



India Hotel Valuation Index – 2008

Uncharted waters?

"I would say, by any commonsense definition, we are in a recession."
-Warren Buffett on the state of the US economy, March 2008.

The economic scenario across the globe is in turmoil. While everyone is waiting to see how the subprime mortgage crisis is going to affect the US economy and subsequently their own, apprehension is gripping investors looking for opportunities in emerging economies such as India and China. Growth in these countries is closely linked to consumption in the US. In our opinion, the ripples from a contracting US market will negatively impact the short-term future performance of these markets.

Nonetheless, the controversial decoupling debate rages on. Increasing evidences show that despite economies being intertwined through trade and finance, the GDP-growth rates are less likely to slow down than that expected earlier. According to *The Economist*¹, some important indicators supporting this argument are

- Exports to emerging countries are increasing faster than the decline in exports to the US. This is helping in stabilizing prices and maintaining growth.
- The four biggest emerging economies are the least dependent on the United States: exports to the US account for just 4% of India's GDP; 8% of China's; 3% of Brazil's and only 1% of Russia's.
- Domestic consumption and investment is increasing in the home markets of the emerging economies. Consumer spending rose three times faster than that in developed countries, albeit over a much smaller base. Investment grew by over 17% in emerging countries as compared to 1.2% in developed countries.

It is, in our opinion, necessary to have confidence in emerging countries, as we believe that these shall be the future global growth engines. The Indian economy has moved decisively to a higher growth rate. Growth in GDP in market prices has exceeded 8.0% in every year since 2003/04 and the trend continues into 2007/08 where a growth of 8.7% is expected². Though the country did face minor hiccups such as the sudden increase in inflation during the latter half of 2007 and the sudden appreciation of the rupee, which caught the entire exporting sector by surprise, the overall fundamentals of the Indian economy continue to remain well founded and resilient.

Overview of the Indian Hospitality Sector

In the 2007 Hotel Valuation Index (HVI), valuations of hotels were '*Riding Cloud 9!*' and they continue maintaining similar levels with supply lagging far behind demand. Though a few Tier-2 cities, such as Pune and Ahmedabad, are witnessing aggressive hotel developments, the Tier-1 cities remain low on supply due to hurdles like high land costs, archaic licensing and development norms and a shortage of international hotel brands especially in the mid market and budget categories. Though the meteoric rise in room rates across hotels has lost a bit of steam, hotels continue to command mind-numbing rates at high occupancies. This is, in our opinion, the ceiling that most hotels shall see in terms of revenues. As is seen in cities like Bangalore and Hyderabad, companies are shying away from the higher end of the market and readily exploring options such as mid market and unbranded hotels.

Overall growth of travel continues to expand rapidly in India. A large fraction of this demand is being created domestically, indicating a strong base and consequently strengthening the argument for further development of hotels, especially in the mid market and lower categories. In 2007, 4.9 million international tourists were expected to have travelled to India; a growth of 12.4% over last year. In the same year, 52.9 million domestic tourists are expected to have travelled; a growth of 14.6%.

The year 2007/08 witnessed a surge in development of mid market hotels in India as domestic demand for that product segment grew the fastest. International and domestic brands are aggressively entering this market and establishing their brands. Innovation is seen in development of new business models and ownership structures of properties. Newer hotels are being built atop malls and other mixed-use developments, mitigating the risks associated with developing a hotel and also capitalizing on the surge in demand for other commercial assets such as office and retail space. Sarovar, Lemon Tree, Fortune, Gordon House, Royal Orchid and Ista are some successful examples of such a strategy. Interestingly, all these are domestic brands with no international presence. While international chains are expected to follow a similar route, they currently have no operational hotels in such a format.

Occupancies in most cities continue to be stable except in Pune and Hyderabad, which have shown a slight decline in overall performance owing to newer developments entering the market and the market showing resistance to the high room rates being charged. As highlighted in the 2008 HVI, hotels in cities like Mumbai and Delhi are adopting a rate strategy vis-à-vis an occupancy one: increasing the revenue per available room. A large quantum of unaccommodated demand is getting accumulated and being catered to by the unbranded guesthouses and serviced apartments springing up in cities like Pune, Bangalore, Delhi, Mumbai and Hyderabad.

