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# VALUATION AND MANAGEMENT OF HOTEL PROPERTY: SWEDISH EXPERIENCE

The purpose of this paper is to provide an understanding of the economic forces that drive hotel real estate value in the market and give an insight into Swedish hotel market development.

A hotel is a real estate property that provides paid lodgingon a short-term basis. Hotels differ by type and by service provided. By type hotels can be divided on resort hotels, luxury hotels and convention hotels. Resort hotels are characterized by the recreation, sport and training facilities and extensive amenities. Luxury hotels provide a full service with fine dining, on-site shopping, guest services and exceptional amenities. Conventional hotels are located near convention center, have large number of rooms, ample meeting space and banquet facilities, restaurants and lounges. By service hotels can be divided on full service, limited service hotels, and extended stay or suite hotels. Full service hotels have in-house dining, swimming pool and fitness center, meeting rooms, conference centers and good amenities. Limited service hotels have comfortable room, affordable rate, continental breakfast, and pool and fitness room, limited amenities. Extended stay or suite hotels provide week-long stay or more, are apartment like, have a small kitchen in each apartment, affordable rates and limited amenities.

Hotel is not just a real estate property that provides the hosting services; it is also a business that includes restaurants, business and conference facilities, and sport and recreation services. When valuing hotels it is sometimes hard to separate the value of real estate with the economic value. The value of income producing properties isdetermined by the ability to generate flow of incomes. But hotel income depends on the factors that are often independent from real estate, such as the level of service, extra services and facilities, etc. That is why the value of the hotel property is the value of operational incomes from the hotel services and the hotel building as a “complete business/product”. When doing hotel property valuation the question regarding what should be valued (the property itself, or hotel business, or both) is arising. Hotels properties are very specific in comparison to other real properties. It is hard to change the use type of the building, for example to transform it in to warehouse, office or

a shop. Payback period is much longer than other commercial premises have. Typical payback period for hotel investment is around 15 years in comparison with office buildings that have much shorter payback period (Yu, p. 360). Therefore commercial banks prefer lending money to office building developers and use higher required rate of return because of higher investment risks. Normally income from rooms takes usually around 60–70% of total incomes, additional incomes from restaurants 20–30% and extra services and facilities generate 5–10% of the total income from hotel property.

Valuers usually use the estimated market value using the tree main approaches – the cost approach, the sales comparison approach, and the income approach. Valuers apply market indicators of return requirements and other valuation parameters to produce their estimates. Investors estimate investment value, which includes the effects of income taxes, the investor's unique cost of capital, and other investor-specific conditions.

The cost approach is based on a determination of the cost of replacing a property, with adjustments for various forms of depreciation and obsolescence. The sales comparison approach compares the known sales prices of hotels that are similar to the subject hotel. The income capitalization approach capitalizes the anticipated earnings of the property in order to estimate its total value. In theory, all three approaches result in the same value estimate. In practice, however, the value indicated by the income capitalization approach most closely reflects the type of analysis generally performed by typical buyers and sellers. The results from the cost and sales comparison approaches are generally used to support and verify the results of the income approach (Rushmore, p. 13).

The income capitalization approach is based on the principle that the value of a property is indicated by its net return, or what is known as the "present worth of future benefits". The future benefits of income-producing properties, such as hotels, are the net incomeestimated by a forecast of income and expense along with the anticipated proceeds from a future sale. These benefits can be converted into an indication of market value through a capitalization process and discounted cash flow analysis (Rushmore, p. 2). The forecast of incomes and expenses is expressed in inflation-adjusted currency unit for each year. Adjustments are also made for different stages of the current business cycle and the probability (risks) of receiving incomes. The residual value reflects the anticipated operating results of the property over its remaining economic life. Estimations in Sweden are based on five year forecast and application of an appropriate discount rate (total property yield).

Market penetration or the "Fair share" concept should also be taken into account when valuating hotels and estimating demand. If a hotel represents 10% of the hotel supply in the market, then all else being equal, it should get 10% of the demand; this is its "fair share". If the hotel is very competitive and it is accommodating more than this amount, then it is "outpenetrating the market". The historical analysis should include a market penetration analysis to show the hotels that are doing the best. Revenues and expenses are to be market-oriented; it is to be assumed that the hotel is managed efficiently (not necessarily with the current management).

The advantages of income approach are that this approach reflects market behavior and the reliable data is readily available. As stated in the textbook entitled "Hotels and Motels: Valuations and Market Studies", "Of the three valuation approaches available to the appraiser, the income capitalization approach generally provides the most persuasive and supportable conclusions when valuing a lodging facility" (Rushmore, Baum, p. 356).

Sales comparison approach is a method whereby the appraiser estimates value by comparing the subject to similar properties which have recently sold. Adjustments are then considered for various applicable factors. Valuer should keep in mind four major factors that affect hotel values – number of rooms, net operating income, average daily room rate (ADR) and occupancy. Sales comparison approach has its limitations for application due to lack of recent sales data, the numerous insupportable adjustments that are necessary and therefore questionable results. But at the same time the sales comparison approach is most useful in providing a range of values indicated by prior sales and for determining market-derived capitalization rates.

