

NON DOMESTIC REVALUATION 2003

CLASS 262

LICENSED HOTELS

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1.0 INTRODUCTION

This practice note relates to the valuation of licensed hotels falling within Class 262, Sub Class "Hotel" for rating purposes in connection with the Revaluation that will be effective from 1st April 2003

The purpose of this guide is to provide a general framework around which the valuation of hotels can be assessed. It should, however, be borne in mind that no scheme can cater for the range of properties which exist within this class and there will remain, as always, discretion with individual valuers to vary the application of the scheme to suite the particular circumstances of each individual case

2.0 REGULATION/CLASSIFICATION

The regulation of hotels is provided for in the Tourism [Northern Ireland] Order 1992. Under the provisions of Article 12, hotels form a statutory category of tourist establishment.

To be eligible for inclusion in the statutory category i.e. to be called a hotel, premises must meet certain criteria relating to the general nature and character of the establishment and the nature, extent and standard of accommodation and services provided.

The inspection, certification and classification of hotels are the responsibility of the Northern Ireland Tourist Board. Premises are classified solely on the basis of the facilities they provide. Under the present system there are five classifications built around a star system as follows:

- 5 star** - prestige hotels which offer the highest international standards of comfort and service
- 4 star** - large hotels with high standards of comfort and service, in well-appointed premises, run by a professional team. All bedrooms have a private bathroom and some also have a private lounge. Food and beverage services meet exacting standards and there is good room service
- 3 star** - hotels offering good facilities and a wide range of services in comfortable surroundings. Food, wines and refreshments are available during the day and all bedrooms have en suite facilities
- 2 star** - hotels offering good facilities with a satisfactory standard of accommodation, food and services. The majority of bedrooms have en suite facilities
- 1 star** - hotels with acceptable standards of accommodation and food. Some bedrooms have en suite facilities.

Unclassified In addition, a number of hotels are ranked as unclassified. These are hotels that do not satisfy the minimum criteria of the classification scheme or do not as yet meet the minimum standards under the 1992 Order. They include hotels that, at the time of inspection, did not meet the requirements of the particular star rating for which they had applied.

3.0 LICENSING FRAMEWORK

Premises that are certified as a hotel under the provisions of the 1992 Tourism Order can be licensed for the sale of intoxicating liquor. Licences are readily available – there is no requirement to prove “need” or to surrender a subsisting licence.

With the exception of the sale of liquor to residents the general permitted hours [11.00am to 11.00pm] and additional permitted hours in premises providing entertainment [11.00pm to 1.00am] are similar to those of public houses.

4.0 AN OVERVIEW OF THE HOTEL INDUSTRY

Table 1 displays the characteristics of the Northern Ireland hotel stock as at the 31st December 2000 and tables 2 and 3 illustrate the distribution of hotel stock over the years by region and classification

Table 1: Hotel Stock 2000

| Classification | Hotels | Available Rooms | Available Bed spaces |
|-----------------------|---------------|------------------------|-----------------------------|
| Five/Four star | 15 | 1,363 | 2,747 |
| Three star | 42 | 1,853 | 4,595 |
| Two star | 40 | 1,088 | 2,470 |
| One star | 19 | 316 | 710 |
| Unclassified | 14 | 393 | 795 |
| Region | | | |
| Belfast | 26 | 1,846 | 3,859 |
| North East | 35 | 1,198 | 2,874 |
| North West | 19 | 635 | 1,559 |
| South East | 33 | 916 | 2,058 |
| South West | 17 | 418 | 967 |
| Total | 130 | 5,013 | 11,317 |