Methodology

The HVI endeavours to understand the valuation of a hotel in a particular city based on the hotel's current performance. Our valuation methodology is based upon actual operating data from a representative sample of branded four-star, five-star and five-star deluxe hotels in the top ten hotel markets in India. The data is then aggregated to produce a proforma performance for a typical 200-room hotel in each city. Based on our day-to-day experience of real-life hotel financing structures, which arise from knowledge gained during the various assignments undertaken each year, we have determined appropriate valuation parameters for each market. These include loan-to-value ratios, relevant interest rates, equity yield

expectations and terminal capitalization rates. These market specific valuation parameters are applied to net income streams for a typical hotel in each city to form an opinion on the valuation index.

City Performance and Valuations

Bangalore continues its strong performance with both occupancies and average room rates stable at 2006/07 levels. Though hotel value per room continue to be third highest in the country (Table 4), values of hotels have dropped by over 18.2% last year owing to displaced demand, stabilizing revenues and steep rise in associated costs such as human resources. Bangalore is witnessing a surge of new developments and this supply is expected to enter the market by 2008/09-end. We expect the valuations of hotels to begin correcting by 2009/10.

Tables 1 and 2 show the marketwide occupancy and average room rates respectively of hotels included in our study set.

Table 1- Citywide Occupancy

	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08*
Bangalore	59.0%	64.4%	69.8%	64.3%	72.0%	78.5%	81.4%	76.7%	75.5%	73.5%
Kolkata	57.8%	54.8%	62.9%	66.4%	65.4%	62.8%	69.0%	76.4%	77.1%	77.4%
Chennai	64.7%	65.3%	64.6%	56.5%	58.3%	66.6%	72.9%	78.2%	74.7%	76.0%
Delhi	54.1%	52.9%	58.9%	53.3%	60.4%	73.1%	79.1%	80.8%	78.1%	78.0%
Goa	58.6%	53.3%	60.6%	53.6%	60.5%	59.3%	62.5%	67.8%	73.5%	75.0%
Jaipur	45.6%	47.0%	55.0%	48.3%	44.9%	58.8%	67.2%	65.7%	66.3%	71.0%
Mumbai	67.6%	64.5%	64.6%	52.0%	63.4%	69.7%	72.0%	76.2%	78.7%	80.0%
Hyderabad	66.0%	61.3%	69.1%	68.0%	68.9%	75.9%	78.7%	82.0%	73.3%	69.0%
Pune								81.9%	83.5%	76.0%
Ahmedabad								69.9%	70.8%	73.0%

*HVS Estimates
Source: HVS Research

Table 2- Citywide Average Room Rates

	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08*
Bangalore	Rs3,254	Rs3,025	Rs3,602	Rs3,735	Rs3,752	Rs4,832	Rs7,470	Rs8,762	Rs10,545	Rs10,100
Kolkata	3,888	3,557	3,698	3,409	2,917	3,021	3,240	3,887	5,366	6,300
Chennai	3,600	3,424	3,796	3,535	3,224	3,323	3,714	4,357	5,610	6,600
Delhi	4,626	4,115	4,526	4,338	4,089	4,269	5,103	6,909	9,482	10,200
Goa	2,863	2,727	2,914	2,676	2,754	3,086	3,985	4,804	5,846	6,500
Jaipur	2,533	2,514	2,902	2,949	2,728	2,980	3,461	4,407	5,364	5,800
Mumbai	6,297	5,661	5,555	4,932	4,184	4,356	4,822	6,041	8,614	10,200
Hyderabad	1,579	1,867	2,316	2,414	2,541	2,774	3,772	4,870	6,091	6,600
Pune								3,761	4,885	5,700
Ahmedabad								2,612	3,118	3,778

*HVS Estimates
Source: HVS Research

Kolkata, a price sensitive market, has historically not been able to command the high room rates that cities like Delhi, Mumbai and Bangalore do, despite having equally good offerings. However, with low active development of hotels and a steep increase in the average room rates, the Kolkata market has witnessed growth in valuations of over 28.0% in 2007/08. Kolkata's attractiveness as an investment option is increasing due to the city developing as a major industrial and medical hub and the lack of new hotels opened this year.

Tables 3 and 4 give the hotel values per room in Indian rupees and US dollars respectively, over the past 10 years, while Table 5 highlights the year on year change.