Cost approach is limited to apply because the effectiveness of valuation is decreasing with time and depreciation of hotel building, functional changes and external factors that affect the hotel values. Because the cost approach does not reflect these income-related considerations and requires a number of highly subjective depredation estimates, this approach is given minimal weight in the hotel valuation process. However, it is useful in establishing a benchmark for buy versus build decisions and for relative pricing over time (Rushmore, p. 2). The main indicators here are the vacancy rate and the average daily rate (ADR). Value estimation should also take into account extra incomes from restaurants, conference services, fitness and relax facilities. The ADR should be market-based, or in other words, the existing ADR may not be the ADR the hotel should be achieving. Historical growth should be examined to see the dynamics of ADR as

well as ADR at competitive hotels should be considered to see the achieved average rate.

One more approach is to determine the hotel value by using multipliers. One of the multipliers that can be used is called a room-rate multiplier (ADR multiplier) and is based on the average daily rate. The value is calculated by the following formula:

$$\text{Value} = \text{ADR} \times \text{Room number} \times \text{ADR multiplier}.$$

For example, if multiplier equals 1000, ADR is $200 and number of rooms is 250, then the value is: Value = $200 × 250 × 1000 = $50 mln. The size of multiplier depends on the hotel class and location, and should be calculated separately for each location area and hotel type and class.

Rule of thumb method is based on the price of the room mini-bar item (MBI multiplier). For example if the price of the Coca-Cola bottle from the minibar in the same hotel is 2$, the value will be: Value = = $2 × 250 × MBI multiplier. The size of MBI multiplier can vary a lot depending on hotel class and location making this method the less reliable. The value should also keep in mind the development activity in the area and the business cycle.

When doing final reconciliation of hotel value valuer should examine the values from the approaches completed and determine which approach is the best. Judgment should be made taking into consideration the quality of data obtained. Even if appraiser can give most consideration to one approach or another, the final value final value should never be determined as an average of the approaches used.

Hotel market in Sweden has a long history and successful performance. That is why it is interesting to consider Swedish experience in hotel industry. Stockholm hotels primarily serves a domestic market, in terms of both leisure and corporate demand, which makes the improvement in the domestic economy an encouraging sign for hotel demand (Balekjian, Sarheim, p. 1). The main international source markets for Stockholm are Germany, the UK and the USA. Additionally, visitation from emerging economies, such as Russia and China, has shown significant growth in recent years Stockholm's demand is primarily business-oriented, accounting for more than 60% of total overnights in the capital (Balekjian, Sarheim, p. 2). Stockholm is both a business and leisure destination; however, its seasonality patterns are still quite pronounced based on the winter season with January and December being the two quietest months (Balekjian, Sarheim, p. 4). Chart 1 describes seasonality of hotel industry in Sweden. Stockholm experience the long-term positive dynamics in volumes of night spend as well as in accommodation revenue, that is shown in Chart 2.

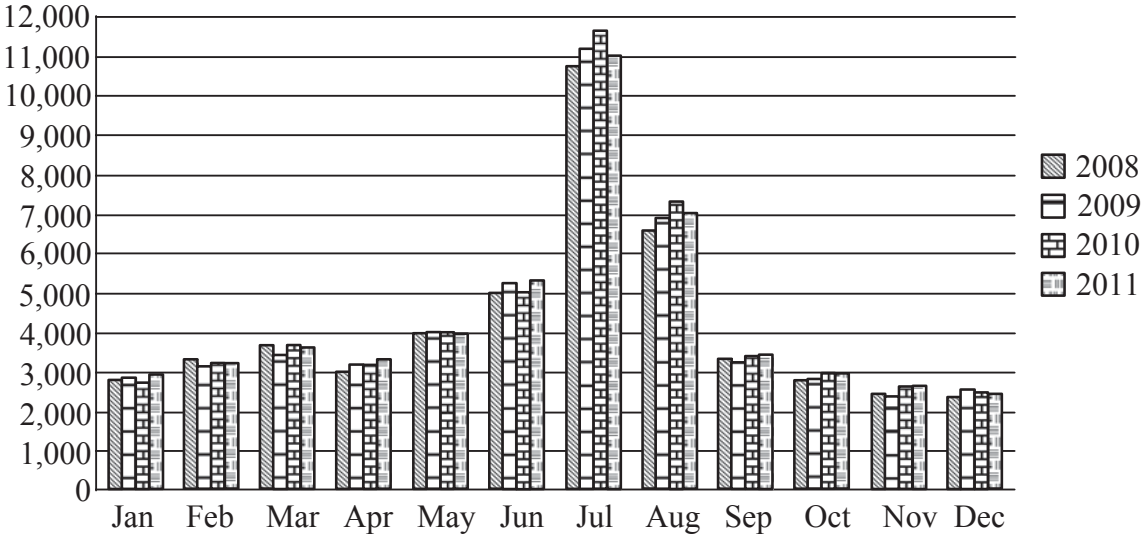


Chart 1. Total volumes/nights spent (in thousands) month by month at hotels, holiday villages, youth hostels, camping sites and commercially arranged rentals in private cottages and apartments in Sweden
(Source: Tillväxtverket/SCB)