Table 2: Hotel Stock By Region

| | Belfast | | North West | | North East | | South West | | South East | | Total | |
|-------------|---------|-------|------------|-------|------------|-------|------------|-------|------------|-------|--------|-------|
| | Hotels | Rooms | Hotels | Rooms | Hotels | Rooms | Hotels | Rooms | Hotels | Rooms | Hotels | Rooms |
| 1991 | 19 | 965 | 16 | 368 | 39 | 863 | 18 | 396 | 34 | 786 | 126 | 3,278 |
| 1992 | 20 | 1,042 | 17 | 290 | 36 | 809 | 14 | 348 | 39 | 795 | 126 | 3,284 |
| 1993 | 20 | 981 | 14 | 378 | 39 | 794 | 15 | 274 | 34 | 762 | 122 | 3,189 |
| 1994 | 20 | 1,075 | 16 | 453 | 38 | 858 | 16 | 332 | 36 | 819 | 126 | 3,537 |
| 1995 | 19 | 1,055 | 17 | 501 | 41 | 955 | 16 | 344 | 36 | 823 | 129 | 3,678 |
| 1996 | 21 | 1,210 | 18 | 536 | 41 | 946 | 17 | 382 | 38 | 901 | 135 | 3,975 |
| 1997 | 24 | 1,468 | 17 | 551 | 41 | 1,098 | 18 | 423 | 37 | 929 | 137 | 4,469 |
| 1998 | 27 | 1,752 | 17 | 547 | 39 | 1,243 | 19 | 435 | 35 | 926 | 137 | 4,903 |
| 1999 | 26 | 1,681 | 17 | 558 | 39 | 1,305 | 18 | 427 | 33 | 922 | 133 | 4,893 |
| 2000 | 26 | 1,846 | 19 | 635 | 35 | 1,198 | 17 | 418 | 33 | 916 | 130 | 5,013 |

Table 3: Hotel Stock By Classification

| | Five/Four star | | Three star | | Two star | | One star | | Unclassified | | Total | |
|-------------|----------------|-------|------------|-------|----------|-------|----------|-------|--------------|-------|--------|-------|
| | Hotels | Rooms | Hotels | Rooms | Hotels | Rooms | Hotels | Rooms | Hotels | Rooms | Hotels | Rooms |
| 1993 | 3 | 181 | 28 | 1,186 | 33 | 843 | 31 | 539 | 27 | 440 | 122 | 3,189 |
| 1994 | 4 | 365 | 31 | 1,377 | 31 | 810 | 34 | 577 | 26 | 408 | 126 | 3,537 |
| 1995 | 6 | 536 | 33 | 1,403 | 34 | 864 | 35 | 586 | 21 | 289 | 129 | 3,678 |
| 1996 | 6 | 539 | 36 | 1,486 | 33 | 892 | 34 | 556 | 26 | 502 | 135 | 3,975 |
| 1997 | 6 | 532 | 46 | 2,184 | 32 | 915 | 32 | 525 | 21 | 313 | 137 | 4,469 |
| 1998 | 8 | 725 | 46 | 2,125 | 37 | 976 | 30 | 483 | 16 | 594 | 137 | 4,903 |
| 1999 | 14 | 1,284 | 45 | 2,009 | 38 | 1,048 | 30 | 423 | 10 | 129 | 133 | 4,893 |
| 2000 | 15 | 1,363 | 42 | 1,853 | 40 | 1,088 | 19 | 316 | 14 | 393 | 130 | 5,013 |

As can be seen the number of hotels peaked in 1997/98 at 137 and have reduced to 130, but the number of rooms available is now at its highest level. The number of 4/5 star hotels continues to increase, accounting for almost 12% of all hotels. After decreasing steadily from 1996, the number of unclassified hotels increased in 2000, with the number of rooms more than trebling. This increase may be explained by the opening of two new hotels in 2000 that remained unclassified at year-end

OCCUPANCY RATES BY YEAR

| Year | Year Average % |
|------|----------------|
| 2000 | 53 |
| 1999 | 53 |
| 1998 | 53 |
| 1997 | 53 |
| 1996 | 56 |
| 1995 | 62 |
| 1994 | 51 |

Turning to occupancy performance average room occupancy has remained static for the past four years at 53%.