Table 3- Hotel Values Per Room (US dollars)

City	1998-99	1999-2000	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	CAGR*
Bangalore	\$105,902	\$104,248	\$121,657	\$123,482	\$134,575	\$230,928	\$358,805	\$493,822	\$547,989	\$498,417	16.8%
Kolkata	112,267	94,469	101,934	105,406	97,800	100,247	120,754	143,216	189,425	269,669	9.2%
Chennai	128,482	119,648	118,658	110,391	99,206	129,122	161,477	215,695	218,241	292,000	8.6%
Delhi	138,050	116,489	128,993	118,883	124,352	182,071	240,737	276,098	436,237	604,988	15.9%
Goa	61,697	51,854	56,965	49,166	55,928	71,180	99,028	111,097	216,009	322,870	18.0%
Jaipur	50,971	50,584	61,786	58,589	49,338	81,786	110,969	133,307	170,270	272,295	18.2%
Mumbai	220,997	183,900	163,427	124,108	125,704	166,720	219,242	273,201	417,036	611,239	10.7%
Hyderabad	77,261	71,266	101,599	94,529	89,325	135,549	169,965	229,825	266,009	262,270	13.0%
Pune								161,189	201,208	218,933	3.1%
Ahmedabad								95,543	108,894	157,289	5.1%
Exchange Rate	42.20	43.50	44.90	47.20	48.20	46.00	45.00	45.00	44.50	40.00	

* Compounded Annual Growth Rate

Table 4- Hotel Values Per Room (Indian rupees)

City	1998-99	1999-2000	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	CAGR*
Bangalore	Rs4,469,062	Rs4,534,799	Rs5,462,390	Rs5,828,363	Rs6,486,523	Rs10,622,676	Rs16,146,209	Rs22,221,989	Rs24,385,497	Rs19,936,691	16.1%
Kolkata	4,737,686	4,109,383	4,576,848	4,975,142	4,713,945	4,611,367	5,433,922	6,444,713	8,429,434	10,786,745	8.6%
Chennai	5,421,926	5,204,677	5,327,731	5,210,472	4,781,721	5,939,618	7,266,468	9,706,291	9,711,711	11,680,000	8.0%
Delhi	5,825,721	5,067,250	5,791,798	5,611,278	5,993,756	8,375,244	10,833,181	12,424,404	19,412,548	24,199,500	15.3%
Goa	2,603,601	2,255,630	2,557,729	2,320,623	2,695,709	3,274,261	4,456,265	4,999,352	9,612,380	12,914,819	17.4%
Jaipur	2,150,982	2,200,391	2,774,174	2,765,393	2,378,076	3,762,162	4,993,612	5,998,804	7,577,008	10,891,812	17.6%
Mumbai	9,326,061	7,999,645	7,337,890	5,857,907	6,058,945	7,669,122	9,865,912	12,294,024	18,558,109	24,449,552	10.1%
Hyderabad	3,260,409	3,100,051	4,561,777	4,461,791	4,305,477	6,235,254	7,648,418	10,342,109	11,837,409	10,480,806	12.4%
Pune								7,253,513	8,953,778	8,757,305	1.9%
Ahmedabad								4,299,436	4,845,791	6,291,551	3.9%

* Compounded Annual Growth Rate

Chennai has historically been a stable market and continues to remain so. While occupancies have generally averaged at 67.8% over a ten-year period, the average room rates have also been well tempered, showing a gradual increase. Owing to a well-spread development across the city's peripheral locations it is witnessing a well spread out development of hotels. Chennai also has some very competitive indigenous brands such as GRT and Ceebros that are now expanding their base in southern India. Value of hotels in Chennai have grown by a healthy 20.3% over the past year and are currently the fifth highest in the country.

Delhi is one of the best performing markets in India. Though the occupancies have remained stable, room rates across the National Capital Region (NCR) have risen steeply making it, along with Mumbai, the most expensive destination in the country. Factors that have enabled this sustained growth of demand are: continued development of Gurgaon as a commercial hub, expansion of the international airport, improvement in basic infrastructure and a demand pattern that is evenly spread across the region. Supply, on the other hand, continues to lag behind demand – primary reasons being the freeze on development plans for a proposed hospitality district as part of the modernization of Delhi airport and Greater Noida expressway hotels – effectively removing 33% of all future supply. Delhi hotels have the second highest valuations after Mumbai and have seen a jump of nearly 24.7% over the previous year.

