IZ-Tutorial “Location- and Market Analysis”: Hotels

A “Quick-Check” of Location and Site Will Not Suffice for Hotel Developers to Put Their Minds at Rest

Special real estate assets require special approaches for location- and market analyses. Martina Fidlschuster and Christine Mayer from HOTOUR, a consulting firm with a focus on the hospitality industry, presents this approach for hotel real estate. They describe the individual steps of analysis: starting with a “quick-check”, followed by a site- and market analysis and continuing on to a feasibility analysis for the respective project phases.

As of 2004, the number of overnight stays in commercial hotel establishments in Germany has increased by 10.6%. Alongside the overall positive economic situation and the interest of international investors, this has led to a noticeable increase in activity on the market for hotel real estate (see diagram on next page). Hotel properties are no longer seen as a backup investment within a weak office market, but have turned into viable investment properties, as such.

Increased investor interest has spurred the interest of project developers. But not every site or property is suitable for a hotel, whereby suitability is determined by a multitude of differing criteria. The analysis design for hotel sites makes evident that the specifications overlap with those for office-, residential-, or commercial sites only for specific aspects. An office property located in a side street rather than in a prime location can certainly constitute a well-functioning, high-return property. A hotel, however, necessitates good visibility and accessibility of the site.

Because of these considerable differences, a detailed market- and location (and site) analysis constitutes an essential starting point for hotel project development. Within this context, the general adequacy of the location and site are determined. At the same time, the basis for the product’s conceptual design and positioning is established. The positioning of a hotel – as a conference or boutique hotel, for example – and its category (see diagram on bottom right) makes it possible to determine required space and provides preliminary indication regarding potential rental income. The assumption that rental income for hotel properties is based solely on space is wrong. The number of rooms is relevant!

The objective of this article is to delineate the distinctive features of a market- and location (site) analysis for hotel project developments for the individual development phases. It is assumed that a site is assessed with regard to its suitability for a hotel operation. Three levels of analysis with increasing depth are differentiated:

- the quick check
- the location (site)- and market analysis and
- the feasibility analysis

During the first phase of project development, the primary goal is to determine whether the use of a project as a hotel is considered promising with as little time- and cost expenditure as possible. Here, the analysis of the micro-location, i.e. the site, is of primary concern.
The First Do-It-Yourself Quick-Check

Based on the following set of relevant questions, as the first step, the project developer can assess the most relevant influential factors by himself.

1) **Location, image factor and site acceptance:** Generally: not all sites match all conceptual designs. While a budget hotel can be successful when located in an industrial area close to the highway and on the outskirts of a city, a luxury hotel would not fit into such an environment. Depending on the desired category, it should be assessed whether guest expectations with regard to the respective conceptual design can be met by the hotel’s immediate location. Neither an all-residential- nor a ghetto-type neighborhood are suitable as a location for a hotel.

2) **Size of site and allowable capacity utilization:** International and national hotel operating companies expect a hotel to have a capacity of at least 80 to 120 rooms (1-2-star hotels) and generally 150 rooms for a 3-star-plus property, in order to operate cost-efficiently. Even smaller boutique hotels should have a capacity of at least 70 rooms. In addition, back-of-house areas and circulation areas must be taken into consideration. A four-star hotel, for example, requires between 50 and 70 m² GFA per room.

3) **Eyecatcher, i.e. visibility:** A hotel’s success depends largely on its visibility. A location at a central point within a city or on a frequented highway is optimal. The hotel operation is noticed, which constitutes the most essential feature for its success. While a hotel can create demand for itself to a certain extent, a significant location disadvantage can only be compensated through exceptional competencies and marketing activities on behalf of the operator. Thus, in the eastern part of Germany, many properties that have failed can be found next to abandoned investments in hardly noticeable side streets or in a picturesque environment in the middle of nowhere.

4) **Site Reachability:** A hotel should be easily accessible. This is also the case with regard to public transportation, whereby the connectivity to railway stations, airports, fairgrounds, etc. are especially relevant. If all four criteria are met, a detailed location (site)- and market analysis are definitely recommended. Even if only three factors are apparent, a more detailed market analysis performed by an expert can pay off. In all other cases, the site appears as though it is not or only conditionally suitable for a hotel property.

