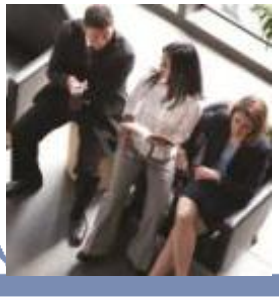
SEPTEMBER 2011

CANADIAN MONTHLY LODGING OUTLOOK

UNDERSTANDING OIL AND GAS LODGING MARKETS IN WESTERN CANADA

Jason Wight
Senior Associate



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| Suite 400 – 145 West 17th Street, North Vancouver, BC V7M 3G4 CANADA

Understanding Oil and Gas Lodging Markets in Western Canada

Introduction

Western Canada, specifically Alberta, Saskatchewan, and northeastern British Columbia, is in the midst of another energy boom. The price of oil has remained relatively stable since recovering from the lows experienced during the global recession, providing some comfort to oil producers. This has resulted in an increase in oil drilling and the revival of deferred oil sands development projects. Lodging markets that are wedded to oil and gas developments often depend almost exclusively on the energy sector for their demand; however, oil and gas related activities generate lodging demand in different ways depending on the type of resource being exploited and the nature of the activity. This article provides an overview of the different types of oil and gas lodging markets located outside of the major urban centres and what affects the lodging industry in these areas where the actual energy drilling, development, and activity takes place. In addition, the outlook for these markets is discussed.

Summary of the Resources

Both oil and natural gas are abundant in Western Canada, but these resources are unevenly dispersed throughout the region, and they exist in different forms that require different recovery techniques. The resources in Western Canada comprise the oil sands in northern Alberta, conventional oil and natural gas in Alberta and Saskatchewan, and shale gas in northeastern British Columbia.

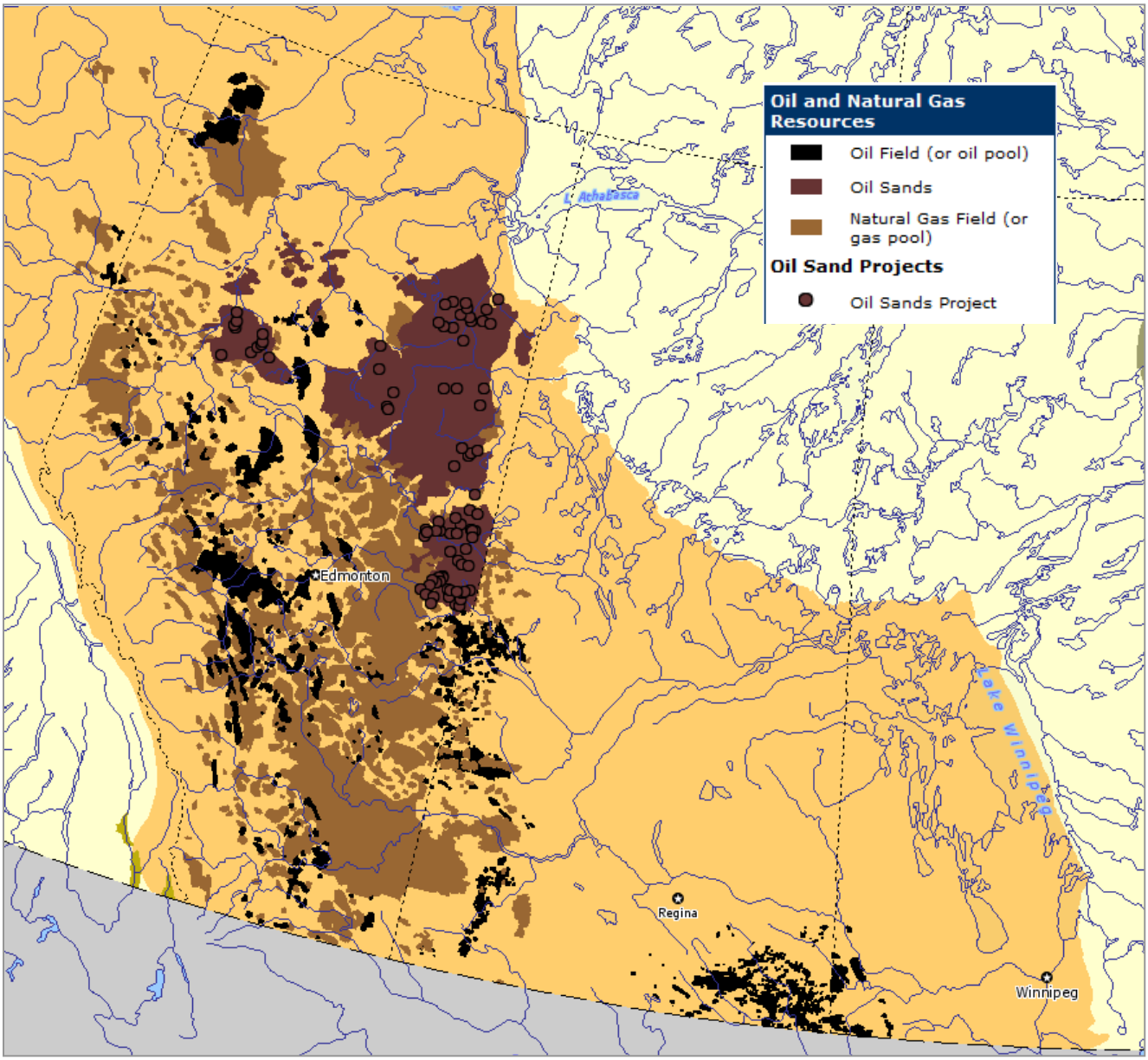
These days, the most attention is directed at the oil sands, which are primarily found in northern Alberta. Oil sands are a natural mixture of sand, water, clay, and bitumen. Bitumen is oil that is too heavy or thick to flow or be pumped without being diluted or heated. The oil is recovered either by mining or the in-situ method. These unconventional methods of oil extraction have higher production costs than conventional crude oil; the approximate breakeven point is $80 per barrel. As was experienced during the global recession, oil sands companies will postpone or cancel major capital projects, such as additional upgraders, and focus exclusively on existing operations when the price of oil falls below this breakeven point.