Table 5- Percentage Change in Hotel Value

City	1998-1999*	1999-2000	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Bangalore	-9.1%	1.5%	20.5%	6.7%	11.3%	63.8%	52.0%	37.6%	9.7%	-18.2%
Kolkata	-8.0%	-13.3%	11.4%	8.7%	-5.3%	-2.2%	17.8%	18.6%	30.8%	28.0%
Chennai	-14.4%	-4.0%	2.4%	-2.2%	-8.2%	24.2%	22.3%	33.6%	0.1%	20.3%
Delhi	-15.4%	-13.0%	14.3%	-3.1%	6.8%	39.7%	29.3%	14.7%	56.2%	24.7%
Goa	23.1%	-13.4%	13.4%	-9.3%	16.2%	21.5%	36.1%	12.2%	92.3%	34.4%
Jaipur	-9.7%	2.3%	26.1%	-0.3%	-14.0%	58.2%	32.7%	20.1%	26.3%	43.7%
Mumbai	5.7%	-14.2%	-8.3%	-20.2%	3.4%	26.6%	28.6%	24.6%	51.0%	31.7%
Hyderabad	42.3%	-4.9%	47.2%	-2.2%	-3.5%	44.8%	22.7%	35.2%	14.5%	-11.4%
Pune								-	23.4%	-2.2%
Ahmedabad								-	12.7%	29.8%

Goa, despite all the pessimism showered by soothsayers, continues to gather strength with each passing year. Goa has traditionally been a strong leisure and meetings, incentives, conferences and exhibitions (MICE) destination. The opening of a convention centre in the future and the development of industry in Goa shall further help cement its position as an important MICE destination. Getting licenses and clearances in Goa continue to remain an arduous task and hence the slow down in new hotel development. This leads to existing hotels commanding exorbitant prices: diverting tourist traffic to other destinations in the country and the South East Asia region, too. There is no supply entering the branded hotel market in the near future, thereby increasing Goa's attractiveness as an investment option. Showing a growth of nearly 34.4% in valuations in 2007/08, hotels in Goa have the fourth most expensive valuations in the country.

Jaipur, according to the World Bank³, is ranked as one of the most business-friendly cities in the country: third amongst the 12 studied. It has also benefited from the construction of the Golden Quadrilateral, a highway development project involving the construction of a high quality highway corridor connecting Delhi, Mumbai, Kolkata and Chennai. Apart from the high flow of tourists into Jaipur, the discovery of oil and gas in Rajasthan has led to increasing demand from related companies such as Cairn Energy, Shell, Oil India and so forth. Occupancies showed a healthy growth, though the average room rates grew by inflation linked 5% and three new hotels also opened. Overall valuations grew the fastest at 43.7% and are currently sixth highest in the country.

Mumbai, the heart of India's commerce and finance, continues to impress with confident increases in average room rates, dislodging Bangalore from the number one position. Though three new hotels commenced operations in 2007/08, demand far outstrips supply. Mumbai's hospitality market has clearly split into smaller micro markets such as South Mumbai, Worli and Parel, Bandra Kurla Complex, Andheri, Mulund, Navi Mumbai and Thane. Current costs of land parcels render it impossible to justify valuations for a hotel while FSI in most parts of Mumbai continue to oscillate between unbelievably low levels of 1 and 1.5. Though there are unconfirmed reports of the current government looking at increasing the FSI in the near future, hotel developments in Mumbai continue to mirror the inefficiency of a non-performing government. With a 31.7% increase over the past year, Mumbai ranks number one in terms of hotel valuations.

Hyderabad, the city of pearls, presents a dilemma for the Indian hospitality sector. Unlike most other cities in India, this city has good development norms, subsidies and governance, thereby reducing the cost of entry for competition. As detailed in our recently published article, 'Metamorphosis of Hyderabad'⁴, Hyderabad has increasingly become an important IT and IteS destination with some of the world's best companies establishing their base here.

Four years ago, HVS had ranked Hyderabad as the most attractive investment destination in India. Today, the picture has altered with room rates stabilizing at 2006/07 rates and occupancies showing a slight decline over the past year. This can be partly attributed to the: opening up of six new properties, rationalization of growth in the IT sector, low barriers to entry for hotel development and emergence of a parallel market of unbranded guesthouses and serviced apartments. With a negative growth in hotel valuations of nearly 11.4% in 2007/08, Hyderabad ranks eight in terms of overall hotel valuations.

Pune has been included in our study set this year owing to the growing interest of investors in this market, its proximity to Mumbai, development of quality industrial and IT areas and also the mammoth construction of hotels. Pune has traditionally been an industrial city with only a handful of branded hotels operating an inventory of approximately 400 rooms. The hotel room count in Pune doubled with the addition of 400 more rooms opening in 2007/08 alone and approximately 5,500 more rooms opening in the next few years. It would be, in our opinion, the first market in India to rationalize dramatically, reducing its attractiveness as an investment destination. With a negative growth of 2.2% in hotel room values, Pune ranks nine in overall hotel valuations among the ten cities considered.