The above figures show the physical nature of the hotel stock but some further comment is required as to the state of the industry. The industry experienced something of a roller coaster ride between 1995 and 2001 due to the seesaw political situation.

At the same time, a large number of new hotels have been built and new facilities have been added to existing hotels in the expectation of an increase in tourism and business travel.

However the “peace dividend” did not materialise by 1st April 2001 and the increase in the supply of bedrooms has created an extremely competitive trading environment. The result has been that many hotels have experienced a decline in turnover in real terms over the past six years (taking into account inflation since 1995) and profit levels (as a percentage of turnover) have also fallen below the level achieved in 1994/95 in many cases.

In addition, the turnover and profit levels achieved by many hotels has been adversely affected by:

- The strength of sterling creating a significant deterrent to cross-border trade and encouraging domestic customers to go south.
- A staff shortage (particularly for key staff such as chefs) and the introduction of the minimum wage pushing up labour costs.
- The climate levy increasing energy costs (which remain relatively high compared to the rest of the UK), insurance premiums rising dramatically in recent years and a marked increase in the cost of training/recruitment.

5.0 BASIS OF VALUATION

Rental evidence for hotels is virtually non-existent. Accordingly, the receipts and expenditure method is considered to be appropriate

Accounts have been obtained from the Agents acting for the industry. Based on an analysis of these accounts a valuation scheme based on differential percentages for the main income streams has been developed. This shortened receipts and expenditure method will form the primary valuation approach for all hotels

Application of the scheme will require an estimate to be made of the likely level of trade [excluding VAT] considered to be maintainable at 1st April 2001 having regard to the physical nature of the hotel and its location. It should be assumed that a competent hotelier responding to

the normal trading practices and competition of the locality would proficiently carry out the business.

The percentage to be applied will vary according to the classification [star rating] of the premises and the nature of the trade being carried on.

The income streams that make up the total trade are as follows:

- Accommodation
- Intoxicating Liquor
- Food
- Other receipts

The “apportionment” corresponds with the widely used accountancy practice in the hotel industry and should be readily available. Whilst receipts under “other receipts” will be included in the estimate of total trade they tend to be fairly modest relative to the others. For the purposes of assessing NAV, receipts under this head will generally be included with “Intoxicating Liquor”.

5.1 Trade Mix

Trade mix [or income split] has a major bearing on the profitability - and hence rental value – of a hotel. Even premises with the same classification are likely to show wide variations in trade mix depending on location, character, range of facilities, business emphasis etc.

The analysed figures reveal a wide variation within classes and between classes. There is, however, considerable common ground. The figures in the table below should be regarded as the performance “norm” for each class of hotel: -

TRADE MIX

| CLASSIFICATION | % ACCOMODATION | % LIQUOR | % FOOD |
|-----------------------|---------------------------|---------------------|-------------------|
| 1 Star | 10-15 | 40-50 | 40-50 |
| 2 Star | 15-20 | 35-40 | 40-50 |
| 3 Star | 20-30 | 20-30 | 40-50 |
| 4 Star | 30-40 | 20-25 | 40 |

- Receipts under “other” sources are included in the liquor figures
- Unclassified hotels should be associated with 1 star if they have not yet met the minimum standards of the 1992 Order. If however they are unclassified because a decision on their classification is outstanding, they should be classified on the basis of the star rating for which they have applied.

There is nothing surprising in the above figures. Hotels at the bottom end of the market have a strong bias towards the function and entertainment trade whereas those at the top have a more balanced spread across the range- business clients seldom stay in 1 or 2 star premises

6.0 DISTRICT RESPONSIBILITIES

Most inspection, analysis and valuation operations will be carried out by one nominated valuer but some District input may be required.

7.0 INSPECTION PROCEDURES

Hotels should be measured on a NIA basis. However, a pragmatic approach should be adopted – there is little point in surveying each and every bedroom, particularly in a purpose built block; a note of the number and type of rooms will suffice.

