

THINKING ABOUT MOTELLING IN CHRISTCHURCH?

Some Thoughts As To Why Now Might Be A Good Time To Consider Buying A Motel Business In Christchurch

June 2011

The latest financial performance figures for Christchurch Motels will of course be for the year ending March 2011. Despite a significant upturn in business since 22nd February (more on that later), most results for the year to March 2011 will not have been very impressive. This was due to a number of factors, including the flow on effects from the recession, however also more to do with the supply and demand situation. A separate article is available entitled the [Commercial Accommodation Market](#), this goes in to more detail on this subject, however in brief the situation could be surmised as follows. In a normal cycle, construction is more prevalent during the boom years, most recently from 2000 to 2007. At that time when finance was more readily available and the economy generally growing, a good deal of accommodation was built by way of hotels, motels, managed apartments and other types of traveller's accommodation. Land costs and building costs were increasing quite quickly during that time and, due to the plentiful supply of accommodation, tariff rates were not able to rise. Thus it became less and less financially viable to develop new accommodation. This brought about a significant reduction in the amount of building going on. We felt that it was likely that the cycle would complete itself by seeing some good growth in revenues over the coming two or three years as demand caught up with and then exceeded supply.

For the Christchurch market, and to some extent for surrounding areas such as Ashburton, Timaru and Hanmer Springs, the situation changed drastically on the 22nd of February 2011. According to widely published information, approximately 50% of Christchurch's accommodation stock is currently out of action. Some of this will be reinstated however some of this will need to be completely rebuilt. Tourist numbers into Canterbury are reported to be down 20% to 25%, a reduction which is nowhere near as large as the reduction in accommodation capacity. Additionally, earthquake related work is putting extra pressure on the demand for accommodation. At this time motels are enjoying very high occupancy during the week from the likes of insurance adjusters, engineers and other professionals at the assessment and recovery stage. There are some conflicting reports, however generally it seems there is not an oversupply of residential rental accommodation available, hence the need for visitors to take longer term accommodation at commercial rates. We believe that this demand may well continue in the near future as people are displaced from their homes for earthquake repair work. We will also need accommodation for the workers and contractors who will come to Christchurch to take part in the building boom. It is easy to see why Christchurch motels are busy for now, the question of course is how long will this last?

Apart from demand relating to earthquake activity and recovery, what should also be considered is the likelihood of recovery in visitor numbers. Quoting ASB chief economist Nick Tuffley, the following information may be of relevance:

- The Boxing Day Tsunami that hit Thailand in 2004, resulted in an immediate reduction in visitor numbers by around 25%. After one year, the industry had recovered to being -5% and normal visitor numbers had resumed after two years.
- In September 1999 a large and damaging earthquake known as the Chi-Chi Earthquake hit the northeast region of Taiwan. This resulted in a 55% drop in visitor numbers in the year 2000. By the year 2003 however the visitor numbers were double the pre-quake levels.

- In May 2008 a 7.8 magnitude Earthquake hit the Sichuan Province in China. Domestic tourism numbers recovered there within one year.
- Looking at the bigger picture, events that can be recalled include the Bali Bombings, the New Orleans Floods, SARS and of course 9/11. History shows that all of these events whilst being very major in their nature were forgotten about fairly quickly as far as tourist behaviour was concerned.
- Statistics show that the visitor arrivals and guest nights were increasing again nationally for New Zealand by April 2011. (www.tourismresearch.govt.nz)
- The recoveries mentioned above were without the help of the world wide publicity from a Rugby World Cup.

So, if visitor demand is likely to recover and other demand stay strong in Canterbury, particularly through earthquake related business, what about the supply side of the equation? A good number of hotel rooms will be demolished in Christchurch over the next 12 months and it will certainly take longer than two years to see those replaced. Under normal circumstances, a hotel would take at least three years from the initial concept through design and planning to resource consents, tendering, construction and completion. For Christchurch this is likely to be further delayed by at least a year before it can even be contemplated in the central city area. The demands on the construction industry may mean less resources available to build any hotels. Also, who is going to want to stay in a high rise building in the CBD in any case in the near future? Some motel construction is underway and planned at present, however the returns based on recent performance would have been poor and these projects can have only been contemplated by those who could accept the low return in the interim whilst taking a long time view. (That situation has also changed now.) The motel numbers are not significant in the scheme of things. For hotel and apartment construction, below is the latest report from Horwath HTL in their May 2011 Hotel, Tourism & Leisure Outlook:

New Hotel & Serviced Apartment Supply Update

OUR market research and enquiries have identified the following new hotel and service apartment supply in the main visitor destinations in New Zealand.

