

RESEARCH REPORT



CONVERTING EXISTING BUILDINGS INTO HOTELS

Challenges and opportunities

Overview

It's been a challenging period for the hotel sector with savvy operators and developers forced to improve their efficiencies and re-think the status quo to remain competitive. Successful hotel developments depend on a careful balance between understanding the needs and wants of its guests, the developer and the hotel operator.

In this research paper Davis Langdon looks at the challenges and opportunities in converting existing buildings into hotels, based on our experience nationwide.

About the Hotel and Leisure Market

The Australian Hotel and Leisure sector has managed to survive perhaps one of the most challenging decades in history – affected by all manner of global events, pandemic outbreaks, economic volatility, exchange rate fluctuations and terrorism.

But despite all odds, the past decade has also seen short-term visitor arrivals continue to grow – increasing at an average of 2 percent a year.

Room occupancy rates during this period have fluctuated from 70 percent at their peaks to as low as 58 percent.

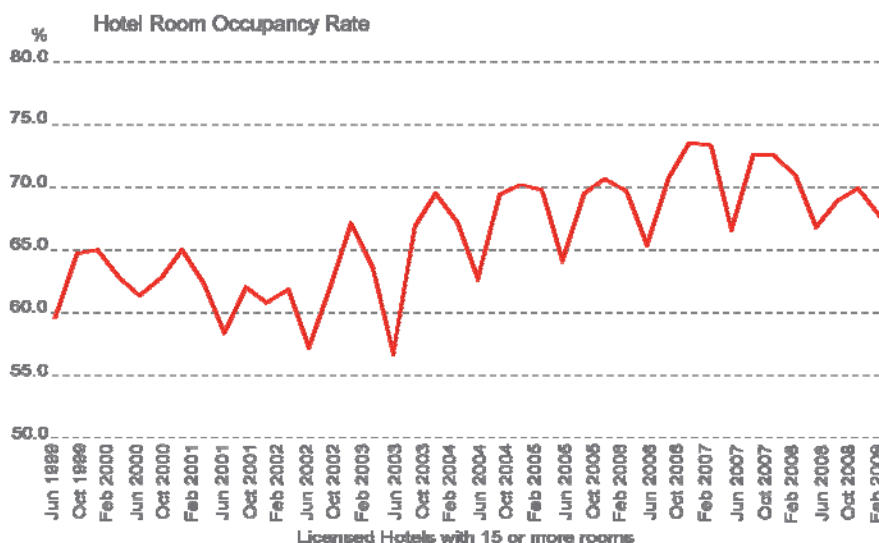


Challenges

It is unfortunate for the sector that moderation in both oil prices and the dollar has occurred at the same time as a global economic slowdown.

Tourism Australia cites that 9 percent of Australia's tourism income is generated from the US market, accounting for \$2.1billion in revenue. However, with the US in recession, the relatively cheaper Australian dollar may not be enough to limit the damage to Australian tourism.

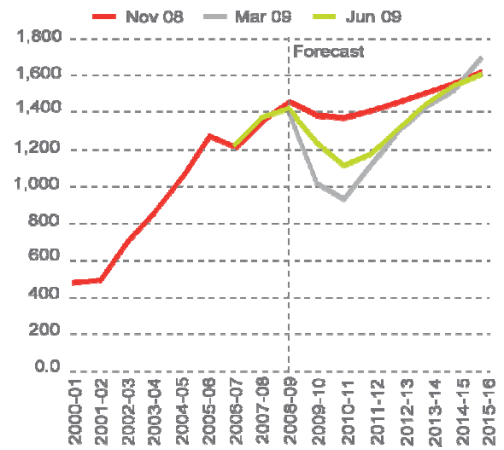
US visitors currently make up 8 percent of Australia's visitors and the Tourism Forecasting Council predicts that Australia will sustain a 1 percent drop in American visitors this year, faring better than the expected 12 percent drop in Japanese visitors and 8 percent drop in British visitors. How the market responds to this remains to be seen.



Accommodation Construction

Accommodation building has been held back by the relatively high Australian dollar discouraging both domestic and international travellers and putting a lid on tourism forecasts.

Taking account of these countervailing forces, the Construction Forecasting Council has been revising forecasts for this sector. The expectation is that activity in accommodation construction will start to slide once the existing pipeline of work is completed, picking up again in 2011-12 to keep pace with ongoing demand.



The Changing Client Profile

Changes in the type of ownership common to the Hotel and Leisure sector have also had an impact on development in this sector. The shift towards sale and leaseback has placed greater emphasis on the split between the operator and the developer. Put simply, the developer is now responsible for the construction and maintenance of the asset, whilst the operator is responsible for implementing the brand.

Developers and their investors are considering accepting the risk profile of non-guaranteed income partly because there is an upside through effective asset management. The long-term value is mainly generated by service quality and is facilitated by building a high quality environment in the first place. Operators, on the other hand, are considering lease arrangements where more predictable cash flows can be planned, leaving the operator with potential upside as demand improves.

Opportunities

Hotel markets across Australia have continued to see high occupancy rates, partly due to the limited supply of rooms. However, as the global economy improves there will be growing pressure on our existing hotel stock, moving forward.

To meet demand developers and operators will need to decide how they will position their asset and their brand, whether they will refurbish existing stock, or create new additions by embarking on a new build or converting an existing building. Needless to say, there are risks and opportunities associated with every option.

A new build can take in excess of three years from inception through to operation – and that's assuming a site has already been secured. For developers and operators this means a long wait before they see a return (until mid-2012 at the earliest) and that's also dependent on their ability to raise finance in this restricted market.