During inspection a note should be made of: -

- Location
- Site layout/access
- Adequacy of car parking
- Physical characteristics
- Type of construction
- Repair
- Star rating, or rating applied for
- Design, layout and quality of interior
- Nature and extent of entertainment, function rooms etc

- Additional facilities such as shops, leisure clubs and fitness suites. Care should be taken to determine whether or not these are in the rateable occupation of the owners of the hotel or are held as a separate hereditament under a franchise arrangement or lease
- Type of trade [business, tourist, leisure, conference, function]
- Trade mix if not already supplied [accommodation, food, liquor]
- Number and type of bedrooms
- Room tariff
- Nature and extent of food and liquor trades
- Nature and extend of entertainment

The above list is by not means exhaustive but gives a flavour of the factors that will influence NAV and should, therefore be recorded at the time of the inspection.

8.0 VALUATION APPROACH

The first step in the valuation process is to estimate the Fair Maintainable Trade [FMT] that the hypothetical tenant would envisage when looking at the premises “vacant and to let”

The estimate of FMT should, in the first instance, be based on actual receipts. These can usually be regarded as being representative of the trade of the hypothetical tenant. It will, however, be necessary to investigate all aspects of the trade in order to consider what should properly be taken into account in the hypothetical scenario. Where appropriate, adjustments should be made for over or under trading due to the personality and business acumen, or lack of it, of the actual occupier. It should also be borne in mind that some types of traded can be incompatible. Hotels with high liquor sales generated by extensive entertainment are unlikely to appeal to the overnight visitor.

Forms of return will be used to assemble past trading figures. These should be analysed with care. As with public houses a diverse range of social and economic factors are at play in this sector of the market and past performance cannot necessarily be relied upon to gauge future performance.

It is important too, to differentiate between inherent and personal goodwill. The former reflects the trading potential that runs with the property by virtue of its design, construction, location etc. Personal goodwill is that which has been created in the business by the present

occupier or management and which may not necessarily be maintainable by the hypothetical tenant. In estimating FMT the Valuer should exclude any turnover that is attributable solely or mainly to the personal skill, expertise and reputation of the existing occupier but include any latent potential that might be realised in the hands of an efficient operator.

Where trade is not disclosed an estimate should be made by comparison with other similar hotels in the area. Comparison should be on the basis FMT but care must be taken to ensure a true comparison is made both in terms of the physical characteristics of the hotels and their business and trade mixes.

The FMT will need to be estimated for each of the main income streams as follows: -

- **Accommodation**

Accommodation receipts are generally regarded as being the most profitable of the income streams and hence, can be viewed as a useful guide to profitability. Accountancy practice in the industry is to show such receipts as 100% gross profit. However, it does not necessarily follow that premises with a relatively high percentage of accommodation receipts for its type will be performing above average. Discounting affects accommodation receipts to a greater extent than other income streams and it may be that additional accommodation income has been “bought” by deals and or incentives. Similarly, poor performing liquor and restaurant trade may have the effects of artificially inflating the accommodation receipts in percentage terms.

- **Liquor**

Liquor sales are regarded as the middle ranking receipts in terms of profitability with gross profit margins in the region of 60% - 65%. In terms of percentage of total trade a wide variation is likely to be encountered depending on hotel classification and business emphasis. Many hotels, especially those at the lower end of the market have a strong bias towards the entertainment/ nightclub business. In these circumstances liquor sales are likely to be the dominant income stream – in essence the premises are being run more like a pub than a hotel.

Given the relative insecurity of liquor sales from nightclub trade caution is required when dealing with this element of the business. The turnover should, depending on the circumstances, be weighted at up to 50% before being added to liquor sales

- **Food**

Although similar to liquor in terms of gross margins, food sales are the lowest ranking receipts from a profitability point of view. They tend to be “function” orientated with a competitive price structure geared to “buying in” liquor trade. As indicated previously there is a fairly consistent pattern across all grades of hotel.

