JULY 2013 | PRICE $3,500

HOTEL VALUATION FACTORS

BRANSON, MISSOURI

Dana Waud
Analyst



www.hvs.com

HVS Global Hospitality Services | 111 N Wabash Avenue, Chicago, IL 60602

Branson Introduction

Located in the Lakes Area of the Ozark Mountains, Branson, Missouri attracts over seven million annual visitors. With a population just over 10,000 residents, Branson was originally developed as a lumber shipment center. Today it is known as the "Live Music Show Capital of the World," and features more than 50 live-show theaters. Branson also attracts visitors interested in outdoor recreational activities at its three lakes, 12 championship golf courses, and an international, award-winning theme park. In the last 10 years, two major retail centers have been developed in Branson. These mixed-use developments contain over 1.5 million square feet of retail, hotel, dining, and convention space.

The Branson hotel market includes a broad range of resort, upscale, midscale, and economy hotels. HVS has recently evaluated a sample of these hotels in Branson. This article will discuss factors that influence hotel values and metrics used to determine hotel values. The article will focus primarily on the Branson, Missouri market, but also draws on data from the broader Midwest region.

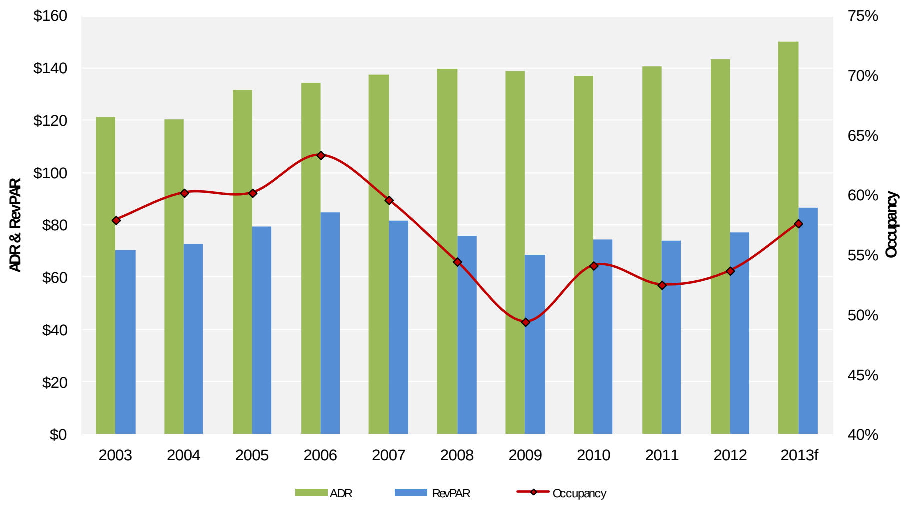
Historical Overview of Branson Market

Major investments in live entertainment, a private airport, a convention center, two expansive mixed-use developments, numerous leisure attractions, and private-sector industry have contributed to a revitalization of the local economy. The Branson Airport opened on May 11, 2009, and is located just 15 miles southeast of Downtown Branson. As of March 2013, Southwest Airlines, Branson AirExpress, and Frontier Airlines serve this airport. Direct service is offered to major cities such as Chicago, Baltimore, Cleveland, Houston, Orlando, Denver, and Dallas. Branson also serves as a regional center for healthcare services. The Cox Medical Center Branson, which changed its name from Skaggs Regional Medical Center in early 2013, serves more than 90 patients a day, houses 165 hospital beds, and employs nearly 1,000 physicians and support personnel. In addition, a new Veterens Affairs (VA) outpatient clinic was opened in Branson in 2008.

Adding further to the growth of the economy, Branson Hills Plaza, a 141-acre development located just off of U.S. HIgway 65, opened its first phase of development in 2006, and has since grown to over one million square feet of retail and dining space, including Target, Home Depot, and a Walmart Supercenter. Additionally, the $450-millions Branson Landing development opened in 2007. Located on the shores of Lake Taneycomo, Branson Landing features a convention center with more than 220,000 square feet of meeting space, two full-service hotels, over 100 shops and dining options, and a $7.5-million water show, which combines the excitement of fire, water and music, daily.

These and other investments during the past decade have led to growth in lodging supply and demand. However, demand declined in 2011 due to a flood, and in 2012, due to a tornado that closed the convention center for two months, and

FIGURE 1: HISTORICAL & PROJECTED HOTEL PERFORMANCE



Source: Smith Travel Research

the connected convention hotel for seven months. Occupancy increased in 2012, due to the decrease in supply. In 2013, year-to-date numbers through the first quarter demonstrate growth in occupancy and average daily rate (ADR).