Conversions on the other hand present opportunities to 're-life' existing building stock. They also have the added benefit of shorter overall programmes, lower construction costs (in the order of 65 percent of new build costs) and quicker returns. What's more, they open up access to some prime city centre locations which may otherwise be unattainable, and they present a more sustainable solution by re-using existing buildings.

Key Components of a Hotel Conversion Programme

Hotel conversion projects are almost invariably budget driven with the main task of the project team to achieve the optimum balance between the hoteliers' vision and the constraints imposed by the budget, timescale and the existing building condition.

In any hotel investment the areas of investment that add the greatest value include:

Guest Rooms	Quality bathrooms, larger rooms, in room AV/IT, individuality
Front of House	Designing bars/restaurants as fashionable venues
Conference Facilities	Valuable revenue generation through creation of flexible spaces along with high tech IT/AV capabilities
Back of House	Good quality staff facilities delivering staff productivity/retention improvements to on-floor circulation Consider new and larger lifts

Technical Challenges Associated with Change in Building Use to Hotel

Hotel conversions are often difficult projects, combining problems associated with working in existing buildings designed for a different use with fixed budgets and tight programmes to deliver viability and optimum revenue stream. One can expect a blended mix of the following:

Building Condition – this is the major unknown associated with these projects; city centre buildings, many of which may have expanded over time, can comprise a complex of old, stitched together buildings.

Structure – the influence of existing structures together with restrictions in floor loading, floor to ceiling heights and the construction of new openings and services penetrations can adversely affect the design of rooms and function spaces (and lifts if necessary).

Floor Plans and Fenestration – depth of floor plate and the arrangement of windows is a major influence on the ability to plan efficiently.

Plant Rooms – the introduction of more extensive and sophisticated building services than the previous building's use required will need to be housed somewhere and can create constraints on options available.

Services Distribution – the size and location of existing risers and horizontal routes need careful consideration to suit the likely increased services requirements.

Fire and Acoustics – both vertical and horizontal space separation between floors and cores can be problematic and attract cost.

Building Code Challenges and Opportunities

The conversion of an existing building into a hotel generally involves an upgrade of the building to meet the current 'deemed to satisfy' requirements of the BCA. Depending on the scope of works, this could mean a full upgrade of the whole building to meet BCA requirements or the upgrade restricted to the defined scope.

Generally, existing buildings lack the fire and smoke compartmentation and the sound insulation requirements required by the BCA for accommodation buildings. The existing building will need to comply with the BCA requirements in this area as a minimum to provide for the safe egress of the occupants and also provide privacy during their stay. In addition, existing buildings will also be required to meet the accessibility requirements of the BCA to the main public areas and also to the rooms themselves. Due consideration of the Disability Discrimination Act (and the pending Access to Premises Standard) is also recommended as accommodation buildings attract a variety of persons and facilities to provide for all abilities.

As not all BCA requirements may be able to be met as part of the conversion, alternative solutions to the 'deemed to satisfy' requirements of the BCA will provide the owner with design options with regards to compliance. Given opportunity early during the design phase, the building surveying consultant can recognise opportunities for alternatives and provide the necessary recommendations and support from other authorities (as deemed necessary) to develop a package that will facilitate the approval process whilst providing design flexibility and savings to the owner.

Indicative Costs

In conducting this study, we've made the following assumptions:

- The overall conversion involves a building of 15,000m² over multiple levels with a basement of 650m².
- The building facade, structure and cores are assumed to be complementary with a hotel use.
- The detailed guest floor cost model details the works associated with the provision of 12 bedrooms, associated corridor space along with works to the central core and external facade. An allowance has been included for lift upgrade only per floor.
- The unit rates in this model are based on price levels current in Perth in the second quarter of 2009 based on lump sum competitive tenders.
- The costs exclude enabling works. Costs of FFE, operating supplies, escalation, professional fees and GST are also excluded.
- Adjustments to unit rates should be made to account for location, site conditions, specific building, programme, design and procurement.

Indicative Overall Costs per Grade of Hotel for a Conversion Project

	Low \$/m ²	High \$/m ²	3 Star (300 bed)	4 Star (200 bed)	5 Star (165 bed)
Basement Parking			\$65,000	\$130,000	\$195,000
Upgrade works, non-structural	\$100	\$300	\$65,000	\$130,000	\$195,000
Back of House			\$1,260,000	\$1,575,000	\$1,785,000
Back of House	\$1,200	\$1,700	\$1,260,000	\$1,575,000	\$1,785,000
Front of House			\$12,690,000	\$15,142,500	\$17,212,500
Function/Meeting/Conference	\$2,200	\$3,000	\$5,940,000	\$7,020,000	\$8,100,000
Gym/Spa	\$2,200	\$3,000	-	\$660,000	\$900,000
Restaurant/Bar/Kitchen	\$3,400	\$4,000	\$2,040,000	\$2,220,000	\$2,400,000
Retail	\$1,900	\$2,500	\$1,710,000	\$1,980,000	\$2,250,000
Lobby	\$4,000	\$4,750	\$3,000,000	\$3,262,500	\$3,562,500
Guest Rooms			\$27,000,000	\$27,000,000	\$31,500,000
Guest Rooms	\$3,000	\$3,500	\$27,000,000	\$27,000,000	\$31,500,000
External Works & Services			\$1,250,000	\$1,450,000	\$1,600,000
External Works, allowances			\$500,000	\$600,000	\$750,000
Services, allowances			\$750,000	\$850,000	\$850,000
Total			\$42,265,000	\$45,297,500	\$52,292,500
\$/m²			\$2,701	\$2,894	\$3,341
\$/bed or key			\$140,883	\$226,488	\$316,924

If you would like to discuss the details of this report further, please contact Neil Dickson, Director and Davis Langdon's Tourism Leader, by email: ndickson@davislangdon.com.au or by phone: +61 8 9221 8870

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