

Appendix A: Market Analysis

Extract from *The Appraisal of Real Estate, Second Canadian Edition, 2002, Chapter 11 – Market Analysis at pages 11.15 and 11.23-25*

The following is a six step process found in *The Appraisal of Real Estate, Second Canadian Edition, 2002*, at pages 11.15 and 11.23-25 applied in the context of commercial accommodation property:

Step 1. *Property Productivity Analysis*. Determine the subject property's competitive ability by reference to such factors as:

- size
- room rate structure
- overall decor and physical appearance
- quality of management
- chain affiliation
- quality and character of the market area
- facilities and amenities offered
- revenue per available room (RevPAR), which is a common unit of comparison in the lodging industry to compare the income of competing facilities
- location
 - airport hotels and highway-oriented hotels catering to transient guests
 - hotels in suburban locations often rely on adjacent commercial or industrial businesses
 - city centre hotels draw both tourists and business travellers
 - convention centre hotels or resort properties are themselves the destination

Step 2. *Market delineation*. Defining the market area for a hotel/motel can be difficult because this type of property does not necessarily rely on households in nearby communities to generate demand. Instead, linkages to sources of visitation in the area can be more significant than the characteristics of the surrounding neighbourhood. Hotel development occurs often in clusters, and the emergence of a new cluster nearby have an impact on the competitiveness of existing properties.

Step 3. *Forecast demand*. The inferred analysis of demand for hotel rooms may include study of the following:

- Travel and tourism data
- Hotel employment data and convention centre data
- Office space absorption and employment statistics particularly regarding wholesale and retail trade; financial, insurance, and real estate (FIRE); and services
- Occupancy rates at competitive lodging facilities in the subject's class and market area

Fundamental analysis of the demand for hotel rooms is based on historical occupancy and room rate data. Interviews with demand generators such as major employers or officials at chambers of commerce or visitor information centres may yield information that supports an estimate of hotel demand from occupancy figures. Data useful in quantifying hotel demand includes the following:

- Number of nights per stay
- Number of people per room
- Periods of use during the year
- Prices paid for rooms
- Food, beverage, entertainment, and telephone usage
- Methods of travel

Seasonal fluctuations in demand must be taken into account for leisure-oriented properties.

Step 4. *Competitive supply analysis.* Information on existing hotels and developments under construction is generally available, but the difficulties in obtaining hotel financing and the influence of foreign investors complicate the analysis of proposed hotels. Even if the market evidence supports demand for a proposed property, new development may be hindered by external forces such as fluctuations in the economies of foreign countries whose citizens invest in Canadian properties. The analysis of all hotels in the market area concludes with a comparison of the relative competitiveness of all existing and planned properties.

Step 5. *Equilibrium or residual analysis.* The current and anticipated demand for hotel rooms, measured in total room nights per year, can be compared with existing and planned supply of available rooms. There may be a lag time between when demand is evident and when supply can be added to the marketplace to accommodate that demand.

Step 6. *Forecast subject capture.* The ration of room nights that any hotel in a market area can be expected to capture can be derived from the fair share allocated to the property adjusted for competitive penetration factors. The allocation of the total number of room nights demanded between competitive properties can be refined by considering customer preferences such as the following:

- Room price
- Travel distance
- Quality of facilities
- Amenities
- Management
- Image

Hotels with particularly high market penetration in one segment will generally have lower penetration rates in other segments.

Though the foregoing quote outlining the six step process is lengthy it is a key part of completing a highest and best use analysis. Furthermore a thoroughly conducted market analysis will provide information necessary in completing the three approaches to value. For example:

1. In the cost approach a market analysis provides information such as current construction costs, forms of depreciation an existing facility may have suffered since construction and estimates of developer's profit.

2. In the income approach through market analysis, data is collected on room rates, occupancy rates, absorption rates, capitalization rates and the competitive position of a facility in its direct market.

In the direct comparison approach market analysis identifies competitive facilities and their degree of comparability with a specific facility. Data collected and an analysis of current market conditions determines current and values, unit prices (price per room) and changes in the market since previous sales occurred.