There are 654 new hotel rooms scheduled to open in Auckland in 2011. Of this new supply, 82% will be located at or near Auckland Airport. This significant increase will place strong pressure on AOR and ADR in the airport precinct post RWC.

The 276 rooms/apartments to open in Queenstown will be managed by Hilton and will add substantial competitive pressure on the 4-5 star hotel market.

The lack of new supply in other centres, including Auckland CBD, should help operators raise occupancies and room rates. ■

Notes: A = announced U = under construction
 O = opened TBC = to be confirmed * = Expansion
 This table excludes proposed new supply that has not been publicly announced.

Region / Location	Status	Opening	Star	Brand/Operator	Announced / Under Construction		Opened in 2010	
					Hotel Rooms	Apartment Units	Hotel Rooms	Apartment Units
Auckland								
Cnr Federal & Kingston Streets*	O	May 2010	4	Rydges			81	
Greenlane	U	Aug 2011	3½	TBC	118			
Emily Place	O	June 2010	4	Waldorf				123
Auckland Airport (Inter)	U	May 2011	4½	Novotel	260			
Near Airport	U	May 2011	4	Sudima	151			
Auckland Airport (Dom)	U	Sept 2011	2	Formule 1	125			
Customs Street	A	2013	4.5	Accor	296			
Rotorua				Nil	Nil	Nil	Nil	
Wellington				Nil	Nil	Nil	Nil	
Christchurch								
Cathedral Square	O	Jan 2010	4.5	Novotel			193	
Gloucester Street	O	Mar 2010	4	Marque			171	
Dunedin								
Princes Street	U	Late 2012	4.5	Distinction	172			
Queenstown								
Kawarau Falls Station	U	May 2011	4	Kawarau Hotel		98		
Kawarau Falls Station	U	May 2011	5	Hilton	178			
Total					1,300	98	445	123

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As can be seen above, the majority of construction either underway, announced or recently opened is in Auckland and mostly near the airport. The report notes the two new hotels which opened in Christchurch earlier in 2010 and the research does not suggest any further projects even in the pipeline at this stage. Our observations concur with this. Queenstown shows the pending completion of the Kawarau Falls Station, a hotel project which had progressed to the stage of having too much investment at stake not to proceed. Other than that though, there seems to be little in the way of major hotel or apartment construction planned for the South Island generally.

Apart from these factors, there is also the general direction of the New Zealand and Asia Pacific economies. Economic confidence is higher than it has been for some time and not without good reasons. Our major trading partner Australia is poised to see some impressive growth being the raw materials bank for the burgeoning Asian economies. New Zealand is in an excellent position to ride the Asian prosperity train via Australia, whilst remaining the food basket of the Asia Pacific region. All of this creates business and domestic activity, all of which requires traveller's accommodation.

Asking prices for motel businesses (leases) are still very reasonable by historical measures. The difficulty we have found in the market over the past two or three years, was that the industry generally had lost much of its profitability. This caused by downward pressure on occupancy resulting in room rate reductions and the loss of margins. We normally would calculate business values on a ratio of profit to price by way of market returns and, whilst vendors were prepared eventually to lower their price expectations, their profitability had fallen even further. This meant that even at a considerably lower asking price the return on investment was not there by normal measures and this made these businesses hard to sell and hard to finance. Understandably, purchasers and their advisors would tend to ignore the historic values (and revenues) and perhaps future values of these businesses and focus only on the current financial performance. This approach could still be argued, given that as mentioned earlier, performances to March 2011 are not that impressive. Price expectations though are still relatively modest. We phoned our Christchurch vendors after the quake to find that most still had a variety of genuine reasons for wishing to move on and left their price as it was, albeit perhaps a bit firmer. This in the knowledge that the whole situation would be changing in terms of occupancy, revenue and profitability.

Christchurch motels are now very busy. Many have solid long term bookings without the need to discount. The discounting, or lack of it, is a major factor in profitability as the room rate charged has no bearing on running costs. So with higher tariffs, profit is enhanced but also longer stays reduce the operating costs for the motelier, further enhancing profits. These revenues and profits will naturally flow through to the current year's financial results and most likely show quite a significant change by March 2012.

We are still hearing the comment that one can only purchase and arrange finance on the most recent financial information. (In "normal" times however, we have seen lease finance arranged on many occasions for motels that had yet to be built.) That being the case, then some of our vendors would need to drop their prices even more to align them with 2011 profitability. We believe this is highly unlikely given the current situation. It is therefore up to the individual as to whether they wish to maintain this stance and simply not purchase a motel. Perhaps wait until the better figures are shown on paper and pay much more?

What do you think?

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