The most recent recession, as well as an increase in supply, has led to a substantial decline in occupancies locally. This impact was exacerbated by the flood in 2011 and the tornado in 2012. Recent trends in 2013 indicate an improving lodging market in Branson. As new hotel supply stabilizes and demand continues to rebound following the most recent national economic recession, occupancy and ADR levels are expected to increase in Branson. Our interviews with local hotel representatives indicated a generally positive outlook for the near future.

Supply Changes

One of the biggest threats to existing hotels and their values is the potential development of new competitors. If supply grows faster than demand, then occupancies must decline, at least in aggregate. On the other hand, ff new supply represents high-quality or high-rated hotels, this supply change can lead to increasing ADR levels, assuming the supply is eventually absorbed and occupancies stabilize at a profitable level in the market area.

The Branson market has experienced significant changes in supply over the past decade, mostly corresponding with major investments in public-private partnerships, as previously cited. The following hotels represent a sample of recent new supply additions and the year each property opened:

- Hilton Promenade (2007)
- Hilton Convention Center (2007)
- Hampton Inn (2009)

Together, these three properties represented a supply increase of 625 hotel rooms within a ten-year period. Fluctuating demand in the area has led to limited supply growth.

The recent openings of the Hilton Promenade and Hilton Convention Center hotels, represent a major upgrade in the quality of accommodations available in the Branson market. As the only upscale hotels in downtown Branson, these hotels enjoy a favorable location and limited direct competition. These properties have quickly become among the rate leaders in the Branson sub-market and are the only full-service hotels in downtown Branson.

Demand Generators

Lodging demand has grown substantially over the last decade, partly due to the new supply built in 2007 that allows previously unaccommodated demand to stay in Branson. A new convention center and business investments have spurred lodging demand growth in the area as well, but the recession as well as two natural disasters have caused demand levels to fluctuate in recent years. The following demand generators are key considerations for hotels in this market:

- Branson Convention Center
- Live-show theaters
- Silver Dollar City
- Branson Airport

- Branson Landing
- Branson Hills Plaza
- Cox Medical Center Branson

Accounting for the two-month closure in 2012, the Branson Convention Center has reported stronger than projected numbers since its opening in 2007. The theaters and live shows are also a major attraction in the "Live Entertainment Capital of the Midwest". However, most theaters close for two months after Christmas, adding to the seasonal nature of the Branson lodging market. Other demand generators include Silver Dollar City theme park, which debuted a new rollercoaster in 2013, and Branson Airport, which began offering service on Southwest Airlines in early March of 2013.

These demand factors are generally strengthening. Though the total number of visitors to Branson declined in 2011 and 2012, due to the flood and tornado, pre-recession numbers showed a continuous increase in visitor statistics. As such, the outlook for lodging demand growth in the area is generally positive.

FIGURE 2: BRANSON LAKES AREA VISITOR STATISTICS

Year	Total Estimated Visitation to Branson	Percent Change
1991	2,918,133	—
1995	5,630,613	93.0 %
2000	7,000,000	24.3
2005	7,330,290	4.7
2006	7,983,945	8.9
2007	8,397,500	5.2
2008	8,088,724	(3.7)
2009	7,781,000	(3.8)
2010	8,010,000	2.9
2011	7,500,000	(6.4)
2012	7,300,000	(2.7)

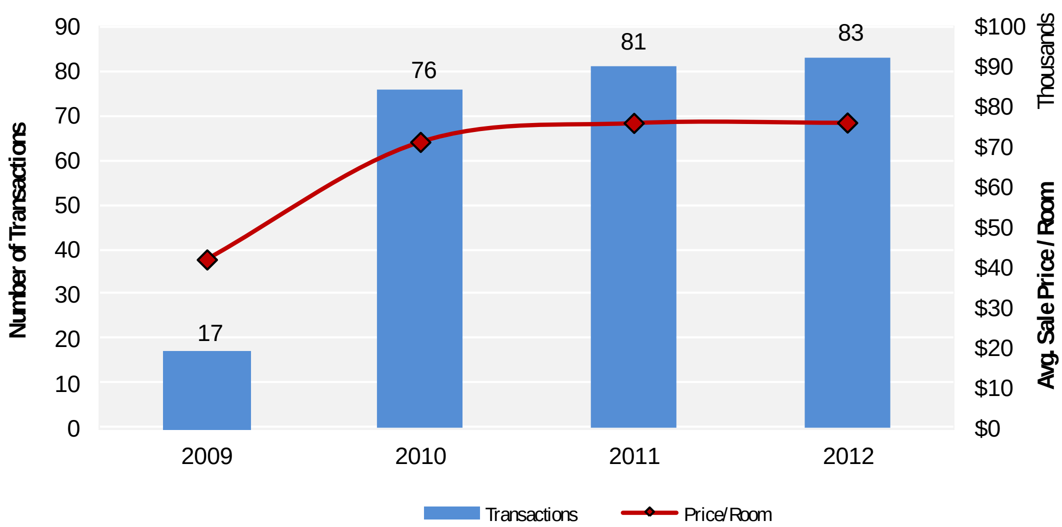
Source: Branson Lakes Area Convention & Visitors Bureau