Crude oil is located throughout Alberta and southern Saskatchewan. Crude oil is accessed by drilling a well and using a pumpjack to extract the resource. The crude is then transported from a production facility to a refinery, where it is upgraded to products such as gasoline.

Natural gas is classified as either conventional or unconventional. How easy the gas is to extract from below the earth's surface determines whether the natural gas is considered conventional or unconventional. Conventional gas is typically "free gas" that is trapped in porous zones in naturally occurring rock formations like sandstone, and it is recovered by drilling a well to access the trapped gas. Conventional gas is located throughout Alberta and southwestern Saskatchewan. Shale gas, which is what is found in northeastern British Columbia, is considered unconventional natural gas. The process of recovering this natural gas involves using horizontal drilling and then techniques to fracture the shale to release the natural gas. This type of drilling was first used in Canada in the 1990s. The technology has experienced significant developments over the past ten years, which has made the process more efficient, reducing the overall cost of the well while increasing production. The shale gas development in northeastern British Columbia is still in its early stages.

The following map shows the location of the oil sands, oil fields, and natural gas fields across Western Canada.

Oil Sands, Oil Fields, and Natural Gas Fields across Western Canada



Source: Natural Resources Canada

What Generates Lodging Demand

The sources of hotel demand in oil and gas markets differ depending on the type of resource that is being extracted. The oil sands are currently benefitting from billions of dollars of investment, and this sector is expected to increase further with many more proposed projects. In the oil sands, hotel demand is generated by companies involved in the construction, expansion, and maintenance of upgrader facilities, mining and in-situ personnel, transportation and logistics companies, general construction, and oil company corporate travel.