**Stoma as a Basis for Conceptual Design and Addressing of Operators**

Addressing the appropriate operator constitutes a decisive criterion for the economic success of the future hotel property and the overall development, since most operators feature special hotel concepts. The name “operator property” contains the two factors for success for a hotel operation: it requires a capable operator and a property that adequately matches the operator’s conceptual design.

A detailed market- and location analysis, which elaborates on the market requirements, possible supply gaps as well as displacement potential, enables drawing conclusions with regard to the optimal operator concept and required infrastructure.

It is not rare for project developers to prefer upper-scale hotels for prestige reasons. But care must be taken! High average room rates merely suggest higher revenues. In practice, these are often much lower.
than expected. Especially in the start-up phase, a well-operated budget hotel can achieve much better returns.

An operator will expect to see a compelling location- and market analysis prior to checking whether a hotel project fits into his portfolio. This must make apparent the suitability of the site for the given hotel project and must entail the rationale for the given hotel brand (and the respective conceptual design) at the given location. The better the expectations of the operator are met, and the more professional the analysis and preparation of relevant information, the greater the chances for success.

If the operating company is merely presented with the results of the rudimentary quick check, a proposal may well be thrown out without further consideration. From the point of view of the operating company, the quick check fails to address decisive questions, thereby making follow-up research necessary for the operator's in-house development group. This is generally the case when dealing with locations other than the “Big Six” cities, where the presence of hotel operating companies are not necessarily a must. Expertise coming from an independent consultant who is familiar with the requirements set forth by the development departments of the operating companies, leaves are more professional impression, thereby increasing the chances for success.

Ideally, the first rough conceptual outline entails both the most relevant conceptual parameters of the project (number of rooms, infrastructure, parking garage, etc.) and the location- and market analysis. With this information, the hotel operating company is in the position to draw resilient conclusions regarding potential interest in the project.

The following discusses aspects with regard to the location (site) and the market for overnight stays, that will most definitely need to be addressed when dealing with most national and most definitely all international hotel operating companies.

1) **Basic economic conditions of the respective city:** A diversified mix of businesses, the presence of firms with a high demand for overnight stays (service providers, international firms, corporate headquarters) and a high level of purchasing power generally constitute – as for other forms of property use, as well – favorable conditions. If the attractiveness of the city with regard to tourism is, moreover, strong enough, so as to ensure high occupancy levels on weekends and during the holiday season, then the basic prerequisites for a successful hotel operation are optimally fulfilled.

2) **Traffic and (Macro-)Site Accessibility:** Good accessibility of the site within Germany and possibly Europe is essential. Good international accessibility is optimal, whereby demand is especially high at international hubs, such as, for example, the Frankfurt airport. It should be taken into account that not only hotels at or adjacent to an airport or railway station benefit from the passenger volume. Much rather, an entire region can benefit, such as, for example, the region around the Munich airport.

3) **Potential for Out-Of-The-Ordinary Business Activity:** International- or national important events, such as fairs, conferences, cultural- or sporting events often create additional demand for hotels. It should, nevertheless, be recognized that special events such as, for example, the Wagner-Festival in Bayreuth or individual international conferences do not suffice to run a hotel profitably throughout the entire year.
4) **Analysis of Micro-Location (beyond the quick check):** The suitability of a site for a hotel property – and especially for the special concept of the operator to be addressed – needs to be made plausible. The advantages of the respective site as compared to other sites in the surrounding area should explicitly be pointed out. A good macro-location will most likely induce many developers to think about a hotel operation with regard to available sites or vacant properties and to offer these to operators.

5) **Demand Generators in Surrounding Area:** Businesses within closer proximity, fair- and conference facilities as well as other event locations are considered demand drivers. Places of interest for tourists – whereby this refers to attractions that are significant beyond the given region, i.e. the cathedral in Cologne rather than the local pond of the fire brigade – are also important to increase occupancy levels through private tourists. It is, however, always advisable to rely on many demand generators rather than concentrating on just one – which is demonstrated by several poor-performing hotels within proximity of local civic centers in smaller primary cities. Generally, the more difficult the market situation (see point 7. Competitive Analysis), the more a detailed analysis of potential demand – i.e. interviews with relevant contacts from businesses and organizers of events - can illustrate the profitability of a commitment.