Hotel Transaction Trends

In the last five years, there have been no hotel sales in the city of Branson. Furthermore, there have only been five transactions in total in the surrounding market area for the last five years. Therefore, we obtained data on the state of Missouri and surrounding areas.

The following table shows the number of hotel sales that occurred in each of the past four years in Missouri and the surrounding area, as well as the average sale price per guestroom in each year.

FIGURE 3: HOTEL TRANSACTION TRENDS AND SALE PRICES PER ROOM



Source: HVS

As you can see, the number of annual transactions has been slowly increasing since a large jump in 2010. The increase in transaction activity in was most likely due to strengthening performance of many hotels combined with increased availability of funding for hotel acquisitions. Transactions in 2012 also appear to represent hotels that were not distressed. This is in contrast to the three previous years, which were marked by heightened uncertainty among hotel investors and limited availability of capital. Two significant factors have contributed to the increasing volume of transactions. Firstly, as performance measures improve and the economy strengthens, the gap between sellers' asking prices and buyers' offering prices has narrowed. Secondly, as banks have strengthened their balance sheets, the availability of commercial real estate lending has increased. This has provided some investors who want to buy hotels with access to the capital necessary to make offers that are being accepted by sellers. Current year data show 39 transactions so far, up from 32 transactions for the same time period in 2012.

Average sale price per guestroom has also increased over the last four years, in line with the number of transactions. As economic conditions continue to improve, the average sale price per guestroom has increased since 2009. Average sale prices reached more than $76,000 per guestroom in 2012, marking a record high level compared to recent years.

These sale price trends reflect changes in the types of assets transacting and the conditions of sale as well as overall trends in hotel values. So, the average sale price of under $42,000 per room in 2009 should not be compared directly with the average sale price of nearly $77,000 per room in 2012 for the purpose of calculating value increases of any particular hotel properties. The transactions that have occurred so far in 2013 represent an average sale price of $ 48,000 per room. This decline in room price can be attiributed to the fact that as a percentage of total hotels sold, more Budget and Mid-Scale hotels have been sold thus far in 2013 compared to the same time period in 2012.

Development Cost Ranges

The replacement cost or development cost of hotels can be another factor that influences hotel values. Perhaps the most relevant unit of comparison for evaluating a hotel's development cost is the cost per guestroom. We have evaluated developer budgets from several hotels in the region. The following table summarizes development cost estimates from a sample of recently planned hotels, representing extended-stay, limited-service, and select-service hotels in the upper-midscale and upscale chains.

FIGURE 4: ESTIMATED DEVELOPMENT COSTS FOR RECENTLY PLANNED HOTELS

Development Cost	Extended-Stay Upper-Midscale	%	Limited-Service Upper-Midscale	%	Select-Service Upscale	%
Building Construction	$55,000	59%	$60,000	65%	$95,000	62%
Furniture, Fixtures & Equipment	12,000	13%	11,000	12%	16,000	10%
Other Costs	12,000	13%	13,000	14%	23,000	15%
Land	14,000	15%	8,000	9%	19,000	12%
Total Development Cost / Room	$93,000	100%	$92,000	100%	$153,000	100%

Source: HVS

These estimates indicate total development costs that range between $92,000 per guestroom and $153,000 per guestroom, including land. Building construction costs represent the largest component of a hotel's cost, between about 59% and 65% of the total estimated development costs for these hotels. Land costs typically represent between about 10% and 15% of total development costs, depending on the location and design of each hotel.