Outside the oil sands, the lodging demand generated from oil and gas resource projects is different. In these areas, the activity of the oil or gas well is the primary generator of lodging demand. Demand is originally generated by

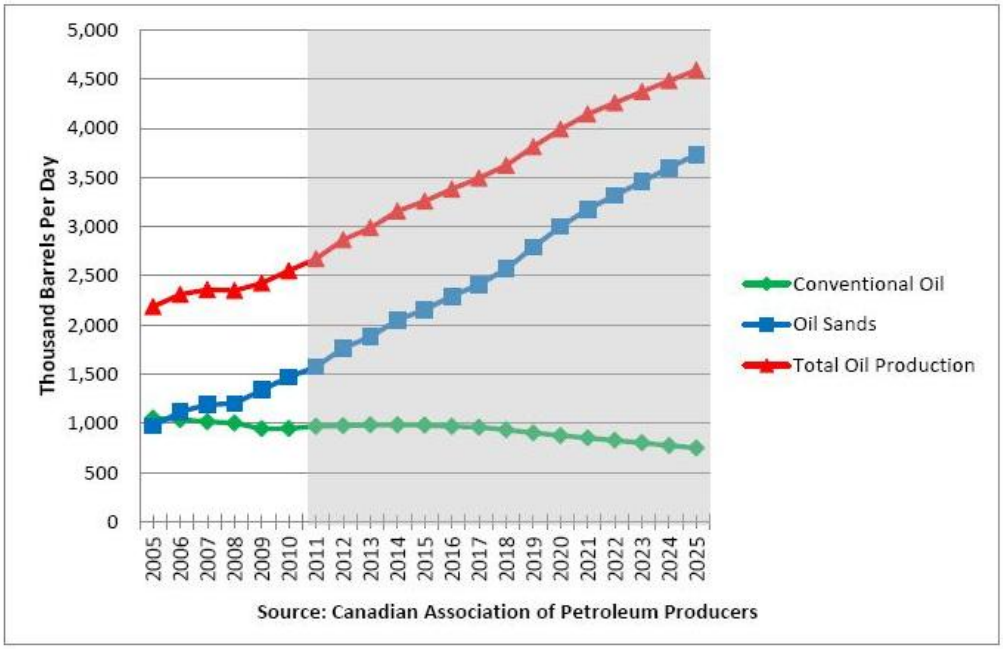
exploration and seismic crews seeking to locate the appropriate areas to drill wells. The process of drilling a well is a big project that involves three to four crews of four to five people from the start of the well to completion. Although each company approaches scheduling differently, crews typically work two weeks of 12 hour days and then get a week off. The rigs are usually operational 24 hours a day. Most crew members work away from their home and therefore require lodging. Based on the number of crews and workers per well, a single well has the ability to generate a number of room nights for hotels throughout the well's life. In addition to the actual rig crews, pipeline construction, transport services, surveyors, and other professional services generate lodging demand in these markets.

In addition, some towns are home to various plants for the oil and gas industry, such as refineries, upgraders, or processing plants. Every couple of years, these facilities go through a process called a "Turnaround." Turnarounds allow for necessary maintenance and the upkeep of operating units to maintain safe and efficient operations. To conduct the Turnaround, specialized contract crews come to the facilities to perform the necessary maintenance work. During this time, the lodging facilities in the market are typically full for the entire length of the Turnaround, and they often require additional rooms in nearby markets.

Outlook

The outlook for the oil sands and conventional oil markets—and the lodging markets that are associated with them—remains positive given the relative stability of oil prices, the favourable energy demand projections, and continued global economic growth. Capital spending is expected to increase in the oil sands with further mine and in-situ development and the potential for more upgraders and expansions to existing upgraders. The current price of oil bodes well for conventional oil-well drilling. As the chart shows, oil production in Western Canada is expected to experience significant growth, driven by continued development in the oil sands. Conventional oil production is expected to remain constant for the short to medium term, but it is expected to decline in the long term as the oil fields become depleted.

Forecast of Crude Oil Production in Western Canada



The short-term outlook for natural gas markets is less favourable because the price of natural gas remains soft. The price of the resource is not expected to experience a significant increase for the next few years. Nevertheless, the long-term outlook for natural gas is positive. Natural gas is becoming increasingly popular because it is a clean-burning energy source and production costs are declining as a result of more efficient processes. The hotel markets associated with the shale gas developments in northeastern British Columbia are faring better than those associated with conventional natural gas markets in Western Canada because the resource is still in the early stages of being exploited and the rapid technology advancements allow more efficient and cost effective collection of the shale gas. Moving forward, shale gas markets will become a large contributor to the global supply.

