



## COMMERCIAL ACCOMMODATION MARKET

### Where Are We In The Cycle?

March 2010

As a motel broker for over 25 years, the writer has seen a number of cycles in this industry. Like most industries, the fortunes of those operating in it are determined to a large extent by the prevailing supply and demand equation. The purpose of this paper is to discuss the current situation and the possible outcomes of the factors affecting the market at this time.

With the economy having recently been through a recession, it is easy to forget that in a normal economy there is growth. This means growth in demand for goods and services across various industry sectors. The visitor accommodation industry usually experiences annual growth, at varying rates. Also in a normal economy, there is growth in supply, new motels and hotels are built to cater for the growth. Supply and demand seldom grow at the same rate and usually there is some "leap frogging" of one over the other. Sometimes, one factor outstrips the other considerably resulting in either an oversupply or an undersupply of accommodation.

Some regions have fared better than others, but in a number of localities there is an oversupply of accommodation at present, to varying degrees. This brings about a softening in average room rates achievable, which has a significant impact on bottom line profits. This is because most costs are fixed and so reduction in room rates transfers straight to the bottom line. (This of course works just as well in the opposite direction, with profits rising quite quickly if the average room rate rises.) The problem for the industry generally, is that room rates have not risen enough over the last decade or so. There will be a number of reasons for this, however the effect is that it is now usually not viable to develop new visitor accommodation, because the return would not be there based on the room rate achievable. Land prices generally doubled between 2002 and 2007 as did building costs. Things are therefore very much out of kilter when one can obtain a hotel or motel room at little if any increase in room rate compared to a number of years earlier. In other words, it does not make much sense considering that the cost of producing a new building has doubled, while the price to stay in it remains the same or very similar. We have therefore an anomaly in the market. Recognising anomalies in the property market and acting on them can be profitable.

In most areas, there is little if any development underway or even proposed at this time. Christchurch is a particularly good example, where despite being the biggest market in the South Island, there is no development of motels underway at present and as far as we are aware none impending. As of early 2010 the Novotel in the Square and the Rendevous in Armagh Street are opening bringing some 360 hotel rooms on stream. This may seem like a large number of rooms, but relative to the size of the market, the percentage increase is not large. Compare this to the period between 1997 and 1999 when at the time of the so called Asian Crisis a number of empty office buildings were available at bargain prices. Examples are the Millennium, the Centra, the Grand Chancellor and Camelot on the Square. All of these office buildings plus some others created some 1200 hotel rooms in an 18 month period between 1997 and 1999. Additionally, due to very good accommodation statistics coming out in the mid-nineties, a number of motel developments which were planned about that time were coming on stream. Estimates at the time were that there was an increase of some 45% in beds available in the Christchurch market.



Naturally this created a huge oversupply problem at the time and some real pressure on those in the industry. As with all cycles though, it eventually turned and by summer of 2000 we were receiving anecdotal feedback that beds were hard to obtain in Christchurch once again. History now shows that the market recovered from there and saw some good times from 2002 to 2007. Compare this to the current situation. We are not aware of any proposed hotel developments in the Christchurch market and our research is unable to find any definite proposals. (There is not to say there are none, however we would be surprised if there were any.) Apart from anything else, funding is difficult these days for any new development projects. The biggest obstacle though, as previously mentioned, is the economic viability. We believe that room rates need to rise some 30% to 40% above where they are now in order for a new development to be financially viable. Room rates ultimately determine profit and profit is what determines the value of a commercial accommodation building.