Ahmedabad is the financial capital of Gujarat and the centre of all activity in the fastest growing state of India. Gujarat has impressed the country with its brilliant performance across all economic measures. With a population of just 5% of India, Gujarat accounts for nearly 16.2% of India's industrial production⁵. Exhibiting a growth rate of nearly 15.2%, it has far outstripped the target of 10% as given by the National Planning Commission and the national average of 8.7%. Direct benefits of this good governance are visible in the growth of Ahmedabad as the focal point for all activity in Gujarat. Occupancies have increased by 3% while the rates have increased by 21%. Though no new hotels began operations in Ahmedabad during 2007/08, a large influx of supply is expected in the near future, reducing the attractiveness of a market, which is yet to realize its full potential. Despite hotel values per room growing by an astounding 29.8%, the rise is largely due to a small base and therefore Ahmedabad ranks tenth in the overall hotel valuations.

Replacement Cost Vs Hotel Value

The cost to benefit ratio is the value of the hotel divided by its replacement cost. We have presented a comparative analysis on the replacement costs of a 200-room five-star hotel in each of the ten cities for 2006/07 and 2007/08. Replacement cost has been estimated as the cost of developing a 200-room hotel (including land cost), with facilities that are currently being offered by most five-star hotels of international standards. We then compare the hotel values in each city during the corresponding period to derive the cost to benefit ratios. A hotel project is considered feasible only when its market value upon completion is higher than its replacement cost and the cost benefit ratio exceeds 1.0. Table 6 gives us the value per room and the replacement costs across the ten cities.

Table 6- Cost Benefit Analysis (Indian Rupees)**Cost Benefit Analysis (2007-08)**

	Value Per Room	Replacement Cost*	Cost Benefit Ratio	Rank
Bangalore	19,936,691	12,988,453	1.53	1
Kolkata	10,786,745	12,705,104	0.85	7
Chennai	11,680,000	11,714,334	1.00	2
Delhi	24,199,500	26,000,918	0.93	3
Goa	12,914,819	15,722,000	0.82	8
Jaipur	10,891,812	12,614,013	0.86	6
Mumbai	24,449,552	27,679,757	0.88	5
Hyderabad	10,490,806	11,524,500	0.91	4
Pune	8,757,305	13,273,504	0.66	9
Ahmedabad	6,291,551	11,524,500	0.55	10

*Based on development cost values in 2006-07

Cost Benefit Analysis (2006-07)

	Value Per Room	Replacement Cost*	Cost Benefit Ratio	Rank
Bangalore	24,385,497	10,914,667	2.23	1
Kolkata	8,429,434	9,596,000	0.88	7
Chennai	9,711,711	9,811,000	0.99	4
Delhi	19,412,548	16,230,286	1.20	3
Goa	9,612,380	11,230,000	0.86	8
Jaipur	7,577,008	9,527,200	0.80	9
Mumbai	18,558,109	20,014,286	0.93	5
Hyderabad	11,837,409	8,865,000	1.34	2
Pune	8,953,778	9,905,600	0.90	6
Ahmedabad	4,845,791	8,865,000	0.55	10

*Based on development cost values in 2005-06

With values of hotels reaching incomprehensible proportions, an interesting trend to track in the future shall be the sale and rebranding of existing hotels. There are a number of domestic, unbranded hotels operating across various cities in India that are also in most cases mismanaged. In our opinion, these hotels are one of the best ways of expanding into cities, as one gets ready access to licenses and the hotel. The hotel, too, benefits as renovations can make it functional within a year of purchasing.

As is discussed in the accompanying article (Hospitality India – Growing Pains) on the difficulties created by India's redundant development norms, the cost of procuring land has become so high that standalone hotel developments are becoming less feasible. As can be seen from Table 6, apart from Bangalore and perhaps Chennai, it is not feasible to buy land and construct hotels in any city of India. Another fact that further dampens investor confidence is that these valuations are based on the current performance of hotels in each city when the performance of hotels in nearly every city is at its peak. With future supply rationalizing the rates, valuations of hotels are expected to reduce while real estate prices are not expected to show a commensurate correlation.

We believe that every location needs to be individually studied and the solution tailored accordingly. Developers need to consider mixed-use constructions where the hotel component is combined with other real estate components. It is imperative for the industry to apprise the government of the barriers raised by unrealistic development norms and advocate for their relaxation – facilitating opportunities for growth and construction of hotels.

Shamsher Singh Mann
Senior Associate

HVS Hospitality Services
6th Floor, Tower – C
DLF Building No. 8
Cyber City – II
Gurgaon 122 002 INDIA

Tel: +91 124 461 6000
Fax: +91 124 461 6001
Email: smann@hvs.com
Website: www.hvs.com

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