The world is becoming increasingly connected. The economic health of countries around the world directly impacts the demand for energy—we are currently feeling the economic worries in Europe and the United States. Energy companies are constantly evaluating whether it makes economic sense to continue to develop their resources. If energy prices drop too much, then energy companies will decide to limit the amount of spending, which decreases activity. As discussed earlier, the amount of labour required for an operation in the oil sands or to drill a well is large. Even a small decrease in the amount of resource development activity can have a significant impact on the lodging facilities in the area.

New supply is a risk that can impact an oil and gas lodging market. Too many new rooms can have negative effects on the market as a whole. Although a market can probably absorb the new supply during an energy boom, the occupancy will decline drastically once activity slows. As experienced in the previous slowdown, this can in turn trigger a rate war among the hotels in the market, consequently magnifying the decline in RevPAR.

Modular lodging units are becoming increasingly popular for oil and gas companies. These modular units are temporary and can be transported to a desired location. A group of modular mobile units is usually referred to as a "camp." Although energy companies prefer to use traditional lodging facilities, they may resort to using camps for accommodating crews if the location of the development activity is remote, if there are not enough guestrooms or the guestrooms are inappropriate, or if it is determined to be more economical. If there is unaccommodated demand in the market, then the opening of a camp will only have a minimal impact on the existing supply; however, camps make it difficult to develop additional hotels because they accommodate lodging demand that would traditionally be accommodated by hotels.

Conclusion

The oil and natural gas industry generates a significant amount of lodging demand in Western Canada. The different types of oil and gas development and activity generate lodging demand in distinct ways. Although many of these markets are benefitting from increased activity since the recession, risks such as global economic uncertainty, fluctuating commodity prices, and additional or alternative lodging supply could impact lodging performance in the future. Overall, the outlook for the oil and gas lodging markets in Western Canada is positive given the fact that global energy demand is projected to increase with the continued development in emerging markets, namely China and India.

About the Author

Jason Wight is a Senior Associate with the HVS Vancouver office in Canada. Jason received his Bachelor of Hotel and Resort Management degree from the Haskayne School of Business at the University of Calgary and a Diploma in Hotel and Restaurant Management from the Southern Alberta Institute of Technology. Prior to joining HVS, Jason held various positions in hotel operations and in the restaurant industry. Jason has completed numerous hotel appraisals and hotel feasibility studies in both major cities and small towns throughout Western Canada.

Canadian Lodging Outlook September 2011

STR and HVS are pleased to provide you with the month's issue of the Canadian Lodging Outlook. Each report includes occupancy (Occ), average daily rate (ADR), and revenue per available room (RevPAR) for three major markets and the Provinces.

If you would like a detailed hotel performance data for all of Canada, STR offers their Canadian Hotel Review. The Canadian Hotel Review is available by annual subscription which includes both monthly and weekly issues. Each monthly issue of the Canadian Hotel Review also includes an analysis provided by HVS. For further information, please contact: info@str.com or +1 (615) 824-8664 ext. 3504.