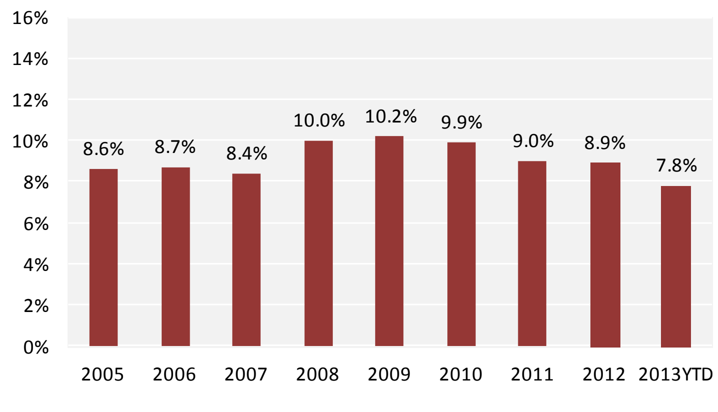
As is typical, average development costs for new hotels appear to exceed the average sale prices of older properties recently sold in this regional market area. When development costs exceed values, this can be an indication that new construction is not feasible in the near-term. However, the sale price of an older hotel is not necessarily a good indication of the market value of a new hotel. The unadjusted sale prices from recent transactions may not be sufficient to derive conclusions about whether a project is feasible because adjustments may need to be considered in order to derive an opinion of market value from hotel transaction data. An experienced appraiser can help determine whether such adjustments are necessary. Moreover, the income capitalization approach is often considered a more appropriate method for deriving value opinions pertaining to commercial properties, such as hotels.

Income Capitalization

The income capitalization approach is often considered the most relevant approach to valuing complex income-producing properties, such as hotels. There are numerous techniques that can be used in the income capitalization approach. One of the simplest techniques is known as Direct Capitalization. In this method, a value conclusion is developed by dividing a hotel's net operating income, from a single year, by an appropriate capitalization rate or cap rate. These cap rates can be derived from actual transactions if the sale prices and annual income figures are available for recent transactions.

Drawing on the extensive HVS database of hotel transactions and income statements, we developed the following figure, illustrating the trend in overall cap rates for hotels in several Midwest states, including Missouri. Cap rates increased significantly in 2008 and remained high in 2009. They began declining again in 2010 as economic conditions led to improved net operating incomes and as the outlook for hotels became more optimistic.

FIGURE 5: HOTEL CAP RATE TRENDS IN MISSOURI REGION



Source: HVS

Why have cap rates fluctuated so much? A cap rate incorporates both a risk component as well as an assumed growth component for income over a holding period. One possible interpretation of this trend in the data is that hotel investors perceived hotel acquisitions to be relatively risky in 2008 and 2009, but that those perceptions began to reverse starting in 2010 as the national economy strengthened, leading to increased competition among buyers seeking to acquire hotels.

A second possible interpretation of the data suggests that hotel investors have become increasingly optimistic, in the past three years, about the potential for hotels to experience significant income growth. This sentiment has been bolstered in recent quarters, especially as strong income growth has been realized at many hotels during 2012 and 2013. Perhaps a combination of both factors – perceived reductions in risk and increased optimism about income growth potential – best explain the data.

Although cap rates can be useful to illustrate trends and can be an important value factor to consider, the Direct Capitalization technique is not always the most appropriate technique for valuing hotels. A discounted cash flow analysis can allow for a more thorough analysis of a multi-year income projection.

An even more thorough analysis could include a mortgage-equity technique, which allows one to value a property based on a typical financing that would generally include a loan component and an equity component. For more information about hotel valuation, please visit our library on the HVS website at www.hvs.com or contact us directly.

About HVS

HVS is the world's leading consulting and services organization focused on the hotel, mixed-use, shared ownership, gaming, and leisure industries. Established in 1980, the company performs 4500+ assignments each year for hotel and real estate owners, operators, and developers worldwide. HVS principals are regarded as the leading experts in their respective regions of the globe. Through a network of more than 30 offices and 450 professionals, HVS provides an unparalleled range of complementary services for the hospitality industry.

Superior Results through Unrivalled Hospitality Intelligence. *Everywhere.*

HVS CONSULTING & VALUATION – CHICAGO OFFICE
HVS Chicago office specializes in hotel consulting and valuation. Our clients include investors, lenders, rating agencies, buyers, sellers, government agencies, tax assessors, operating companies, and owners. Contact us any time at **(312) 526-3885** or visit our website at **http://www.hvs.com/Services/Consulting/Chicago/** for more information.

About the Author

Dana Waud is an Analyst at HVS's Chicago office, specializing in hotel consulting and valuation. She holds an EMBA and Masters Degree in Hospitality Administration from École hôtelière de Lausanne in Switzerland. She graduated from Boston University's School of Hospitality Administration with a Bachelor of Science in Hospitality Administration. She is currently working to obtain her State Appraisal Trainee license for Illinois. Ms. Waud can be contacted by telephone at (312) 846-1028 or by email at dwaud@hvs.com.