Newmark Knight Frank

VALUATION & ADVISORY

CREATE MORE ACCURATE HOTEL VALUATIONS WITH **THE COMPETITIVE QUOTIENT**

The valuation of a given property, which is defined by a well-supported opinion that represents a clear understanding from all applicable parties, can mean the difference between achieving a critical goal—for example, closing a sale, securing a loan, reporting details to investors, selecting a prime asset—or absolute failure.

A crucial part of the valuation exercise when it comes to hotels is understanding the competitive profile of a marketplace and how each property measures up to the rest of the market. To do this, you must develop a clear picture and comprehension of a property's direct (primary) and indirect (secondary) competitors.

One common pitfall related to valuation is the propensity to assign all of a property's direct competitors a 100% competitive rate. However, this would not be an accurate assumption, since hotels seldom compete in this manner due to the differences created by various strategies and characteristics, such as:

- Market segments
- Operating strategies
- Price sensitivities
- Amenities
- Facility needs

Additionally, competitive rates of secondary competitors are tricky in their representation, as the actual percentage selected can be relatively arbitrary. Our client methodology involves the use of an intuitive and valuable tool, which helps address these obstacles: the competitive quotient.

UNDERSTANDING THE COMPETITIVE QUOTIENT

In short, the competitive quotient represents any potential "overlap" between a property and its competitors. For example, a subject property with a comparable demand mix as a competitor would have a significantly higher competitive quotient relative to a subject property that possesses a wildly varying demand composition. If the overlap is greater, the competitive quotient will potentially be higher.

The following example analyzes an actual market offering, and represents a combination of full-service, select-service, limited-service and extended-stay hotels. This market's competitive landscape dictates a limited capacity for multiple assets with identical service orientations.

The table below represents estimated segmentation percentages of the subject property as well as each of its competitors (for the purpose of this example). It is based on analysis of rate structure,

COMPETITIVE PROPERTIES - OPERATIONAL ANALYSIS

			Estimated Segmentation			
Property Name	# of Rooms	Service Orientation	Commercial	Group	Leisure	Extended-Stay
Subject Property	162	Select-Service	37%	11%	47%	5%
Alpha Hotel	301	Full-Service	32%	29%	34%	5%
Beta Hotel	150	Select-Service	29%	35%	31%	5%
Charlie Hotel	306	Full-Service	27%	40%	29%	4%
Delta Hotel	107	Limited-Service	37%	3%	55%	5%
Epsilon Hotel	134	Extended-Stay	9%	3%	16%	72%
Total/Average Including Subject	1,160		30%	25%	36%	9%
Total/Average Excluding Subject	998		29%	28%	33%	10%

service orientation, condition, location, meeting facilities, operational strategy and other aspects.

Once these measurable numerals are applied, the rate differential between each competitor and the subject is considered, in addition to the overall price sensitivity of the regional lodging market. We can then make qualitative adjustments to the competitive quotient based on this information.

For instance, in certain markets, price sensitivity is high. In these cases, the competitive quotient between properties drops at a quicker pace, as the differential in the average daily rate between hotels increases. On the other hand, markets with low price sensitivity will feature a lower competitive quotient, since it will be less affected by the differential in room rates. In this example, the subject's competitive market is assumed to have a moderate level of price sensitivity, therefore demanding a relatively medium-sized adjustment to the potential competitive quotient.

The following table represents a summary of the estimated competitive overlap of each property when measured against the subject's demand levels, in addition to an aggregated overlap potential amount during the base year. It also features the rate differential between the subject and each of its competitors, followed by our overall competitive quotient conclusion for the competitive set.

For the purposes of this analysis, properties with a 70%-or-higher competitive level are thought of as primary competitors, with the remainders considered secondary in nature.

A CLEAR PICTURE OF THE COMPETITION IS KEY

Developing an accurate competitive landscape with this process, though highly involving, is essential for many reasons. The most prominent reason may be the impact of new future supply.

If a new, highly competitive hotel that rivals a subject property, the impact of the project becomes more significant as the quantity of competitive rooms in the market lowers. The fewer the rooms in a market, the lower the buffer becomes. If the total competitive inventory in a given market is overstated, the impact of new supply would likely be understated, and vice-versa.

Determining the competitive quotient of hotels by using the above outlined approach generally lends a noteworthy amount of significance to market-trend projections and, once complete, a much more reliable cash-flow estimate for a given property.

COMPETITIVE QUOTIENT OVERVIEW

Property Name	# of Rooms	Service Orientation	Base Year ADR	Rate Differential	Segmentation Overlap					Competitive Quotient Conclusion	Primary/ Secondary
					Commercial	Group	Leisure	Extended-Stay	Total		
Subject Property	162	Select-Service	$104.05	-	-	-	-	-	-	-	-
Alpha Hotel	301	Full-Service	$91.00	12.5%	95%	82%	87%	100%	89%	85.0%	Primary
Beta Hotel	150	Select-Service	$86.00	17.3%	92%	76%	84%	100%	84%	75.0%	Primary
Charlie Hotel	306	Full-Service	$99.00	4.9%	90%	71%	82%	99%	80%	80.0%	Primary
Delta Hotel	107	Limited-Service	$77.00	26.0%	100%	92%	92%	100%	95%	85.0%	Primary
Epsilon Hotel	134	Extended-Stay	$105.00	0.9%	72%	92%	69%	33%	44%	45.0%	Secondary
Total	1,160									79.9%	

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