September 2011	Occupancy Rate (%)		Average Room Rates ($CAD)		REVPAR ($CAD)		Room Supply	Room Demand	Number of Rooms	
	2011	2010	2011	2010	2011	2010	% chg	% chg	Sample	Census
Montreal	74.3%	74.8%	$136.05	$139.59	$101.07	$104.36	-0.1%	-0.7%	16,815	27,928
Toronto	79.7%	77.1%	$153.90	$144.54	$122.63	$111.40	4.5%	8.0%	31,337	37,384
Vancouver	78.2%	76.0%	$153.74	$144.55	$120.26	$109.87	0.0%	2.9%	19,214	26,320
Provinces										
Alberta	69.7%	66.6%	$139.92	$139.77	$97.54	$93.15	1.6%	6.2%	37,216	67,390
British Columbia	71.3%	70.5%	$140.76	$135.84	$100.43	$95.77	0.3%	1.5%	36,163	83,828
Manitoba	71.3%	70.9%	$113.13	$115.75	$80.69	$82.11	3.0%	3.5%	5,013	13,864
New Brunswick	64.2%	67.7%	$113.90	$115.31	$73.14	$78.04	0.8%	-4.3%	5,396	11,435
Newfoundland	87.8%	82.2%	$145.35	$132.32	$127.63	$108.81	0.7%	7.6%	1,789	5,880
Nova Scotia	76.4%	80.2%	$128.52	$131.07	$98.15	$105.14	0.9%	-4.0%	6,209	13,013
Northwest Territories	INS	INS	INS	INS	INS	INS	INS	INS	66	1,543
Ontario	73.7%	71.1%	$132.05	$127.11	$97.33	$90.43	1.7%	5.4%	84,252	139,161
Prince Edward Island	69.8%	68.2%	$125.44	$128.34	$87.52	$87.47	2.2%	4.7%	1,013	4,173
Quebec	73.4%	72.9%	$138.00	$139.01	$101.29	$101.36	-0.3%	0.3%	27,597	78,111
Saskatchewan	74.1%	73.7%	$122.65	$120.15	$90.87	$88.55	1.5%	2.0%	7,485	17,009
Yukon Territory	INS	INS	INS	INS	INS	INS	INS	INS	332	2,265
Canada	**72.5%**	**70.8%**	**$134.42**	**$131.73**	**$97.40**	**$93.21**	**1.0%**	**3.4%**	**212,531**	**438,086**

September 2011 Year-To-Date	Occupancy Rate (%)		Average Room Rates ($CAD)		REVPAR ($CAD)		Room Supply	Room Demand	Number of Rooms	
	2011	2010	2011	2010	2011	2010	% chg	% chg	Sample	Census
Montreal	66.4%	63.6%	$135.70	$134.38	$90.11	$85.41	-0.2%	4.3%	16,815	27,928
Toronto	69.3%	69.5%	$134.79	$134.56	$93.40	$93.54	3.4%	3.1%	31,337	37,384
Vancouver	69.7%	70.9%	$145.46	$155.57	$101.42	$110.32	0.1%	-1.5%	19,214	26,320
Provinces										
Alberta	62.4%	59.4%	$135.78	$136.11	$84.68	$80.78	2.7%	7.9%	37,216	67,390
British Columbia	63.9%	64.2%	$137.97	$147.65	$88.17	$94.76	0.7%	0.3%	36,163	83,828
Manitoba	66.0%	66.1%	$111.83	$111.47	$73.76	$73.64	1.7%	1.6%	5,013	13,864
New Brunswick	58.1%	58.8%	$112.72	$111.99	$65.50	$65.82	1.9%	0.8%	5,396	11,435
Newfoundland	74.0%	72.9%	$135.18	$129.26	$99.98	$94.26	0.4%	1.8%	1,789	5,880
Nova Scotia	63.3%	64.1%	$120.37	$119.39	$76.20	$76.54	1.3%	0.0%	6,209	13,013
Northwest Territories	INS	INS	INS	INS	INS	INS	INS	INS	66	1,543
Ontario	63.2%	62.4%	$123.34	$123.33	$77.90	$76.99	1.5%	2.7%	84,252	139,161
Prince Edward Island	56.5%	53.5%	$115.23	$119.86	$65.14	$64.10	0.5%	6.2%	1,013	4,173
Quebec	64.6%	62.7%	$135.09	$133.24	$87.31	$83.60	-0.3%	2.7%	27,597	78,111
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Yukon Territory	INS	INS	INS	INS	INS	INS	INS	INS	332	2,265
Canada	**63.5%**	**62.5%**	**$128.94**	**$130.28**	**$81.91**	**$81.47**	**1.2%**	**2.8%**	**212,531**	**438,086**

*INS = Insufficient Data

About STR

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STR OFFICE:

735 East Main Street
Hendersonville, TN 37075
Phone: 615-824-8664

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HVS CANADA OFFICES:

Toronto:
6 Victoria Street
Toronto ON M5E 1l4
Phone: 416-686-2260

Vancouver:
Suite 400 – 145 West 17th Street
North Vancouver BC V7M 3G4
Phone: 604-988-9743