- **Other Receipts**

Income from other sources includes room hire, telephone calls, door receipts and machine income. Although they tend to represent only about 5% of turnover such receipts can be highly profitable and should, where quantifiable, be added to the liquor trade, indeed it may, on occasion, be appropriate to include them in the accommodation income if they amount to much in excess of the 5% norm.

The only cautionary note is in respect of door receipts. The amounts generated can, at times, be quite substantial, but the nature of the entertainment being provided is frequently such that the door receipts are not as lucrative as they might first appear. Where door receipts represent the bulk of the other income they should generally be “weighted” at 50% and then added to the liquor trade, subject to the nature and extent of the entertainment being provided.

General Comments

- Certain hotels derive considerable benefit from business generated from a central booking system and/or head office advertising and promotion. This benefit may not necessarily be maintainable by the hypothetical tenant and some adjustment to either the actual turnover or percentage to NAV may be appropriate
- Leisure clubs are generally not profit centres in their own right, despite external membership schemes, but are provided by hoteliers as a facility for guests. As such, their presence is inherently reflected in the room rates and a hotel’s accommodation income. Leisure club income should be weighted at 50% before being added to food sales for valuation purposes to reflect the high staffing and energy costs.

8.1 PERCENTAGE TO NAV

Having established the appropriate levels of FMT for each income stream the next step in the valuation process is to apply differential percentages to establish NAV. Appendix A sets out the range of percentages depending on the hotel classification.

The choice of actual percentage is a matter of valuation judgement. At any level of trading, profitability will vary with the level of gross profit and the expenses required to maintain the property and the particular type of trade being carried on.

In selecting percentages, regard should be had to all positive and negative features of the premises and their trade and the significance of such features in relation to the level and sustainability of the FMT adopted. In essence, where factors exist which indicate higher levels of profitability then higher percentages should be applied and vice versa.

Factors influencing choice of percentages include: -

Primary

- Quality of location
- Age and operational efficiency
- Type and mix of trade and its security
- Seasonality of trade
- Physical characteristics (purpose built / conversion)
- Nature and extent of bedrooms, public areas and function/conference facilities
- Cost of repair and maintenance
- Overall standard relative to class

Secondary

- Nature and extent of competition
- Site layout/access/parking facilities
- Interior design and layout
- Special character/appeal
- Bedroom occupancy rate
- Price structure
- Nature and extent of entertainment

Consideration of the above points, and their opposites, should provide some indication as to the expected level of profitability for the particular hotel viewed against the ranges shown for the individual classes set out in Appendix A.

9.0 INTERACTION WITH THE PUB SECTOR

Throughout the province there are a number of hotels that in reality are operated more in the nature of public houses. They tend to have a relatively low level of occupation receipts but substantial wet and or dry trade. They are probably located in town or village centres and entertainment frequently accounts for a high proportion of the liquor turnover.

Where such premises are encountered regard should be had to the appropriate public house scale. The valuation so derived should take precedence over that emanating from the application of the hotel scheme, subject of course to the maintenance of some sense of relativity.

10.0 RELATIVITY

Having arrived at an initial valuation it will be necessary to stand back and take an overview of the assessment to ensure relativity with other comparable premises.

11.0 CONTACTS

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APPENDIX A

RECOMMENDED PERCENTAGES TO NAV

| Hotel Classification | Accommodation | Liquor | Food |
|-----------------------------|----------------------|---------------|-------------|
| 1* | 5.5-6.5 | 5.0-6.5 | 3.0-4.0 |
| 2* | 6.0-7.5 | 5.0-6.5 | 3.0-4.0 |
| 3* | 7.0-9.0 | 6.0-7.5 | 4.0-5.0 |
| 4* | 8.0-10.0 | 7.0-8.0 | 5.0-6.0 |
| 5* | 8.0-10.0 | 7.0-8.0 | 5.0-6.0 |