6) **Development of Hotel Market – Supply:** A hotel market with many new hotels (especially within the same market segment) indicates that the operator may face strong competition. On the other hand, this could also constitute a signal for an expected increase in demand. The evaluation thereof requires special market expertise. Special attention should be paid to research into other planned hotel development projects. It would be quite embarrassing – and rather senseless - to address a hotel operating company that is in the prospect of opening a hotel in a neighboring street.

**Development of Hotel Market- Demand:** A longer-term assessment of the development of overnight stays is essential rather than merely performing a comparative analysis with the previous year. Even if a time series based on historical data does not necessarily predict the future, consistent growth is a good indicator of healthy demand and is more valuable than the mere comparison of a poor year in 2005 with a positive year in the World-Cup year 2006. In addition, the structure of demand, i.e. reasons for overnight stays, length of stay, etc. needs to be analyzed in order to define potential target markets.

7) **Competitor Analysis:** The defined relevant competitors – based on the aspired market segment – must be inspected and strengths and weaknesses must be analyzed. Potential operators want to know how supply is structured: Do supply gaps exist, could these constitute a competitive advantage for the projected hotel: Are the defined potential competitors – based on the respective segment – situated in unfavorable locations, is the condition of the property poor, are significant characteristics non-existent, could this represent a supply gap that the projected hotel could fill. However, should a number of hotel properties display a poor condition, this could also provide indication for the poor profitability of these hotels, which does not allow for larger investments.

8) **Rough Conceptual Design:** The most relevant features of a hotel (hotel segment and type of hotel, number of rooms and room size, restaurant – and conference facilities and other infrastructure as well as the back-of-house areas) must be defined so as to selectively address potential operators who are then able to assess whether the projected hotel fits into the product portfolio. A hotelier is not expected to define his unique selling proposition. The project should already entail this. The operator will then advance and refine it.
9) **Delivery Entrance and Access to the Site:** The hotel’s access route constitutes the first impression a guest is confronted with. It is thus the signature of a hotel. An essential feature of the conceptual design is thus to illustrate to the operator how the driveway should function from the guest’s point of view and where to best position the parking garage. Just as important is the delivery access, which must be kept separate from the guest access route. Ultimately, guests do not want to share an entrance with suppliers.

10) **Last But Not Least:** Even if this does not constitute part of the analysis presented to hotel operators: To find an operator that is optimal for the hotel project, it should be clear whether a lease-, management-, or franchise agreement are all considered possible. Most international hotel operating companies tend to prefer less risky and off-balance sheet management- or hybrid contracts, that – although they allow for higher returns – may not meet the requirements of end investors and are thus wrongly avoided by project developers. Whether certain hotel operating companies and investors are open to which type of contract should thus be researched in advance.

Based on these location-, market-, and project findings, the operator can accurately assess whether the given project fits into his portfolio. If he is interested, an offer will be put forward. An expert should assist in the negotiation process up to the point where a Letter of Intent is signed, since the best solution is always one that is sustainable. High lease-payments may be tempting, but if the operator cannot generate these out of his ongoing operations, sooner or later these will have to be renegotiated.

**Feasibility Analysis to Address Investors and Financial Institutions**

To speed up the financing of a hotel project, it is advisable to present financial institutions, i.e. end-investors, with a feasibility analysis. In addition, a qualified and compelling Letter of Intent (LOI) from a hotel operating company is generally expected. All components of the “location- and market analysis” must be part of this feasibility analysis. Banks generally expect:

1) **Detailed market- and location analysis (see above):** Banks consider hotels risky investments. Only persuasive concepts in suitable locations stand a chance.

2) **Expertise:** The financing bank thoroughly assesses whether the borrower possesses the relevant know-how and expertise in order for a project to become successful. It is thus advisable to be prepared for arguing against the resistance to- and preconceptions of hotel properties.

3) **Benchmarks, comparative data of similar properties:** To present projected revenues in a plausible manner, a comparison to sector-specific figures is helpful.

4) **Profitability Forecasts:** Based on the findings of the location- and market analysis as well as the benchmarks of comparable hotels, a detailed profitability forecast for different scenarios is prepared.

5) **Estimation of investment:** A detailed cost analysis (DIN 276) should be entailed within the feasibility analysis. This helps determine whether the projected revenues – based on the market analysis – justify the overall investment.

