outside factors. Examples include population shifts and declining neighborhoods, changes in traffic patterns, economic adversity among local businesses and hotel room oversupply. Unlike functional obsolescence, external obsolescence is generally incurable because a hotel owner has no control over it.

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@hvsinternational.com
Web Site: http://www.hvsinternational.com

Vancouver Office
4235 Prospect Road
North Vancouver, BC
Canada V7N 3L6
(604) 988-9743
(604) 988-4625 fax

Toronto Office
2120 Queen St. East, #202
Toronto, ON
Canada M4E 1E2
(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