In 2008, total national guest nights for the year dropped quite notably. This is unusual and in 2009 the market recovered to some extent edging up just 0.5% to the end of November 2009, compared to the previous year. At 2.7million guest nights for the year, this was down 4% from the November 2007 high. So, a drop of 4% doesn't sound much, but given that during a two year period normally, there could be between say 12% to 15% compounded growth, it makes quite a big difference. This is part of the reason for the downward pressure on tariffs resulting in the low profitability being experienced by the industry in recent times. We have however, returned to growth in guest nights and it is likely that this will continue. (See article attached and [www.tourismresearch.govt.nz](http://www.tourismresearch.govt.nz)) The question therefore is where is the supply going to come from to absorb this growth? Apart from the economic viability being questionable at today's tariffs, the tap cannot be turned on overnight in providing new accommodation. Also, vastly increased development levies have been imposed by most local councils in the last couple of years, most of the recent developments obtained permits prior to the impost of those extra costs.

If someone were forward looking enough to anticipate the return to growth and was prepared to accept a below market rate of return in the interim, then now would probably be a good time to start thinking about building. (In the current environment it would be difficult to fund such a proposal.) We need to see an increase in average room rates across the board to bring the development viability back in to line. In the meantime, we may see the pendulum start to swing the other way in terms of supply and demand. If we have increasing demand and almost static supply, then hopefully the operators will be able to raise their prices when they are no longer under pressure just to fill their rooms. Once room rates reach a point where development is viable again, we may commence the next leg of the cycle in creating additional supply. It would seem logical that it would be a great time to be in the industry if it was experiencing rising tariffs, resulting in exponential increases in profitability, which is then leveraged in to business values which are normally based on a multiple of profit.

We would be very interested to hear from anyone who can see events taking a different path and to what possible circumstances could lead to this.

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■ INBOUND AND OUTBOUND

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## Aussies push visitor numbers to record

The number of overseas visitors arriving for short-term stays in January reached a record for the month, as numbers from Australia remained high.

Statistics New Zealand said yesterday 256,700 visitors arrived in January, up 5 per cent from a year earlier, and above the previous January high of 253,500 in 2008. Visitor arrivals had risen in eight of the past 10 months, compared with the same months a year earlier.

Visitor arrivals from Australia rose 13,000, or 16 per cent, in January, compared to a year earlier, continuing large monthly rises that started last April.

Visitor arrivals from Korea rose 1900, or 30 per cent, while those from Japan rose 1200, or 16 per cent.

It was the first time since September 2007 that visitor arrivals from Japan had improved, when compared with the same 2009 month, but numbers from Japan were still only almost half the peak of 16,000 in January 2005, SNZ said.

Visitors from China fell 4800, or 34

per cent, affected by the timing of Chinese New Year.

The 2.47 million arrivals in the January 2010 year were up 22,000 on the January 2009 year, and similar to that for January 2008.

The number of visitors from Australia rose 12 per cent, or 117,700, to 1.1 million for the year, while those from Britain were down 22,400, or 8 per cent, visitors from Japan fell 20,300, or 20 per cent, from Korea they dropped 19,700, or 26 per cent, and from China down 18,400 or 16 per cent.

Visitor numbers from Australia had more than doubled since the January 2000 year, while the 79,600 from Japan was less than half the annual high of 174,800 recorded in the January 2003 year, SNZ said.

During January, New Zealand residents left on 106,800 short-term overseas trips, up 1700 or 2 per cent from January 2009. For the January year, the number of departures fell 2 per cent to 1.92 million. NZPA

## Permanent arrivals beat those heading overseas

The number of people arriving permanently or long-term in this country exceeded the number of departures by 2500 in January, the highest net gain for a January month since 2004.

The increase was driven by 1700, or 30 per cent, fewer permanent and long-term (PLT) departures to Australia, compared with January 2009, Statistics New Zealand (SNZ) said yesterday. PLT arrivals overall fell 400 from January 2009.

Seasonally adjusted, PLT arrivals

exceeded departures by 2000 in January 2010, up from 1700 in December, and similar to the average of 1900 since February 2009.

In January 2010 there was a net inflow of 1100 migrants from Britain, with 400 each from India and China. The net outflow of 2100 migrants to Australia was the lowest for a January month since 2004, down from 4100 in both January 2008 and 2009, SNZ said.

The net migration gain for the year to January was 22,600, up from 4500 in the January 2009 year. NZPA