6) **Plans:** The construction documents should entail the functionality and building standards. The title from the land registry and the plans of the site should also be a part of the overall documents, alongside the certificate of development rights, time schedule, contracts and specifications.
7) Presentation (introduction) of operator: Potential operator(s) should be presented alongside the LOI, which entails the most important aspects of the operating contract. It should be noted that many banks or end-investors still prefer the allegedly safe fixed-lease contract.

Financing negotiations are very time-intensive. Six to twelve months from the first introduction to the final commitment are not uncommon and should be planned accordingly. Transparency is essential, whereby all information should be prepared in a clear and coherent manner.

Conclusion

Failed properties are often the result of an incorrect perception of the market- and location of a property (aside from treacherous intentions). A hotel represents a very complex operating property with comparatively low initial returns and an increased risk in the first years of operation. Conceptual mistakes can only be compensated for when the location is exceptional.

However, if all conditions are thoroughly assessed and correctly analyzed, a successful location-oriented hotel project development is possible on a sustainable basis. In the long run, a hotel in the right location with the right concept and the right operator is a better investment in terms of value appreciation than any office real estate investment.

The authors: Christine Mayer, consultant, and Martina Fidlschuster, managing partner of Hotour Hotel Consulting GmbH (a consulting firm specializing on the hospitality and tourism industry). The focus of the Frankfurt-based firm is the consulting of institutional and private investors, project developers and financial institutions (www.hotour.de).
### Hotel Segmentation (HOTOUR):

International hotel-segmentation standards

<table>
<thead>
<tr>
<th>Segment</th>
<th>Requirements Micro- / Macro- Location</th>
<th>Standards, typical infrastructure</th>
<th>Typical brands</th>
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</table>
| 5-star city hotel | • Primary locations  
• Exquisite location or exclusive distance to surrounding area | • Typical size: 120-180 rooms  
• Ø-size of standard room 35-45 m²  
• 80 m² GFA / room*  
• Typical infrastructure: 2 restaurants, bar, conference- and banquet facilities, large spa, very generous public spaces | Four Seasons, Ritz Carlton, Rocco Forte, Park Hyatt, Mandarin Oriental, Kempinski, Raffles, Althoff |
| 4-5 star | • Also larger secondary locations  
• Representative surrounding area, suitable for establishing prestige | • Typical size: 150-300 rooms  
• Ø-size of standard room 26-35 m²  
• 60-80 m² GFA / room*  
• Typical infrastructure: 2 restaurants, bar, conference- and banquet facilities, wellness area, generous public spaces | Hilton, InterContinental, Le Méridien, Sofitel, Marriott, Sheraton, Hyatt, SAS Radisson, Gran Mélia, Steigenberger |
| 4-star | • Also smaller secondary locations  
• Representative surrounding area, suitable for establishing prestige | • Typical size: 150-300 rooms  
• Ø-size of standard room 24-30 m²  
• 50-70 m² GFA / room*  
• Typical infrastructure: usually 1 restaurant, bar, conference facilities, sauna and fitness area, tightened public spaces | Maritim, Sol Mélia, NH, Crowne Plaza, Dorint, Steigenberger |
| 4-star conference hotel | • Also smaller secondary locations  
• Representative surrounding area, suitable for establishing prestige | • Typical size: >300 rooms  
• Ø-size of standard room 24-30 m²  
• 75-85 m² GFA / room*  
• Typical infrastructure: 2-3 restaurants, bar, > 1500 m² conference areas, generous public spaces | Maritim, Sol Mélia, NH, Crowne Plaza, Dorint |
| 3-4 star | • Also larger tertiary locations  
• Average to upscale surrounding area | • Typical size: 120-200 rooms  
• Ø-size of standard room 20-24 m²  
• 40-55 m² GFA / room*  
• Typical infrastructure: 1 restaurant, bar, conference facilities, sauna and small fitness area, tightened public spaces | Novotel, Holiday Inn, Lindner, NH, Courtyard by Marriott, Four Points, Mercure, Park Inn, InterCity, Welcome Hotels, Achat |
| 2-star | • Also in smaller cities and industrial areas, also motorway service areas | • Typical size: 80-150 rooms, within the city up to 250 rooms  
• Ø-size of standard room 16-18 m² | Ibis, Express by Holiday Inn, Motel |
<table>
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<th>1-star</th>
<th>One, B+B Hotels</th>
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<tr>
<td>• Average to simple surrounding areas, i.e. arterial roads, industrial areas</td>
<td>• 25-35 m² GFA / room*&lt;br&gt;• Typical infrastructure: 1 bistro-bar, conference facilities, limited public spaces</td>
<td></td>
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<tr>
<td>• Also small cities and motorway service areas&lt;br&gt;• Average to simplest surrounding area</td>
<td>• Typical size: 60-100 rooms, within the city up to 250 rooms&lt;br&gt;• Ø-size of standard room 12-14 m²&lt;br&gt;• 20-25 m² GFA / room*&lt;br&gt;• Typical infrastructure: breakfast area, front desk</td>
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*Depending on the size and number of conference rooms