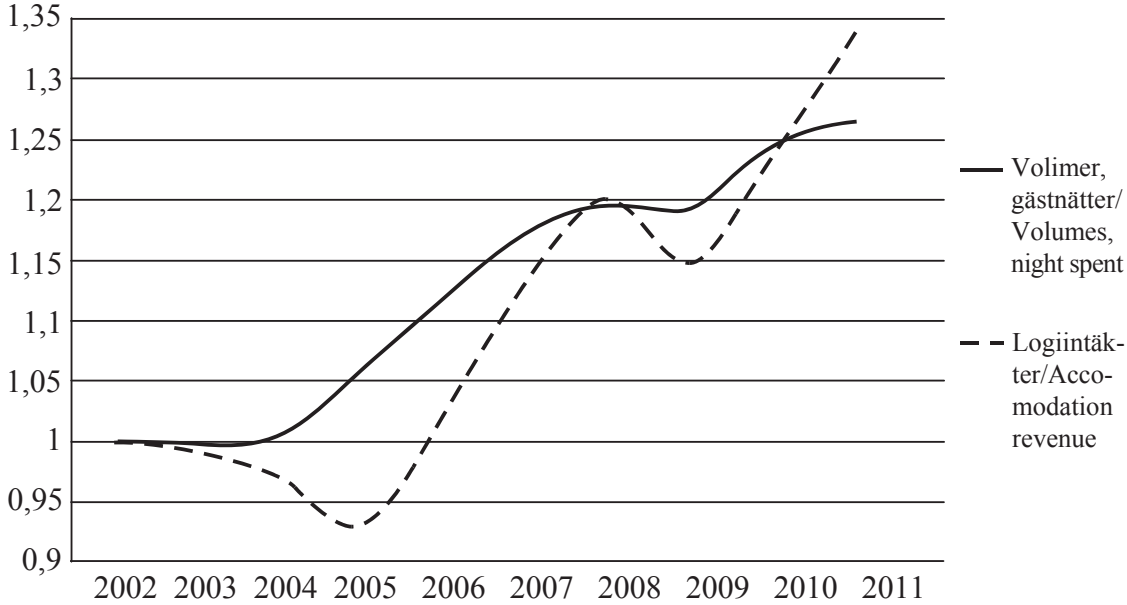


Chart 2. Index for development of accommodation revenue (current prices) and volumes/nights spent at hotels, holiday villages and youth hostels in Sweden
(Source: Tillväxtverket/SCB)

According to a report produced by the Stockholm Business Region Development agency, there are 136 hotels in Stockholm accounting for more than 16,800 rooms. The city's hotel room supply covers all categories, with the majority being branded by groups such as Scandic, Rezidor and Choice. Currently, the city's room supply is dominated by the four-star category, accounting for nearly half of total room supply (Balekjian, Sar-

heim, p. 6). Table illustrates the confirmed future branded hotel supply in Stockholm over the next few years.

**New Supply – Stockholm, Sweden**

| Property | Category | Number of rooms | Opening date | Location |
|---|---|---|---|---|
| Radisson Blu Waterfront Hotel | 4-star | 418 | 2011 | Waterfront Congress Centre |
| Scandic Grand central | 4-star | 397 | 2011 | Vasagatan |
| Scandic Victoria Tower | 4-star | 300 | 2011 | Kista Science City |
| Clarion Hotel Arlanda Airport | 3-star | 414 | 2012 | Arlanda Airport |
| Quality Hotel Solna | 3-star | 380 | 2012 | Solna |
| Omena Stockholm | 2-star | 200 | 2013 | Torsgatan |
| Total | | 2109 | | |

Source: HVS Research

The split between real estate and operating business became more common for hotels in recent years, as the market assigned specific roles to investors (i.e., landlords), end-users (i.e., hotel operating companies) and developers (e.g., resort developers that include a hotel in the development mix).

In the conclusion it is important to underline that valuation of hotel property requires understanding of the economic forces that drive hotel real estate value in the market. Hotel is not just a real estate property that provides the hosting services, but also a business. When valuing hotels values should estimate value of real estate together with the economic value.

Sweden and particularly Stockholm hotel market experience positive dynamics during recent years. Belarus and other countries should consider the experience of Sweden when creating necessary conditions for successful development of hotel market. This implies several measures. First of all, renovation and certification of existing hotels. Second, integration into international and online booking systems. Third, creation of market information system that is transparent for foreign investors.

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