Comment: primary locations: cities with more than 2 mil. overnight stays; larger secondary locations: cities with more than 1 mil. overnight stays; smaller secondary locations: cities with more than 500,000 overnight stays; tertiary locations: cities with more than 100,000 overnight stays

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### Hotel-Segmentation According to DeHoGa¹:
From tourist (economy) – to luxury hotel

<table>
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<tr>
<th>Description</th>
<th>Min. Room Size</th>
<th>Typical Infrastructure</th>
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</table>
| * Tourist (Economy) | Single: 8 m²  
Double: 12 m² (without bathroom) | All rooms incl. bathroom / WC², simple room furnishing, wake-up device (alarm), chair, table, storage device, reception area, color TV incl. remote control in room, daily cleaning of room, beverages available on premises, extended breakfast, restaurant |
| ** Standard       | Single: 12 m²  
Double: 16 m² (incl. bathroom)        | Medium quality of furnishings in room, sanitary products (shampoo or shower gel), 1 seating accommodation per bed, night light, breakfast buffet, payment with cash card or credit card possible |
| *** Comfort       | Single: 14 m²  
Double: 18 m² (incl. bathroom)        | Upscale furnishing, 10% non-smoking rooms, hair dryer, dressing mirror, luggage rack, telephone in rooms, internet access in rooms, heating devices in bathrooms, bilingual staff, front desk occupied 14 hrs. |
| **** First Class  | Single: 16 m²  
Double: 22 m² (incl. bathroom)        | TV with TV-guide, hotel bar (open 6 days), elevator (> 3 floors), adjustable makeup mirror, bathrobe and slippers on request, internet access in rooms, 24-hr. room service or minibar, front desk occupied 18 hrs. |
| ***** Luxury     | Single: 18 m²  
Double: 26 m² (incl. bathroom)        | At least 2 suites, hotel bar (open 7 days), sanitary products (individually packaged), bathrobe and slippers, safe in rooms and at front desk, speakers in bathroom, 24-hr. room service, front desk occupied 24 hrs., concierge, mystery men checks, nightly turndown service |

¹ DeHoGa = Deutscher Hotel- und Gaststättenverband (German Hotel- and Restaurant Association)

² Small portion of rooms with bathroom in hall possible
The Hotel Market 2007

Without doubt did the soccer World Cup have a positive effect on the hospitality industry, although not to the extent originally expected. It is correct that the past year showed an increase in overnight stays of 2% for all of Germany compared to the previous year. The large percentage of international guests is also evident. But of the 4 mil. additional international overnight stays, merely approx. half can be ascribed to the World Cup. Further, the increase was not only achieved throughout the duration of the World Cup, but throughout the entire year.

It is clear that the soccer-event was a sustainable PR-success for Germany. Germany was acknowledged as an excellent organizer of the World Cup and as an open-minded holiday destination worth visiting for many more reasons than business. Hotel- and tourism associations agree that this will have a positive future effect especially on city travel.

This is confirmed by the order books of hoteliers, which are filled nicely for 2007. They are filled well enough for hoteliers to feel invigorated again after a long dry spell and feel comfortable in adjusting prices upwards. Sophisticated yield-management systems are thereby increasingly used, whereby computer programs promptly calculate prices based on demand. The hospitality sector has many good reasons to look into the future positively.

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Source: Fidlschuster